Predatory Lending and the 'Anti-predatory Lending Act'

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By Donald J. Martin, CRP, RAA, GAA

A bill is being considered by Congress that will crack down on mortgage lenders who encourage the re-financing of home loans based on above- market values. Martin explains the issue and points out the important role appraisers play in reporting accurate valuations through ethical practices.

Congress continues to take a serious look at issues involving predatory lending and its negative effects on homeowning families in the United States and the appraisal industry.

Although some urban areas seem to have borne the brunt of the practice, no part of the country is immune to predatory lending, which in many cases has led to foreclosure and bankruptcy.

Also affected is the appraisal industry. Appraisers in some instances have been pressured to meet or exceed a pre-determined value. Failure to meet this request can lead to a drop in business for the appraiser, should the lender then choose to take its business elsewhere to get a more favorable valuation. This has made it difficult in some areas for honest appraisers to get work.

A Definition of Predatory Lending
With predatory lending, homeowners are asked to continue to borrow from what is sometimes non-existent equity in their home. Each time they receive a new loan, the total debt owed grows until it reaches a level which, in some cases, only unscrupulous lenders will consider, according to some members in the home-sale industry.

In those cases, the amount of money that is loaned significantly exceeds the value of the home. The amount of money that the homeowner is worthy of being loaned is exhausted, and the value of the home, based on previously inflated appraisals, already is in excess of the home's true "market value." Homeowners then become saddled with overextended credit at high-interest rates.

Less than a few generations ago, these interest rates would be considered exorbitant or even illegal. Today, many homeowners find themselves in an ever-increasing cycle of debt. And because the home's value no longer can be inflated to cover the debt, existing mortgage payments become unmanageable.

As those payments become unmanageable, many homeowners attempt to sell their home, but with little or no success. They then must foreclose on their home and file for bankruptcy. And some suffer the damage of broken homes and families.

Putting an End to Predatory Lending
A bill, H.R. 3901.IH, which was written to protect consumers, has been presented by Rep. Jan Schakowsky (D-IL) and is co-sponsored by 12 other representatives. It was introduced in March 2000 and soon after was referred to a House subcommittee. Further action on the bill is expected this year.

The purpose of the bill is: "To amend the Truth-in-lending Act, the Revised Statutes of the United States, the Home Mortgage Disclosure Act of 1975, and the Home Ownership and Equity Protection Act of 1994 to protect consumers from predatory lending practices, and for other purposes." A complete version of the bill can be found at *http://thomas.loc.gov/home/c106query.html* with a search on "predatory lending."

H.R. 3901.IH would establish new procedures and standards to prevent predatory lending and significant additional costs to taxpayers.

The need for such legislation is apparent in places such as the Chicago, IL, metropolitan area. A year ago, the Department of Housing and Urban Development (HUD) sought to market and sell approximately 1,137 homes in Chicago that were part of the 3,150 homes held in inventory from foreclosures nationwide.

When a foreclosure occurs, the lender seeks to have the home re-appraised at its "true" market value or "most probable sales price," which is what the home should sell for within normal marketing time within its market. When the home finally does sell, the lender takes a significant loss, adding to other losses already incurred. Lenders that experience a significant number of these losses may be forced out of business, as was the case during the savings and loan crisis of the 1980s.

Neill Fendly, CMC, president and CEO, Pathfinder Mortgage, Phoenix, AZ, is concerned that the Anti-predatory Lending Act is too specific and will taint the lending industry based on the actions of a few bad apples.

"Nobody disagrees with the necessity to remove a few bad apples from an industry. Let me give an analogy: If you have a million acres of forest and 100 diseased trees, you want to destroy the 100 trees, not burn down the entire forest."

Fendly said that "a total mortgage reform package will be brought before Congress. Anti-predatory is a small piece that will be part of a total composite mortgage lending package, including annual percentage rate changes, RESPA [Real Estate Settlement Procedures Act] and TILA [Truth-in-lending Act] rewrites.

"This [Anti-predatory Lending Act] is severely flawed. The industry needs broader reform. There is a lot of conversation, and several drafts are being worked on for a proposed bill. The Hill has become very aware of the need for mortgage reform, and I am positively optimistic."

