Predatory Mortgage Loans Practices

If you would like, print this study aid for future reference.

Predatory mortgage loans involve a wide variety of abusive practices, including:

- **Excessive Fees**: Points and fees are costs not directly reflected in interest rates. Because these costs can be financed, they are easy to disguise or downplay. On predatory loans, fees totaling more than 5 percent of the loan amount are common.

- **Abusive Prepayment Penalties**: Borrowers with higher interest subprime loans have a strong incentive to refinance as soon as their credit improves. However, most subprime mortgages carry a prepayment penalty—a fee for paying off a loan early. Be careful of prepayment penalties that last more than three years and/or cost more than six months’ interest.

- **Kickbacks to Brokers (Yield Spread Premiums)**: When brokers deliver a loan with an inflated interest rate (i.e., higher than the rate acceptable to the lender), the lender often pays the broker a fee known as a yield spread premium. This payment makes the loan more costly to the borrower. You can avoid this by shopping around for the best rate.

- **Loan Flipping**: A lender flips a loan by refinancing it several times within a short timeframe to generate fee income, without providing any net tangible benefit to the borrower. Flipping can quickly drain borrower equity and increase monthly payments—sometimes on homes that had been previously owned free of debt.

- **Unnecessary Products**: Sometimes borrowers may pay more than necessary because lenders sell and finance unnecessary insurance or other products along with the loan.

- **Asset-Based Lending**: Predatory lenders may approve a loan based on the value of a customer’s equity in the home, instead of his or her ability to repay the loan. The lender may later encourage the customer to default so the lender can take ownership of the home.

- **Steering and Targeting**: Predatory lenders may steer borrowers into subprime mortgages, even when the borrowers could qualify for a less expensive, typical loan. Vulnerable borrowers may face aggressive sales tactics and sometimes outright fraud.