

N.C. Legislature Acts on Predatory Lenders and High-Cost Loans, But Was It Enough?

by Anne Bullard



Summary

The 1999 General Assembly passed a bill regulating "predatory lending"—the practice of lending money for home loans based on unethical lending standards. Some consider the bill to be among the most aggressive in the nation in curbing these kinds of loans. Consumers like Dezell Wiley are the reason state lawmakers acted. Targeted for repeated refinancing—or "flipping" in the industry parlance—this 89-year-old Durham resident now owes more than \$70,000 on a house she purchased for \$13,500 in cash from an insurance settlement in 1967.

A bill enacted overwhelmingly by the 1999 N.C. General Assembly attempts to put the brakes on the type of lending that got Wiley in financial trouble. The new law: (1) defines high-cost loans and declares that lenders cannot make such loans without regard to the borrower's ability to pay; (2) outlaws the practice of flipping, or repeatedly refinancing loans when the new loan is of no benefit to the buyer; (3) prohibits lenders from financing credit-life, disability, or unemployment insurance policies with a single lump total added to the amount of the loan (these policies must instead be paid on a monthly basis); and (4) outlaws penalties for earlier-than-scheduled payoffs of home loans of \$150,000 or less.

Critics say these changes will dry up available funds for people with less than sterling credit. But advocates say there is still plenty of profit to be made, and some argue that even greater reforms are needed. Additional legislation introduced in the 1999 session would require mortgage brokers and mortgage bankers to be licensed by the State Banking Commissioner and outlaw "yield spread premiums," which are fees paid to brokers who sign consumers to loans with interest rates that are higher than those for which they might legitimately qualify. This additional bill is eligible for consideration by the 2000 General Assembly.

**Durham homeowner Dezell Wiley—mired in debt from aggressive lenders.
(photo above left)**

For nearly 20 years, Dezell Wiley lived mortgage-free in her tidy brick home on Durham's South Roxboro Street. The three-bedroom house, just down the hill from C.C. Spaulding Elementary School, represented a sad legacy. Wiley bought it with life insurance proceeds a year after the untimely death from cancer of her son, Harold, an Air Force veteran. Wiley paid \$13,500 cash for the house in 1967.

Now, at age 89, Wiley owes more than \$70,000 on the same house, and she must spend almost all of every Social Security check to make the \$742.52 monthly payment. It is a debt the retired American Tobacco Company worker will never be able to repay.

How did she get so far in the red? Repeated refinancings—five of them between 1994 and 1997—each rolled new closing costs and other, questionable fees onto the previous debt. In the shady trade of predatory lending, this practice of serial refinancing is known as “flipping.” “These people were chewing me up and spitting me out, and I didn’t even know it,” Wiley says.

Wiley’s walk down the long path toward losing the equity in her home started with two legitimate loans from First Union National Bank—first in 1984, when she borrowed \$12,000 against the house, and again in 1989, when she refinanced that loan. After the second loan went through, finance companies began mailing Wiley solicitations, promising cash to help her consolidate her other bills. The money she got out of the refinancings “wasn’t all that much, but it would help pay a bill,” she explained.

But at no time when her loan was flipped did Wiley receive more cash than the closing costs of her new loan, says her lawyer, Melinda Lawrence. Wiley entered into the loans without reading the fine print, which at various times included up-front charges for credit life insurance policies,¹ as well as balloon payments (see Glossary) due when the loans matured, and other fees all financed over the

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—MELINDA LAWRENCE, ATTORNEY FOR
DURHAM HOMEOWNER DEZELL WILEY

life of the loans. The loan balance kept escalating. Over the 15-month period between September 1996 and December 1997, Wiley refinanced her home three times and paid various fees and closing costs totaling more than \$11,000, all of which was tacked onto the loan balance. “Basically, she’s lost \$40,000 in equity over the last 10 years, and not gotten anything for it,” says Lawrence, a Raleigh attorney.

