CARSEY INSTITUTE

POLICY BRIEF NO. 4

FALL 2006

Subprime and Predatory Lending in Rural America:
Mortgage lending practices that can trap low-income rural people

Predatory lending, which encompasses a range of financial practices that are often targeted at low-income individuals and threaten their income and assets, is becoming increasingly prevalent in rural communities. While predatory lending practices can include check-cashing outlets for payday loans, car title loans, refund anticipation loans and rent-a-center loans, among others,[1] this report focuses on predatory practices in the housing market. A home is usually a person's largest investment, making home mortgages a prime target for predatory lending.

Using targeted marketing and promises of "easy credit" and "quick cash," predatory lenders can trap borrowers in a cycle of high interest payments, abusive fees and terms that can lead to home foreclosures, and ultimately devastate borrowers' financial futures.

Individuals and communities that have few lending options are vulnerable to predatory products.[2] The use of these products appears to be growing in rural areas, where there are fewer commercial financial banking firms serving rural borrowers than in urban counties.[3] Lacking access to financial alternatives, rural residents are susceptible to a range of predatory financial institutions and products that charge excessive fees and diminish their ability to save and build wealth.

This brief examines predatory mortgage loans, which have emerged in the expanding subprime mortgage market, looking at who is most at risk of being abused by such lending practices and where these practices occur. One key finding is that rural minorities are more likely than whites to take out High APR Loans or "HALs." The report also details the widespread use of HALs to purchase manufactured housing, a key component of the rural housing market. A Maine case study illustrates the persistence of predatory lending in rural communities. The report concludes with recommendations to address predatory lending practices at the federal and state levels.

Predatory Mortgage Lending Hurts Families

Children have a better chance for success when they are raised in families who own their own home and have stable financial assets. When parents or caregivers have little savings to fall back on, they may seek assistance from predatory lenders, as the story below illustrates.

Ms. Leah Pyy grew up in Falmouth, Maine in a clam shop with no running water, and she always dreamed of owning a home. In 1995, she and her husband bought a home for themselves and their grandson, who had been living with them since 1993.

"The house means the world to me, especially since it's a safe place for my grandchild to live and play," Ms. Pyy said.

She had been in a serious car accident years before that left her disabled, and it was not easy for the family to make ends meet. After buying the house, the Pyys went into debt and fell behind on their house payments.

"I heard that you could get out of debt by using your home equity to pay credit card bills," Ms. Pyy said, who soon found herself ensnared in a predatory mortgage loan. "There were a lot of loan papers, a lot of fine print that didn't mean anything to me. We were desperate, and the bank seemed to be offering us a way out."

They obtained a second mortgage for $31,500 at an interest rate of 13.75 percent that cost $4,787 in closing costs. As a result of this expensive mortgage loan, the Pyys fell deeper and deeper in debt.

Although she now understands how to avoid predatory lending traps, Ms. Pyy continues to receive calls every week from mortgage companies that want to lend her more money.

"These days, I know better – but I'm sure they're reaching a lot of others who are desperate, as I was," Ms. Pyy added.

Adapted from "Statement of Ms. Leah Pyy, Victim of Predatory Mortgage Lending," presented at Coastal Enterprises, Inc. press conference, February 13, 2006.

The Subprime Mortgage Market and Predatory Lending

Subprime mortgages carry higher costs than prime loans, ostensibly to compensate lenders for the added risks imposed by borrowers who may be at greater risk to fail to repay their loans. In recent years, the subprime mortgage market has increased significantly. In 1996, subprime lenders reported $90 billion in lending. By 2004, the subprime mortgage market had grown to $401 billion.[4]

Within the subprime market, loans with interest rates at least three percentage points higher than that of U.S. Treasury securities of comparable maturity are considered High APR Loans (HALs). [5] Examining the prevalence of HALs has been difficult, given the lack of consistent data. However, the most recent Home Mortgage Disclosure Act (HMDA) [6] data provide some important insights into this market.

Even more costly are what the federal Home Ownership Equal Protection Act (HOEPA) defines as "high-cost loans." These loans charge points and fees that are 8 percent or more of the mortgage amount (10 percent for second mortgages) and interest rates of 8 percent above the U.S. Treasury yield. A "high-cost" loan triggers certain consumer protections under federal law and under some state laws, such as those discussed in the Maine case study included in this brief. Subprime lenders avoid making high-cost loans so the actual number of loans of this type is negligible.

