Predatory Lending

What is Predatory Lending?

The Truth In Lending Act defines predatory lending as extending credit to a consumer based on the consumer's collateral if, considering the consumers current and expected income, the consumer will be unable to make the scheduled payments to repay their obligation. In other words, **predatory lending is lending to a homeowner in order to generate a claim on the equity of his or her house**. There are various definitions for predatory lending, but in very general terms predatory lending is a process, often starting with misleading sales tactics, that culminates in the origination of a loan to a borrower who is paying too much in fees, interest or insurance. This person may not fully understand or may not be aware of all the provisions of the contact; and generally they do not have the financial capacity to repay the loan.

All Sub Prime Lenders are Not Predatory Lenders

While sub prime lenders charge higher interest rates and fees than conventional lenders, these fees usually correspond to a higher degree of risk to the borrower. However, there are some sub prime lenders who engage in unethical predatory lending practices based on excessive rates and fees. These lenders distort the commonly used sales and underwriting tools to the detriment of the borrowers.

Who Is the Target of Predatory Lenders?

Predatory lenders look for homeowners who have substantial equity in their homes, but need cash or have poor credit. Predatory lenders thrive on a consumers need for immediate cash or lack of familiarity with the standard credit products and practices. To be considered an ideal target of a predatory lender, the individual will have minimal cash flow and savings, a large amount of equity in their homes and limited experience with financial services, or even may be on a fixed income. Geographically speaking, these people prey on residents of lower income communities, minorities, women and elder individuals who are disproportionately victims of predatory lenders.

Tactics that Predatory Lenders Use

Predatory lenders use a variety of tactics to generate a claim of a homeowner's equity. Some of these tactics are high interest rates and high points. Also, there are balloon payments and negative amortization; packing or padding costs and fees; flipping; high LTV loans, and locking borrowers in.

How We Can Protect Ourselves from Predatory Lenders

There are a few simple steps that homeowners can take to protect themselves.

1. Follow the basic rule of buyer beware; never sign a contact or any piece of paper without reading it;
2. Carefully and fully understand what it obligates you to do; if possible, get an attorney or trusted financial advisor to review it before you sign it.
3. Don’t agree to a loan if you don’t think you can make the payments;
4. For any loan, make sure you understand all of the terms before you sign it;
5. If the annual percentage rate of the loan is a lot higher than the interest rate quoted on the loan, there may be unnecessary fees attached; compare the APR and interest rate on your loan with the APR and interest rate offered by conventional bankers;
6. Shop around, don’t let anyone rush you into a decision on a loan or home improvement contract; go first to a conventional bank if you need a loan;
7. Don’t agree to a loan without knowing the amount of closing cost, fees and other upfront costs;

These are simply a few of the things you can do; there are a lot more. Education is the key to avoid becoming the victim of a predatory lender.