Borrowers often find themselves trapped in that ruinous cycle of refinancing known as "flipping," each time with high closing costs and other fees that only increase their debt. This cycle frequently throws the borrower into a downward spiral that ends in foreclosure.

"It's a dance that basically crucifies consumers," says Eakes. "It just digs people into a hole so deep they can never get out." Eakes estimates that fully one-fourth of all subprime loans contain predatory provisions.

Predatory loans "are designed to fail," claims the Coalition for Responsible Lending, a group representing almost 3 million North Carolina members of various organizations like the NAACP (National Association for the Advancement of Colored People), AARP (American Association of Retired Persons), and the N.C. Association of Realtors. The coalition reports that the subprime market has grown as much as 600 percent since 1994, according to some estimates.

This year, the N.C. General Assembly took a first step toward curbing unscrupulous lending practices, enacting legislation that state Attorney General Mike Easley hailed as "the toughest bill against predatory lending in the country." Senate Majority Leader Roy Cooper, who hopes to succeed Easley as attorney general in the 2000 elections, sponsored Senate Bill 1149.[2] It sailed through the Senate on a vote of 48–1 and then passed the House 110–2. Other states monitored the progress of the legislation, as did subprime mortgage lenders across the U.S.

"We're going to be the trend-setter in the nation," says Cooper, a lawyer from Rocky Mount. "I think this bill will go a long way toward cleaning up predatory lending in North Carolina."

Opponents are less sanguine about the legislation's effects. Subprime lenders note that they frequently offer borrowers with marred credit their only chance at home ownership. The loans are riskier, the lenders say, and creditors willing to take the risk deserve higher returns. The new law, they fear, will dry up credit for poor borrowers.

"I think you will see many lenders fearful of making loans," Laura Borrelli, president of the National Home Equity Mortgage Association, told a national trade publication shortly after Senate Bill 1149 received approval. "The potential for litigation, not just for subprime lenders but for all lenders, is staggering."[3]

Robert E. Lamy, assistant professor at the Babcock Graduate School of Management at Wake Forest University, warned in a reader's perspective column in *The News & Observer* of

"We're going to be the trend-setter in the nation. I think this bill will go a long way toward cleaning up predatory lending in North Carolina."

—SEN. ROY COOPER (D-NASH), SPONSOR OF LEGISLATION

Glossary of Terms in Predatory Lending

Balloon payment—A larger final payment due at the end of a financing period that is required in order to pay off a loan. A large balloon payment could prevent a borrower from being able to complete scheduled payments and thus force the borrower to refinance, incurring additional fees.

Flipping—The practice of repeated refinancing of loans where there is no benefit to the borrower. Predatory lenders frequently seek to refinance or "flip" their loans only months into the life of a mortgage.

High-cost home loan—A mortgage loan of $240,000 or less is defined as high-cost if it meets any of the following conditions:

(1) Origination costs (points or prepaid interest plus fees) total more than 5 percent of the loan amount;

(2) The interest rate is at least 10 percent higher than the yield on current U.S. Treasury securities;

(3) It authorizes a prepayment penalty for paying off a loan early of greater than 2 percent or for longer than 30 months.

Legislators attached special conditions to home loans in this category in an effort to discourage lenders from making them.

Packing—The practice of adding often-unnecessary fees to a home loan contract. These might include insurance premiums, or poorly defined fees for "processing," "flood certification," or "tax service."

Prepayment penalties—Charges assessed by the lender for early payment of a loan or paying a loan in full before it is due.

Subprime lenders—Lenders who extend credit to low-income clients or those with marred credit ratings. Their clients often have B or C credit ratings, not the preferred A or A-. Subprime refers to the credit rating of the borrower, not the interest rate. Subprime lenders believe they are serving a market that might otherwise have too little access to credit, though interest rates charged to borrowers are higher than those charged by traditional banks.

Yield-spread premium—The fee a mortgage broker receives from a lender for signing a borrower to a loan carrying a higher interest rate than the rate for which the borrower might qualify.

Raleigh, N.C., that legislators "may wind up hurting the very citizens they're trying to help."[4] Lamy warns that excessive regulatory oversight and restrictions on interest rates and fees may dry up credit for consumers with cash flow problems who are not being served by traditional banks. He characterizes the subprime mortgage market as "an excellent example of how competitive capital markets successfully evolve" and describes some of the more aggressive lenders as "a few bad apples."

Cooper discounts the concern about limiting access to capital for cash-strapped consumers. "I tend to think it will not reduce credit," he says. "Lenders will make plenty of profit and will still want to make these [subprime] loans."

Senate Bill 1149 amends state usury laws regulating lending in several ways. It:

- Defines "high-cost home loans" as those of $240,000 or less where fees and discount points intended to lower the interest rate of the loan exceed 5 percent of the principal amount, or where the annual percentage rate is more than 10 points higher than the yield on current U.S. Treasury securities (about 15.75 percent at the time the bill passed). Lenders cannot make high-cost loans without regard to the borrower's ability to repay. Up-front fees cannot be financed on these loans, and borrowers must undergo credit counseling through a counselor certified by the N.C. Housing Finance Agency before closing. Also, balloon payments required to pay off a loan after a specified period that total more than twice the amount of a regular payment are prohibited on such loans. Cooper says lawmakers wanted to discourage lenders from making high-cost loans by placing what he describes as "onerous" restrictions on them.
- Outlaws "flipping," the practice of refinancing when the new loan has no benefit to the borrower. This provision applies to all mortgage loans issued in North Carolina, not just high-cost loans. Many times, predatory lenders refinance their own loans after a matter of months or a few years, adding fees that boost their profits. Many times, they promise lower monthly rates, but the savings are illusory. "This can happen two or three times, and pretty soon the homeowner has no equity in the house," Cooper says.
- Prohibits lenders from financing single-payment credit life, disability, or unemploy-

"I think you will see many lenders fearful of making loans. The potential for litigation . . . is staggering."

—LAURA BORRELLI, PRESIDENT OF THE NATIONAL HOME EQUITY MORTGAGE ASSOCIATION