Nationwide Policy

The 1980s savings and loan crisis led to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), which mandated significant changes in bank regulations. One of the sections of this act, Title XI, established the Appraisal Subcommittee (ASC) of the Federal Financial Institutions Examination Council.

From Title XI and the creation of the ASC came the licensing and certification requirement of real estate appraisers nationwide, resulting in the Uniform Standards of Professional Appraisal Practice (USPAP), which is updated annually.

USPAP established the appraisal standards and requirements for appraisers and users of appraisal services. These requirements were designed in part to prevent losses such as those ultimately incurred by lenders and taxpayers when the savings and loan industry was bailed out through the Resolution Trust Corporation (RTC).

Many in the industry now consider it time for Congress to provide new legislation about predatory lending as it did with previous legislation that mandated the procedures, standards, and licensing of real estate appraisers.

Mike Foil, appraiser, Foil Appraisal, Payson, AZ, is concerned about the lender pressure on appraisers and maintaining ethical appraisal practices. "The system is broken and until commissioned employees, who have no liability and stand to lose nothing, are no longer in charge of selecting the appraiser, it will stay that way. As bad of a situation as this is, it is only half of the problem."

"I do recognize that these employees are doing what it takes to make the deal so they can get their commission. They see it as a part of their job. For this reason, I find just as much or more fault with the appraisers who yield to this pressure. We, as appraisers, are expected to hold ourselves apart from the influence and remain objective and unbiased. Some find that hard to do and have become the prostitutes of the profession. This has made it very hard, in some areas, for honest appraisers to compete for the local work.

"If you cannot compete on a level playing field with other appraisers in your area, you find yourself accepting more and more work from appraisal management companies (AMCs) at a reduced fee and having to travel to other areas to stay busy. Many appraisers with integrity and years of experience, find themselves barely able to stay in business. With all of this, some good appraisers are going out of business and their work is going to bad or inexperienced appraisers."

This frustration with the pressure on appraisers led Foil to write a petition for appraisers in support of the anti-predatory movement. As of February 1, 2001, more than 4,200 real estate appraisers from across the country had signed the petition. The petition and list of signatures can be viewed online at *http://www.appraisersforum.com/petition/index.htm*.

Current Requirements

The USPAP (2001 edition), published by the Appraisal Standards Board, through The Appraisal Foundation, as authorized by Congress, mentions predatory lending. The practice falls under the management section of the ethics rule and requires appraisers to adhere to principles that do not allow predatory lending. Within this section it stipulates:

"Whenever an appraiser develops an opinion of value, it is unethical for the appraiser to accept compensation in developing that opinion when it is contingent upon:

the reporting of a predetermined value, or a direction in value that favors the cause of the client, or the amount of the value opinion, or the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the value opinion."

Additionally, Standards Rule 2-1 within real property appraisal reporting contains binding requirement that must be adhered to with no departure permitted, stated as follows: "Each written or oral real property appraisal must clearly and accurately set forth the appraisal in a manner that will not be misleading."

Appraiser Rick Wells, IFAS, ACE PS, Inc., Silverdale, WA, said that appraisers are "pressured to ignore anything that negatively impacts closing the deal."

One appraiser even said they had a lender offer to have the appraiser's photos retouched by a guy in a photo lab to cover peeling paint.

"I've been an appraiser for 24 years and I've seen the industry standards go up and down; but now, it's the worst ever," said Wells. "The lenders go as far as to require appraisers to get [errors and omissions] insurance. This way, lenders can point the finger at appraisers when the deal goes bad."

Wells said he no longer solicits conventional loan work because "after an appraiser is the cause of a few blown deals, the appraiser becomes blacklisted.

"Insurance covers the lenders when deals go bad, but the appraiser gets hung out to dry. And after a few losses, those premiums go up."

Licensed and certified appraisers are required to adhere to USPAP. The ethics rule and Standard 2, in particular, discourage predatory lending. U.S. states that provide licensing and certification also offer legal remedy that subjects appraisers to disciplinary action and potential loss of license or loss of certification.