Predatory mortgage loans have been defined as those loans that (1) charge more in interest and fees than needed to cover the associated risk; (2) contain abusive terms and conditions (see box); and/or (3) do not take into account the borrower's ability to repay. They often target women, minorities, and communities of color. [7] Predatory loans can add a great deal to the cost of mortgages, costs most low-income borrowers cannot afford. It is important to recognize, however, that although predatory loans are concentrated in the subprime market, not all subprime loans or even HALs are predatory. As subprime lending activity has increased, concern over wealth-stripping predatory lending has increased as well.

Predatory loans often contain a consumer-unfriendly prepayment penalty, which is assessed if a borrower pays off the loan before a specified time has elapsed. Prepayment penalties can trap consumers in subprime loans—even if they qualify for a lower-cost loan—because they cannot afford the prepayment penalty. These penalties drain equity from the borrowers when they refinance or sell their homes and create an incentive for borrowers to continue paying on loans with higher costs than they might otherwise qualify for.

Identifying a Predatory Mortgage Loan

Predatory mortgage lending includes a range of abusive terms and activities, including the following:

- **Excessive points and fees**—Points and fees in excess of five percent of the total loan amount are considered excessive.
- **Prepayment penalties**—Penalty fees imposed on borrowers who repay all or the majority of a loan before a set time period.
- **Loan flipping**—Refinancing a mortgage loan without conveying a net benefit to the borrower, usually in order to extract additional fees and charges.
- **Steering**—A borrower is "steered" to take out a higher cost loan than they could have qualified for.
- **Financed credit insurance**—Financing mortgage insurance through a lump-sum payment folded into the mortgage loan.

Adapted from:
Dickstein, Carla et al., 2006. *Predatory Mortgages in Maine: Recent Trends and the Persistence of Abusive Lending Practices in the Subprime Mortgage Market*. Coastal Enterprises, Inc., and Center for Responsible Lending.

ABOUT THE DATA

Since 1975, the Home Mortgage Disclosure Act (HMDA) has required that all depository financial institutions that meet a specific asset level and are headquartered in a metropolitan area are required to report information on mortgage applications. This geographically based dataset provides demographic information on the applicant, the loan disposition, and other characteristics that can be used to track lending rates and trends.

This information brief presents Housing Assistance Council (HAC) tabulations of 2004 Home Mortgage Disclosure Act (HMDA) data. For the first time in 2004, HMDA data include interest rate information for approved mortgage loans, providing important insight into the subprime lending market.

While HMDA data are a critical resource to understanding lending trends, the limitations of these data in rural America must be acknowledged. Only those depository institutions with assets of $33 million (adjusted to $35 million in 2005) that were headquartered in a metropolitan area were required to report HMDA data in 2004. Consequently, an untold number of rural lending data are unavailable, as many small, rural financial institutions were not required to report HMDA data. Despite these limitations, HMDA provides the best available information on rural lending and high cost mortgage loans.

Some researchers who have analyzed predatory lending have characterized it as "redlining in reverse."[8] The same poor and minority communities that were often denied access to credit are now being flooded with loan products that often strip equity and diminish wealth. Research has shown that African American and Hispanic borrowers are more likely to receive HALs than similarly qualified white borrowers, regardless of income. [9] Steering borrowers to loans with higher fees and interest rates than they could qualify for is a major component of predatory lending. It has been estimated that as many as half of all subprime loan borrowers could in fact qualify for conventional rate mortgages.[10]

Rural High APR Lending

As shown in the HMDA data, among the 555,941 rural mortgage loan originations reported in the 2004 HMDA data, 17.4 percent, or nearly 97,000, were classified as HALs. This was slightly higher than the national and metro rates.

Further analysis of these data also shows that HALs are concentrated in rural areas with chronic poverty, and, often, a high proportion of minorities. Figure 1 illustrates the location of HALs in rural America as identified in the 2004 HMDA data.

As shown in Figure 1, HALs can be found in rural counties throughout the U.S., but there are some regional differences. Throughout the northeast and the far west, most rural counties have high APR lending rates of less than 20 percent. Rates of high APR lending increase considerably in the central and southern regions of the country, particularly in rural areas that have historically high rates of poverty and racial and ethnic minorities. In almost 500 rural counties, nearly all of them in central and southern regions, one-third or more of the total mortgage originations were for HALs. These higher rates of high APR loans occur overwhelmingly in Persistent Poverty Counties. Figure 2 shows the location of Persistent Poverty Counties—those counties that have had poverty rates of 20 percent or more for the last three decades.

Connected to these issues of location are issues of race and ethnicity. As the map shows, concentrations of HALs can be found across the Mississippi Delta region, in counties with Native American reservations and poor Hispanic-American communities, and in some Appalachian communities. Half of the counties with significant rates of higher cost loans –30 percent or more – are counties with minority populations of 33 percent or more.