***“It sounded pretty good,
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—DURHAM HOMEOWNER DEZELL WILEY,
VICTIM OF AGGRESSIVE LENDING

Wiley’s current loan came from Associates First Capital Corporation, a Texas-based lender that is the subject of an investigation launched in July 1999 by N.C. Attorney General Mike Easley. The Associates was owned for 80 years by Ford Motor Credit Corporation until it was spun off in 1998. The company began sending Wiley pamphlets within weeks after a previous refinancing, offering her a deal that would allow her to skip her December 1997 house payment. “It sounded pretty good, especially near Christmas, when you want to get a little extra money,” she says.

That \$72,241 loan transaction proved costly: for the privilege of skipping that \$700 payment, Wiley paid \$1,367 in closing costs that were rolled into the amount of the 11.29-percent loan. And her fast-growing indebtedness increased by another \$2,500. After a few months, Wiley says, she began receiving phone calls from the company’s Charlotte office, claiming incorrectly that she was “behind” in her house payments and would have to pay additional fees. Wiley argued with the callers, and even got a teller at her bank to verify that she had deposited the money for the bank draft on time. The worrisome phone calls continued each month, stopping only after Wiley consulted a lawyer, “when [the loan officer] found out I had a little more sense than he thought I had,” she says.

After reading a local newspaper article about predatory loan practices that cited a case involving The Associates, Wiley called The Center for

Anne Bullard is a writer and editor living in Raleigh, N.C.

Community Self-Help, a Durham-based organization that also was mentioned in the news story. Officials at the non-profit agency, which tries to help poor people gain a financial footing through home ownership, put her in touch with attorney Lawrence.

Prime Time for 'Subprime'

Unfortunately, Wiley's story is hardly unique, except for the details. Martin Eakes, Self-Help's founder and CEO estimates that 50,000 North Carolina families are victims of predatory lending. The Coalition for Responsible Lending argues in handouts that predatory lenders have "stolen" \$300 million in equity from N.C. homeowners and predicts that borrowers may lose another \$2 billion in equity over the next several years. Burgeoning consumer debt, tax law changes that eliminated the tax deductibility of other types of loans, and the 1981 deregulation of mortgage lending in

North Carolina helped open the door to mortgage brokers and lenders, some of them unscrupulous.

Predatory loans strip cash-poor, equity-rich homeowners of their only form of wealth—the equity in their homes. As in Wiley's case, many of the loans are marketed as second mortgages, or home equity loans, to unsophisticated borrowers living in poor neighborhoods. Elderly homeowners, minorities, or borrowers with low incomes and/or credit problems who might not qualify for a conventional loan are favorite targets. Lenders often extend "subprime" (see Glossary) credit to people with B or C credit ratings at interest rates higher than the rates available to borrowers with preferred A or A- ratings, though they are also happy to lend to people with stronger credit ratings who agree to the terms. While most subprime loans are legitimate, unethical lenders sometimes lure consumers into predatory loans with telephone calls or mail solicitations promising money for a vacation, home repairs, or debt consolidation.



Karen Tam

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

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—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.

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

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 unemployment

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

ment insurance policies. Unethical lenders frequently "pack" their loans with such charges, often unnecessary, driving up the loan amount and thereby increasing monthly payments over the life of the loan. Policies paid on a monthly basis would still be permitted. North Carolina would become the first state to halt the financing of the policies in mortgage loans when this provision takes effect next July 1, 2000. A legislative study commission has been appointed to study the effects of the single-payment policy prohibition.

- Prohibits prepayment penalties—charges for paying off a loan before it is actually due—on home loans of \$150,000 or less. Since 1977, state law has prohibited penalties for early payoff on mortgages of \$100,000 or less. "Why should a poor person be penalized for doing something we tell them is a good thing to do?" asked Eakes,—“trying to get out of debt.”
- Requires a Legislative Research Commission panel to study implementation and enforcement of the act and try to determine whether it is reducing predatory lending practices and whether it is hurting the amount of available credit. The panel may report preliminary findings to the 2001 General Assembly and must report to the 2002 session. In addition, the study commission is to examine whether financing credit life insurance offers any benefit to consumers and report to the 2000 General Assembly on this issue.