"Lenders must be required to obtain impartial appraisals instead of rubber stamps of value," said appraiser Ken Altemeyer, New Haven, MO.

According to Foil, there are lenders—whether banks, savings and loans, mortgage brokers, credit unions, loan officers, or real estate agents—who "have individuals within their ranks, who, as a normal course of business, apply pressure on appraisers to hit a pre-determined value.

"This pressure includes the following: the withholding of business if we refuse to inflate values; the withholding of business if we refuse to guarantee a predetermined value; the withholding of business if we refuse to ignore deficiencies in the property; refusal to pay for an appraisal that does not give them what they want; and black listing of honest appraisers in order to use 'rubber stamp' appraisers, etc."

H.R. 3901.IH seeks to address this problem through its section that deals with coercion of an appraiser. It reads: "No creditor may compensate, directly or indirectly, coerce, or intimidate an appraiser for the purpose of influencing the independent judgment of the appraiser with respect to the value of real estate that is to be covered by a conforming home loan or is being offered as security according to an application for a conforming home loan."

Although the bill's language is significant, many in the appraisal industry believe additional legislation with sufficient penalties to discourage the practice of predatory lending is required as well as a re-examination of what constitutes due diligence for those engaged in lending activity.

To contact a U.S. Senator or U.S. Representative about H.R.3901.IH, see *http://www.senate.gov* or *http://www.house.gov/writerep*.

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Homeowner Beware

By Deborah Stadtler

"Shopping for a Home Equity Loan," a consumer alert issued in January by the Federal Trade Commission (FTC), arms consumers with information on how to secure a reputable home-equity loan. Consumers, particularly the elderly, minorities, and those with low incomes or credit problems, should be mindful of questionable practices that put homeownership at risk.

Scammed!
Several scams relating to home equity loans can hinder homeowners' ability to pay off a loan and can even lead to foreclosure.

Equity stripping involves a lender basing the loan on the equity in the home, not on the borrower's ability to repay based on income. A homeowner is stripped of any equity in the home if foreclosed.

A lender offering to refinance the mortgage and lower the monthly payments, not mentioning the hidden balloon payment, is key in this scam. The lower payments frequently repay only the interest, leaving the entire principal due in one lump sum.

Loan flipping starts with a homeowner refinancing for extra cash. The lender offers another refinance—and more cash—after only a few payments. Each refinance allows higher interest rates, fees, and any early-payment fees to be rolled into the new loan, creating more debt for the homeowner.

A false "home improvement" loan engages a contractor in the scam. The contractor pressures the homeowner into agreeing to improvements on the home and into signing papers for the work. The papers authorize a home equity loan with a high rate, points, and fees; and the contractor may or may not do the work correctly, or at all.

Credit insurance packing scams include extra credit insurance or "benefits" rolled into your mortgage at closing. The lender hopes the borrower will not notice the extras, or will agree to them anyway, not knowing the higher costs involved.

Mortgage servicing abuses occur when the lender does not provide homeowners with accurate or complete account statements and payoff figures. It makes it difficult for borrowers to determine how much they have paid or how much they owe.

Tips For Consumers
Consumers are advised by the FTC to take several steps to avoid dealing with unscrupulous lenders.

The first step is to comparison shop. By comparing loan plans from several lenders—not just the ones that approach them—homeowners can secure better loan terms.

Second, homeowners must ask questions. Borrowers should make sure all the loan terms, fees, points, rates, and other costs are clearly spelled out and understood. Third, borrowers must negotiate. They should ask lenders to meet or beat other deals and make them compete for the loan.

Last, borrowers should read the closing papers carefully. Consumers can walk away or negotiate changes before signing. Even if a homeowner closed on a loan, he or she has three days to cancel the deal without penalty under the Truth-in-lending Act.

For information on consumer alerts and home equity frauds, contact the FTC at 1-877-FTC-HELP or see *www.ftc.gov*.

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The Employee Relocation Council (ERC) is a global community of professionals developing and sharing cost-effective, innovative, and caring solutions to support the mobile workforce.

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