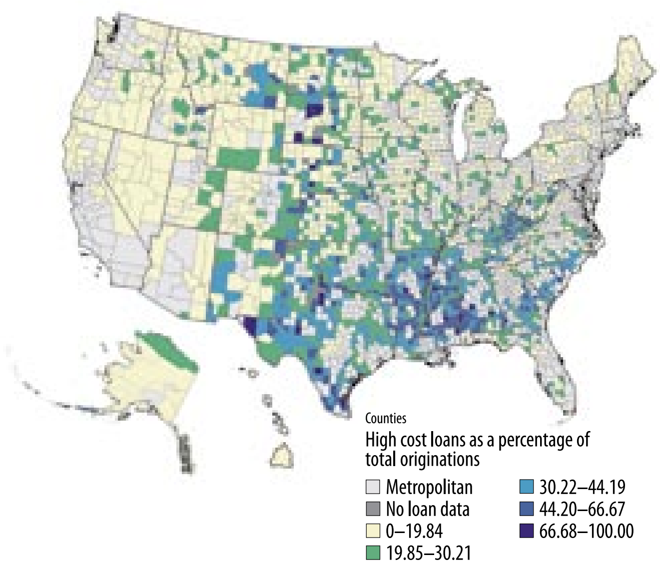
Rural America tends to be more racially and ethnically homogenous than the rest of the nation. Less than one-fifth of rural residents are minorities and 11 percent of all rural homeowners are minorities. As in urban areas, minorities in rural America receive a disproportionate share of HALs. Although, rural minorities account for less than 9 percent

Table 1. 2004 High APR Mortgage Loan Originations, HMDA

	Total Loans	High APR Mortgages	
		#	%
Urban	5,243,959	810,934	15.5%
Rural	555,941	96,897	17.4%
National	5,799,900	907,831	15.6%

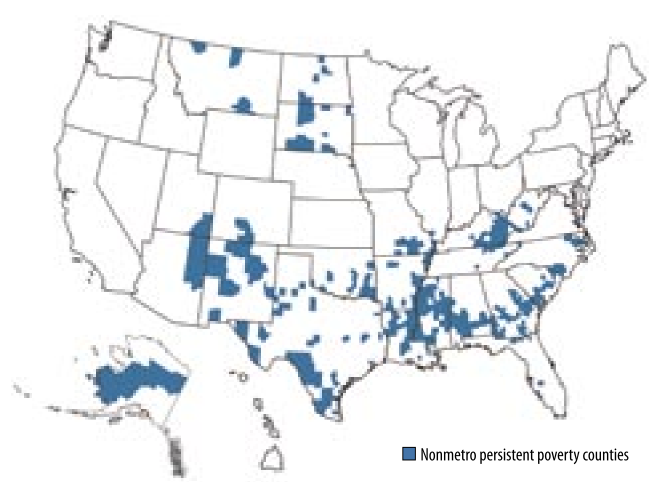
Source: HAC tabulations of 2004 HMDA data.

Figure 1: Map of High APR Lending



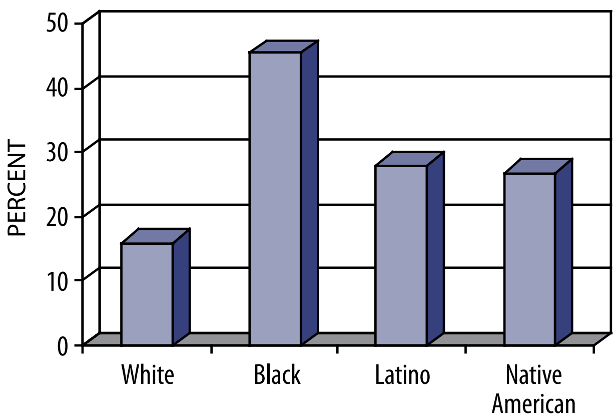
Source: HAC tabulation of 2004 HMDA data.

Figure 2: Map of Persistent Poverty Counties



Source: Map prepared by ERS from U.S. Census Bureau data.

Figure 3. HALs by Race and Ethnicity



Source: HAC tabulations of 2004 HMDA data

of all rural HALs, minorities were much more likely to receive HALs than Whites. The proportion of HALs for rural minorities far exceeds that for rural non-Hispanic Whites. As shown in Figure 3, slightly less than one-third of all rural Latino and Native American borrowers received HALs in 2004. Almost half (46.5 percent) of all rural African-American borrowers received a HAL. In comparison, less than 17 percent of rural non-Hispanic White borrowers received high APR mortgage loans as reported by HMDA.