Here a Fee, There a Fee

When Eakes' clients at Self-Help began complaining to him three or four years ago about problems with their mortgage loans, Eakes at first thought there must be a mistake in the documents they brought him. "We looked at these loan papers and said, 'There's got to be a typo here,'" he recalled. "What we discovered was this very pervasive practice where lenders were systematically targeting unsuspecting borrowers to strip the wealth, the cash value out of the home." Eakes began to see a pattern in the loans: points and fees that accounted for as much as 10 or 15 percent of the loan amount, steep penalties for early repayment, and balloon payments that required borrowers to seek a new loan when they came due.

One of the most egregious practices, Eakes thought, was that of requiring borrowers to buy

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—MARTIN EAKES, FOUNDER AND CEO,
CENTER FOR COMMUNITY SELF-HELP

thousands of dollars in credit life insurance, paying for it in a single premium at closing instead of in monthly payments. When borrowers couldn't come up with the lump sum, the premium was added to the loan amount, financed at the same high rate. "It's like asking a utility customer to pay five or 10 years' worth of bills in advance and then pay interest on them," Eakes says.

Regulatory agencies like the N.C. Banking Commission and the state attorney general's office also had begun to hear tales of exorbitant rates and fees on mortgage loans. "We were seeing fees that were not common even four or five years ago," says Philip A. Lehman, assistant state attorney general in the Consumer Protection Section, "fees that were limited only by the lenders' imagination." They might include document preparation, underwriting, or "processing" fees, and in some cases even cancer insurance and auto club membership. The "junk fees" could add up to thousands of dollars.

The problem is not that predatory lenders fail to disclose the fees. Usually, Lehman says, the loans spell out even the harshest of terms in black and white. But the lenders don't talk about them, and unsavvy borrowers don't realize what they're agreeing to.

"A lot of people don't even seem to be aware of it when they've made a bad deal," Lehman says. "You're not reading and discussing and negotiating" with the lender during a closing, he explained. "You are sitting there signing document after document after document, with no clue of what's in them."

Lehman and Cooper, the bill sponsor, hope North Carolina's law will prompt federal action to give borrowers more protection from unscrupulous lenders. The Homeowners' Equity Protection Act (HOEPA)—passed by Congress in 1994—was intended to protect consumers against mortgage lending abuses. "But what it's become is just another

piece of paper, another disclosure that doesn't accomplish its purpose," says Lehman. Cooper calls the federal law "woefully inadequate."

Since 1990, the home equity market in North Carolina has doubled in size and continues to grow at a rate of almost 19 percent per year, according to the Coalition for Responsible Lending. The Federal Reserve Bank estimates that the goal of debt consolidation prompts consumers to take out 68 percent of all home equity loans and 90 percent of subprime loans.

The need for cash can prompt homeowners to refinance even when they already have the best possible loan rate—zero percent—or, like Wiley, when they have paid for their homes. *The News & Observer* of Raleigh, N.C., reported in the spring of 1999 that six of 70 owners of homes built by Habitat for Humanity in Wake County and two of 65 in Durham County refinanced their no-interest loans through subprime lenders to get cash. The result in most cases was that their debt doubled.⁵

Subprime lending is not confined to second-tier finance companies. While traditional banks may be reluctant to extend conventional loans to credit-risky or poor borrowers, they have established their own stake in the booming subprime market. The state's two largest banks have subprime operations: Bank of America owns NationsCredit, which has 33 offices across the state, and several other subprime subsidiaries; First Union operates The Money Store. The reason? Profits and to serve a market. *Forbes* magazine estimates that subprime consumer finance companies enjoy six times the profits of even the most successful banks. However, subprime lenders lend to people who that might not be able to get credit elsewhere, and many are legitimate business operations.

