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High Cost Home Loans

High cost home loans strip equity and leave homeowners making high payments on their most valuable asset. Predatory practices in the home loan industry can cost people their homes.

In most cases, a home is the most important way for a family to accumulate assets. The accumu lated value, or equity, can be passed onto future generations, or taken out in the form of a loan. It can be used to pay for an education, to start a business, or as a way to assure future financial stability.

Predatory home lending is a threat to Texas because it strips the equity from a home and leaves the homeowner in or near financial ruin. Predatory lending can include the following practices:

- Interest rates that have little relation to the credit worthiness of the borrower;
- Excessive fees that must be paid for a loan or that are rolled into it, increasing the amount borrowed;
- Little consideration of the ability of the borrower to repay loans made on the basis of the equity in the home;
- Failing to move qualified borrowers to a lower-priced "prime" loan;
- Home improvement scams where lenders pay despite low-quality or unfinished work.

Lenders that make credit available to people with blemished or no credit histories are called "subprime" lenders. The loans are made at far higher rates than standard loans.

Texas leads the nation in the percentage of refinance and home equity loans made by subprime lenders. Nationally, about 20 percent of these loans are made by higher-cost subprime lenders, but in Texas, about one-third of loans were made through subprime lenders in 2000.

Subprime loans cost more than conventional loans, but under the right circumstances might be an appropriate loan for a borrower with a poor credit history. Rates for subprime loans over the last couple of years were about 10.27 percent, but rates ranged as high as 19 percent.

Compared to more typical rates of around seven percent, consumers who pay 10.27 percent for a subprime loan will pay almost $2000 in interest alone each year for the life of the loan.

Through an analysis of data reported by lenders, higher-cost subprime refinance and equity loans are disproportionately affecting women, people who live in neighborhoods with high elderly populations, and minorities.

For example, Black borrowers are 3.9 times more likely than non-Blacks and Hispanics are 1.6 times more likely than non-Hispanics to end up with a loan from a subprime lender.

Texas attempted to address potential abuses in the home equity market with the constitutional protections approved in 1997. While some of these protections have helped, improvements are needed to assure Texas families' hard-earned equity is protected.

For example, though fees for equity loans are limited to three percent, this excludes fees like discount points or origination fees, which are deemed "interest." Often, these fees are rolled into the principle on a loan, eating away at equity. "Flipping," or repeated refinancing of loans, is limited to once per year for equity loans, but sometimes lenders go back to borrowers year after year and strip equity from loan by encouraging refinancing. In addition, some lenders make loans when it is clear the borrower will be unable to pay it back.

Recommendations

Consumers Union is working with a number of groups on reforms to curb these lending abuses. We support changes to Texas law including:

- Prohibit the financing of fees above the three percent limit, including closing costs and lender charges deemed "interest";
- Require loan counseling for high-cost loans during the 12-day waiting period;
- Limit "discount" points to legitimate charges that actually provide a substantial benefit to consumers;
- Prohibit financing of credit insurance or debt cancellation agreements;
- Prohibit lending without regard to a borrower's ability to repay;
- Prohibit "flipping" if the refinance loan does not provide a tangible net benefit to the borrower.

In Short

Texas leads the nation in subprime lending, especially in the refinance market. About a third of borrowers took their refinance loan from a subprime lender, compared to only 20 percent nationally. Black borrowers were 3.9 times more likely to take a subprime loan than non-Black borrowers.