Manufactured Housing

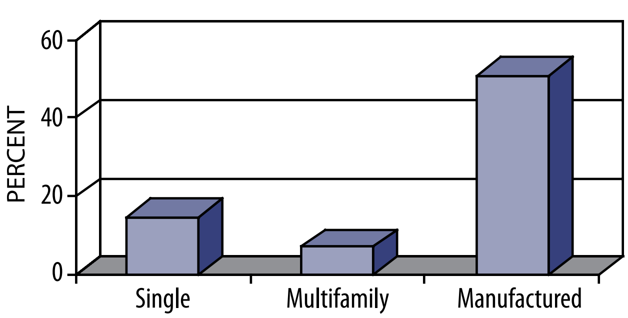
One housing sector in rural America that is particularly tied to high APR lending is manufactured housing, which represents 15 percent of the rural housing stock.

The vast majority of manufactured housing continues to be financed using personal property loans, which do not have the same consumer protections as mortgage loans. Personal property loans allow borrowers to purchase a manufactured home with little or no down payment; however, the rates and terms are often significantly higher than conventional mortgages.

Lenders that do make mortgage loans for manufactured homes impose stricter underwriting standards than do personal property lenders. Many mortgage lenders require manufactured homes to be placed on permanent foundations and on land that is privately owned. These requirements may be beneficial to the borrower in the long run but often increase the initial cost of the home.

For those rural residents who took out a real estate loan, as reported in HMDA data, to purchase their manufactured homes in 2004, 50.7 percent received HALs (See Figure 4).

Figure 4. Percent of rural property type with high cost loan



Source: HAC tabulations of 2004 HMDA data

The Effects of Predatory Lending in Rural Communities

The Center for Responsible Lending (2001) estimates that predatory mortgage lending practices cost borrowers at minimum $9.1 billion annually.[a] It has been demonstrated that certain loan term characteristics (e.g. balloon payments and prepayment penalties) substantially increase the likelihood of foreclosure, and can jeopardize homeownership for those homeowners.[b] While there has been little research on the impact of predatory lending in rural communities, several studies have demonstrated the financial and physical impact predatory mortgage loans have on central city residents and neighborhoods. In addition to stripping the equity of individual homeowners and charging the most in terms of interest and fees to those who can least afford it, predatory mortgages can have significant community impacts as they can lead to increased foreclosures and vacant housing units (ACORN 2000).

Research has shown that rural borrowers are more likely than those in urban areas to be subjected to prepayment penalties.[12] One study showed that in 2002, rural subprime borrowers were six percent more likely than urban borrowers to have a loan that included a prepayment penalty with a term of at least two years (CRL 2004). More tellingly, rural subprime borrowers were 20 percent more likely in 2002 to take out a mortgage with a prepayment penalty carrying a term of five or more years than urban borrowers.

Overall, 63 percent of rural subprime mortgage loans imposed a prepayment penalty on borrowers with a two-year penalty period. And 39 percent of all rural subprime mortgages studied had pre-payment penalties carrying terms of three years or longer (CRL 2004).

[a] Eric Stein. 2001. Quantifying the Economic Cost of Predatory Lending. Center for Responsible Lending, Durham, NC.

[b] Quercia, Stegman, and Davis. 2005. The Impact of Predatory Loan Terms on Subprime Foreclosures: The Special Case of Prepayment Penalties and

Conclusion and Recommendations

A home is the most valuable asset for most low-income rural residents, as it is for most Americans. Predatory loans diminish the value of homeownership because they strip equity and undermine families' ability to build assets. As discussed, although rural residents receive HALs at only slightly higher percentages than urban homebuyers, in rural areas, minorities are significantly more likely than whites to receive these loans.

To protect the benefits of homeownership, national and state officials should adopt and enforce policies that better regulate supprime lending terms, monitor lending and real estate practices in this growing sector, and educate and protect borrowers.

Needed Federal Action

The Homeownership and Equity Protection Act (HOEPA), which passed in 1994, applies to all lenders in all states, while preserving the authority of individual states to enact laws that provide more rigorous consumer protections.[13] Recent attempts to pass new anti-predatory legislation at the federal level are conflicted over preserving state control versus creating uniform federal standards that preempt state law.