Gathering Momentum

As lending abuses became more widely reported, an unlikely coalition began forming in 1999 to push for legislative action. In the end, it included a wide-ranging assortment of community groups, including the Coalition for Responsible Lending, the Community Reinvestment Act of North Carolina (CRA-NC), the N.C. Fair Housing Center, the NAACP, and Habitat for Humanity; regulatory agencies like the attorney general's office and the state banking commissioner; and trade groups representing banks, mortgage bankers, and brokers themselves, who wanted the predatory lenders stopped.⁶

Jim Lofton, Secretary of Administration under former Governor Jim Martin, served as President of the N.C. Association of Financial Institutions while the predatory lending bill was being debated in the General Assembly. The association's membership was comprised of five of North Carolina's largest banks—Bank of America, BB&T, First Citizens, First Union, and Wachovia. Initially, that association—which has since been folded into the N.C. Bankers Association—withheld support from the bill, voicing concern over the costs that would be associated with changing loan software to use only in their N.C. branches. But by the end of the process, the big banks were on board. "I want North Carolina to be the best state for banking and the worst state for predatory lending," Lofton told a legislative committee. "I think in this legislation we've done that."

Lawyer John McMillan lobbies for the 700-member N.C. Association of Mortgage Brokers, which also backed the bill. He says his group wanted clarification of the law with respect to mortgage fees and supported Cooper's bill from the beginning. "Our members were not doing those things that were labeled predatory lending practices. Cleaning up the industry . . . is beneficial to the overall mortgage lending community," he says.

The state NAACP brought about 50 members to the Legislative Building in June to lobby for the bill's passage. At a press conference, the Rev. George Allison, state executive director, accused predatory lenders of practicing "economic rape" in minority communities and compared them to "hustlers, loan sharks, and drug dealers." He urged legislators to "put [predatory practices] to death once and for all."⁷

At a May rally, a group of about 50 bill supporters had gathered outside the Legislative Building. "If poor people must be charged slightly

"Before the ink even dried on the predatory lending legislation, subprime lenders got a taste of just how difficult the operating and regulatory environment in the Tar Heel State has apparently become."

—INSIDE B&C LENDING,
TRADE PUBLICATION

Public Awareness or Politics?

When the legislature enacted a new law regulating so-called predatory lending in the summer of 1999, North Carolina Attorney General Mike Easley took the offensive, launching a three-pronged plan of legislation, litigation, and education. But critics, noting Easley's high profile appearance in public service ads running in African-American media outlets, argue there is a fourth prong—politics.

As reported in the *Winston-Salem Journal*, it cost \$160,000 for a series of radio ads that featured Easley and former Charlotte mayor Harvey Gantt, a popular black leader and two-time Democratic nominee for the U.S. Senate. An additional \$20,000 went for print advertisements appearing in black-oriented newspapers across the state.¹ The full-page print ads offer a prominent consumer warning about avoiding home equity scams, but they also include a photo of Easley and mention his name five times.

In addition, Easley's office has printed 25,000 copies of a "Consumer Alert" brochure that features a photo of Easley paired in large type with "Attorney General Mike Easley's tips for avoiding home equity scams."

Easley is seeking the Democratic nomination for governor in 2000. Besides educating consumers, critics see the public service advertising campaign as an effort to aid his gubernatorial campaign and particularly to attract black votes. But Easley's office describes the predatory lending campaign as an honest effort to raise public awareness. "He's got extraordinary credibility among consumers," says Alan Hirsch, special deputy attorney general and head of the consumer protection division. Hirsch notes that consumer education and enforcement of consumer protection laws is part of the attorney

general's job. African-Americans have been targeted, Hirsch says, because they are more likely to be the targets of home equity scams.

However, critics point to two ethical lines Easley may have crossed. In 1997, the General Assembly adopted a law barring declared candidates for Council of State offices from appearing in state public service ads during an election year unless there is a state or national emergency.² "No one likes the idea of someone getting an unfair advantage in a statewide race," says Rep. Leo Daughtry (R-Johnston), who pushed for the legislation and is himself a candidate for the GOP gubernatorial nomination.

Hirsch notes that the election year actually began January 1, 2000. No advertisements were scheduled to run after December 31, 1999, so the attorney general was in full compliance with the law, Hirsch says.