The mortgage industry has pushed strongly for uniform standards and federal preemption of state laws – focusing on H.R. 1295, sponsored by U.S. Reps. Bob Ney and Paul Kanjorski. Although the industry argues that complying with a myriad of state laws is costly, research by the Center for Responsible Lending has shown the cost of such compliance to be approximately $1 per mortgage transaction.[14]

Many advocates for low and moderate income families support a strong federal law that does not preempt stronger state laws; one example cited is H.R. 1182, sponsored by U.S. Reps. Brad Miller, Melvin Watt and Barney Frank. These groups argue that states need the ability to change their laws quickly to respond to changing markets and stamp out abusive practices that may differ from state to state.

The Center for Responsible Lending has made recommendations to address unfair lending to racial and ethnic minorities in both rural and urban areas. Those recommendations call for stricter oversight of yield spread premiums, which encourage mortgage brokers to steer borrowers into subprime loans; requiring lenders and brokers to offer only loans that are suitable and reasonably advantageous for a given borrower; giving regulators wider authority and adequate resources to fully enforce fair lending laws; and creating incentives and new policies to ensure that minority borrowers are fairly served.[15]

Policymakers should also consider the following recommendations:

- In addition to anti-predatory lending laws, Congress should consider strengthening the Community Reinvestment Act. CRA has been a critical tool used by local communities to encourage and increase access to affordable lending products. More effective use of the CRA process in rural communities and a strengthening of the law could result in more affordable lending products targeted to rural borrowers and less reliance on subprime products.
- Government agencies, including the U.S. Department of Housing and Urban Development, private lenders, and other stakeholders should collaborate to fund, design, and implement effective, independent housing counseling programs and materials for low-income borrowers considering subprime loans. Federal regulators could stimulate banks to help fund these activities through the Community Reinvestment Act (CRA) examinations or through incentives.[16]
- The federal government should require small banks and those headquartered in non-metropolitan areas, which are now exempt from many reporting requirements under HMDA, to comply with proposed new reporting requirements in order to provide a full picture of lending practices in rural areas. Rural communities would then have a better understanding of lending trends and activity and would be better prepared to address lending abuses.

Needed State Actions

While federal policy can be an important tool to help protect borrowers from predatory mortgage lending, it should not preempt state policy. In passing anti-predatory legislation, some states[17] have closed loopholes in HOEPA and placed limits on abusive loans and practices. In general, the state laws attempt to:

- Reduce excessive points and fees that strip equity from borrowers. This is usually done by reducing the percentage of points and fees (from 8 to 5 percent) that define a high-cost loan and trigger additional consumer protections. Also, additional fees that are presently not counted are included in the total percentage.
- Provide consumers with additional protections for high-cost loans, such as requiring mandatory credit counseling, prohibiting pre-payment penalties, or prohibiting the financing of fees.
- Require interest rates to reflect the risk of the loan rather than upfront points and fees that strip equity from borrowers. Interest rates are more transparent to consumers.

- Protect consumers in disputes with lenders. Some states prohibit mandatory arbitration, which tends to favor lenders; some give borrowers legal protections even if their mortgage is sold in the secondary market.
- Require a net tangible benefit to the borrower in any refinance loan. This is designed to prevent loan flipping and equity drain through excessive fees.

Other states should follow the lead of "best practice" states such as North Carolina and Massachusetts, and adopt similar policies to protect vulnerable homebuyers both in rural and non-rural communities in their states.

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[2] Goldstein, Deborah. 1999. Understanding Predatory Lending: Moving Towards a Common Definition and Workable Solutions. Joint Center for Housing Studies of Harvard University: Cambridge, MA.

[3] The Federal Deposit Insurance Corporation reports that while 56 percent of the nation's banks are headquartered in nonmetro areas, rural counties have an average of 4.33 banking firms compared to 10.90 for urban counties. See, http://www.ers.usda.gov/publications/RCAT/ract93i.pdf, for more information.

[4] Quercia, Roberto G, Michael Stegman, and Walter Davis. 2005. The Impact of Predatory Loan Terms on Subprime Foreclosures: The Special Case of Prepayment Penalties and Balloon Payments. Center for Community Capitalism: Chapel Hill.

[5] These data are reported through HMDA using the "rate spread" variable.

[6] The Home Mortgage Disclosure Act (HMDA), enacted by Congress in 1975 and implemented by the Federal Reserve Board's Regilation C, requires lending institutions to report public loan data.

[7] Berenbaum, David. 2002. The National Community Reinvestment Coalition. The Myths of Subprime Lending. *Rural Voices*, Spring 2002, p.7.

[8] Squires, Gregory D. 2005. "Predatory Lending: Redlining in Reverse." [online]. Available from www.nhi.org/online/issues/139/redlining.html.

[9] For the most comprehensive analysis of predatory lending targeted to racial and ethnic populations, see Gruenstein, Debbie, et al. 2006. Unfair Lending: The effect of Race and Ethnicity on the Price of Subprime Mortgages. Durham, NC: Center for Responsible Lending. Also see, Association of Community Organizations for Reform Now (ACORN). 2000. "Separate and Unequal: Predatory Lending in America." ACORN: Washington, D.C.

[10] Fannie Mae and Freddie Mac. 2004. Separate and Unequal: Predatory Lending in America. ACORN: Washington, DC.

[11] The data reflect HAC's analysis of 2004 HMDA data and "rural counties" are nonmetro counties. Nonmetro counties refer to places defined by the Office of Management and Budget (OMB) as nonmetropolitan in 2003. Nonmetropolitan areas are those counties that lie outside core based statistical areas.

[12] Center for Responsible Lending. 2004. Rural Borrowers More Likely to be Penalized for Refinancing Subprime Home Loans. http://www.responsiblelending.org/pdfs/kf-Rural_Borrowers-0904.pdf

[13] These best practice states include North Carolina, New Mexico, and Massachusetts.

[14] Center for Responsible Lending. July 2005. Strong Compliance Systems Support Profitable Lending While Reducing Predatory Practices. Issue Paper No. 10. Center for Responsible Lending.

[15] For more information, see the Center for Responsible Lending 2006 report "*Unfair Lending: the Effect of Race and Ethnicity on the Price of Subprime Mortgages*." This report can be found on the Center's website at: http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf

[16] The FHLB subsidizes the interest rates for advances (loans) and provides direct subsidies to FHLBank System members engaged in lending for affordable housing. The 12 FHLBanks reserve 10 percent of their collective net income or $100 million, whichever is greater, for use in the Affordable Housing Program.

[17] These states include North Carolina, New Mexico, Massachusetts.

Acknowledgements

We thank Josh Silver and Jim Campen for their helpful external review of this policy brief and Amy Seif of the Carsey Institute, Priscilla Salant, and the Hatcher Group for editorial assistance.

The Carsey Institute appreciates early review by the National Community Reinvestment Coalition (NCRC); however, NCRC is not responsible for the findings of this research.

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The Housing Assistance Council (HAC), founded in 1971, is a nonprofit corporation that supports the development of rural low-income housing nationwide. HAC provides technical housing services, loans from a revolving fund, housing program and policy assistance, research and demonstration projects, and training and information services. Coastal Enterprises, Inc. (CEI) is a community development finance institution that supports small businesses and affordable housing development primarily in Maine through financing, technical assistance, and workforce development. The Carsey Institute partners with HAC and CEI to provide information on predatory lending to policymakers, practitioners and the general public.

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The Carsey Institute Reports on Rural America are supported by the Annie E. Casey Foundation's initiative to strengthen rural families, the Ford Foundation, and the W.K. Kellogg Foundation.

The Persistence of Predatory Lending:

A Case Study from Maine

Introduction

In 2005, Coastal Enterprises, Inc. (CEI) and the Center for Responsible Lending (CRL)[1], conducted the first systematic investigation of the nature and extent of predatory lending in Maine.[2] The impetus for the study was a concern that Maine citizens were not receiving the same protections against predatory lending practices that are available in other states such as Massachusetts, New Mexico and North Carolina.

The research examined trends in Maine's subprime mortgage market and the characteristics of loans made in Maine from 2000 through 2005 to determine if they had predatory characteristics. A number of data sources were used, including available empirical data on the subprime market[3]; publicly available foreclosure records and lien histories; and interviews with various stakeholders and borrowers. In addition, the researchers reviewed the relevant laws and regulations in Maine's Consumer Credit Code to answer a basic question: Do current laws in Maine provide an appropriate framework to regulate subprime mortgage lending, given the lending practices revealed by the research?

Key Findings of Maine's Subprime Mortgage Market

Like other parts of the country, Maine's subprime mortgage market has grown dramatically. Between 2000 and 2004, its subprime market grew 436 percent by dollar volume. In 2004, it topped $1 billion with about 8000 loans. In 2003 subprime loans (excluding subprime loans for manufactured housing) were almost 10 percent of the total Maine mortgage market. Over 30 percent of all subprime loans made in Maine by lenders on HUD's Subprime Lender List in 2003[4] were from two out-of-state non-bank lenders, Option One Mortgage Corporation and Ameriquest.

Mainers obtain a higher percentage of their subprime loans in the form of cash-out refinances than do borrowers in any other state. Between January 2004 and May 2005, 65 percent of the state's subprime mortgage market represented cash-out refinances,[5] which is where most abuses in the subprime mortgage market typically occur. During the same period, only 28 percent of subprime mortgage loans in Maine were used for home purchases, the lowest in the nation. This trend is consistent with Maine's high home ownership rate, rising property values in many parts of the state, rising consumer debt, pockets of economic distress, and aging population—conditions that make it vulnerable to predatory lending practices.

Predatory lending is evident in Maine's subprime loans. An examination of subprime mortgage loans shows the following predatory characteristics:

- Steering. A conservative analysis of data suggests that at least 15 percent of the subprime mortgages in Maine between 2003 and 2005 went to families who could have qualified for a less expensive loan.
- Prepayment Penalties with terms greater than 24 months have increased, albeit only marginally, since the passage of Maine's 2003 anti-predatory lending law from 12 percent of subprime originations to 15 percent.
- Abusive lending terms in subprime foreclosure records. Subprime records in four district courts showed loan terms strongly associated with predatory lending, including: mandatory arbitration (17 percent of records); prepayment penalties (11 percent); points and fees over five percent; and evidence of flipping. In total, at least 26 percent of the records contained one or more of the following terms: mandatory arbitration, points and fees over five percent, or prepayment penalties. Most records did not document loan characteristics, so our findings very likely substantially under-report the extent of predatory lending characteristics.

Stakeholders also described extensive debt consolidation driving a market for subprime loans with abusive loan terms, aggressive sales tactics and equity stripping. Interviewees included mortgage brokers, bank and credit union lenders, bankruptcy trustees, bankruptcy attorneys, housing counselors and borrowers. Those interviewed also noted general concerns about inflated appraisals; "bottom feeders[6]" targeting borrowers in bankruptcy; steering and flipping. One of the borrowers interviewed lost about $100,000 in equity to predatory practices, and five of the nine borrowers interviewed were either in, or had gone through, the foreclosure process.

Characteristics of Subprime Mortgage Market in Rural Maine

Between January 2004 and May 2005, 52 percent of the Maine subprime originations were in rural parts of the state, while only 42 percent of Maine's population is rural. Maine ranked fourth in the nation for the concentration of subprime mortgage loans in rural areas. Maine's rural counties that are further away from more urban areas of southern Maine had higher concentrations of subprime mortgage loans as a percentage of total mortgage loans. The highest concentrations of subprime loans were in some of the poorest rural "rim counties" – Somerset, Washington and Piscataquis. This is consistent with the findings that rural communities have fewer lending options and are more susceptible to subprime lenders. However, the research could not determine whether the high concentration of subprime loans in rural areas reflected a higher risk for these loans.

Most of the data that indicate predatory lending characteristics of subprime loans are not available by rural areas. What data are

Table 1: Summary of Multiple Refinances seen in Portland, South Paris, Newport and Lincoln County District Courts Registries of Deeds Sample

District Court	Number of lien histories reviewed for subprime foreclosures	Refinances where interest rate increased between subprime loans	Multiple refinances by subprime lender	Total possible flips	Percentage of possible flips for sample
Portland	30	3	7	10	33
Lincoln	11	3	1	4	36
South Paris	20	0	5	5	20
Newport	15	0	2	2	13

available come from 357 foreclosure and lien records determined to be subprime loans[7] in three rural county courthouses in Lincoln County, South Paris, and Newport. Predatory lending characteristics evident in these records included excessive points and fees, mandatory arbitration clauses, prepayment penalties over two years, and multiple refinances that suggest possible flipping[8] of loans with no net tangible benefit to the borrower as shown below.

Conclusion and Recommendations

Predatory mortgage lending in Maine leads to lost wealth for families and, too often, lost homes. A 2001 study estimated that Maine lost $23.4 million in 2000 through equity stripping practices.[9] This figure does not include foreclosure losses. One out of five subprime mortgages originated in 1999 entered foreclosure by 2005, giving Maine the highest cumulative rate in New England for that period.[10] It is not clear how much of that figure is a result of predatory mortgage lending, but as cited above, national research has shown a higher risk of foreclosure from some predatory mortgage lending practices.

The study found that Maine's current legal framework fails to protect its families from the abusive lending practices identified in the research. A so-called anti-predatory lending law passed in 2003 (PL49) has not provided adequate protections, and in fact legalized some of the abusive practices identified in the national Household and Beneficial Finance Corporations lawsuit settled by the Maine Attorney General in 2003. Additionally, many of the practices alleged in the lawsuit such as excessive points and fees, prepayment penalties, abusive use of open-ended credit, and flipping are largely legal in today's Maine market.

Protections against predatory lending could be substantially strengthened through state legislative action. Maine regulates eighty-nine percent of recognized subprime lenders identified in the HUD Subprime Lender List. In addition, Maine regulates all mortgage brokers. As such, Maine can draw on the experience of a number of best practice states with strong anti-predatory laws, such as North Carolina, New Mexico and Massachusetts, to improve its legislation and ensure that more Maine families hold on to their homes and their hard-earned wealth acquired through home equity. A recent study by the Center for Responsible Lending of 28 state reforms found that strong state laws are working well to prevent predatory lending. Furthermore, borrowers have ready access to subprime credit in these states., and borrowers pay about the same or lower interest rates for subprime mortgages.[11] Recommended changes in Maine's Consumer Credit Code are as follows.

Redefine what is meant by "high-cost" loans and provide more protections for these loans

The percentage of points and fees that trigger a "high-cost" loan should be reduced, more types of fees must be counted, and open ended loans, such as a line of credit, must be subject to the definition. Extra protections for "high–cost" loans include mandatory credit counseling, prohibiting pre-payment penalties, and prohibiting the financing of fees.

Ensure appropriate recourse for consumers if they have problems with their loans

Mandatory arbitration should be prohibited, thus ensuring that borrowers can pursue a dispute with the lender through the court system. Assignee liability provisions should be adopted that allow borrowers to pursue justice from secondary market lenders who buy their loans.

Require that loans that are refinanced have a net tangible benefit to the consumer.

This provision will prevent loan flipping and stripping of equity from borrowers through excessive points and fees.

These recommendations provide more transparency of the true costs of loans to consumers and more protections. None of the recommendations prevent a lender from charging whatever points or fees or interest rates it considers necessary. If the threshold of a high-cost loan is lowered, the lender can still make a loan that exceeds the threshold but would trigger additional consumer protections. While strong legislation is essential, solving the problem of predatory mortgage lending requires complementary efforts such as consumer/financial education and better outreach by responsible lenders to borrowers who might otherwise fall into the hands of predatory lenders. However, such actions will have little impact unless they are supported by effective policies to help ensure that responsible lenders can compete in Maine.

By Carla Dickstein and Hannah Thomas,
adapted from Dickstein et al (2006).

Endnotes

[1] CEI, based in Wiscasset, Maine, is a community development corporation (CDC) and community development finance institution (CDFI). CRL is a subsidiary of Self-Help Community Credit Union headquartered n Durahm, North Carolina, which is also a CDFI.

[2] See Carla Dickstein, Hannah Thomas and Uriah King. 2006. Predatory Mortgages in Maine: Recent Trenads and the Persistence of Abusive Lending in the Subprime Mortgage Market. Coastal Enterprises, Inc., Wiscasset, ME. This study was supported by the Annie E. Casey Foundation, Maine's Attorney General and AARP.

[3] These included data collected under the Home Mortgage Disclosure Act (HMDA), from the Mortgage Bankers' Association and most important, from an industry database that compiles self-reported data from the mortgage industry on the characteristics of loans, described in Dickstein et al (2006).

[4] Data is from the HUD 2003 list of subprime lenders.

[5] A cash-out refinance gives the mortgagor cash back after paying off the mortgage , any junior mortgage and settlement costs. The cash paid out comes out of the equity in the house and is often used to pay off credit card debt.

[6] These individuals offer to get people out of Chapter 13 bankruptcy by refinancing the loan at outrageous terms that homeowners cannot afford. In almost every case, the loan leads eventually to foreclosure, and the excessive fees charged in this last-ditch refinancing strip away any equity the homeowner may have had left in the house.

[7] Subprime loans were determined by the lenders' inclusion in the HUD Subprime Lender List, and in the top 25 list from Inside B &C Lending, an industry publication.

[8] In order to fully assess flipping, we would have to review every borrower's loan documents and loan history. Hence we refer to "possible flips."

[9] See Eric Stein. 2001. Quantifying the Economic Cost of Predatory Lending. Center for Responsible Lending, Durham, NC.

[10] This finding is from the industry database analysis. Details of this database are described in Farris and Richardson, "The Geography of Supbrime Mortgage Prepayment Penalty Patterns." Housing Policy Debate 15 (3) 687-714.

[11] See Wei Li and Keith Ernst. 2006. The Best Value in the Subprime Market: State Predatory Lending Reforms. Durham, NC: Center for Responsible Lending. This peer-reviewed study used statistical analysis to compare states with anti-predatory lending laws to states without these laws.