In addition, the money from the ads came from settlements won by the attorney general's office in other consumer protection cases. A provision in the state constitution says that fines and penalties for violations of state laws must go to counties to help pay for schools.³ The position of the Attorney General's Office, however, is that the settlement dollars are not fines and penalties as specified in the state constitution, and this area of the law remains in dispute.

—Mike McLaughlin

¹ David Rice, "Critics: So-called public service ads are campaign for Easley," *Winston-Salem Journal*, Winston-Salem, N.C., Sept. 12, 1999, p. B1.

² *Ibid.*

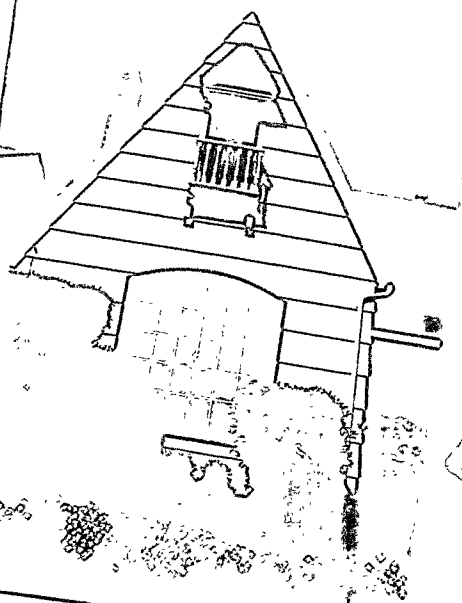
³ N.C. Constitution, Article 9, Section 7.

Mike McLaughlin is editor of North Carolina Insight.

higher interest rates because their loans are higher risk, then so be it," says Eakes, an organizer of the broad-based coalition. "But I refuse to accept that the poor and elderly should be charged fees that middle-class borrowers are never charged, simply because they have been deceived or because they are unsophisticated."⁸

Eakes, a primary force in building support for the bill, also bombarded legislators with information, including a videotape featuring four news reports about predatory lending. The video features network reports by ABC, CBS, and CNN, as well as two news broadcasts by an Atlanta TV station. Several of the interviews focused on loan practices

CONSUMER ALERT



Don't let your home
become a house of cards.

Beware of Home Equity Scams.

A Consumer Alert from
North Carolina Attorney General Mike Easley

of The Associates, the finance company that holds Wiley's mortgage. ABC's "PrimeTime" featured Philip White, a former assistant manager at an Alabama branch of The Associates. He says he quit his job when he became "sick and tired of lying to people."

"Somebody would walk out with a \$40,000

real estate loan at a 15 percent interest rate, paying 5 points, with insurance on it, and we'd say, 'What a sucker. Ch-ching. We just made the company some money.'" White told the network that his branch had a "designated forger" to sign borrowers' names on occasion.⁹ Ford Motor Credit officials say they conducted an investigation and

"found no basis whatsoever" for White's allegations.

Another broadcast report also examined The Associates' loan practices. Howard Rothbloom, an attorney for an Atlanta-area borrower, says the company entered a "win-win situation" with every predatory loan. "If these borrowers pay their notes, then The Associates makes high interest. And if they don't pay their notes, then they get the homes, and the homes have high equity in them."¹⁰

However, Fred Stern, a former senior vice president of The Associates, responded that the company is providing a service for its customers. "We're filling a need for people to have access to credit that they might not be able to get elsewhere," Stern said in a CBS Evening News "Eye on America" segment that aired March 16, 1998.

"Preying on homeowners that have spent a lifetime building equity in their homes is unconscionable."

—N.C. ATTORNEY GENERAL

MIKE EASLEY

In the interview, Stern denies that The Associates has a policy to flip loans and says the company does not take advantage of poor or elderly customers. "It is not our policy to do anything that does not make sense for the customers or for ourselves," Stern says. In May 1999, The Associates responded to lawsuits filed in Massachusetts and California by agreeing to allow interest rate reductions of up to 2.25 percent on their loans and to commit \$100 million to Neighborhood Assistance Corp. of America, a Boston-based program that offers mortgages with no fees and no down payments.

Raleigh lawyer Jerry Hartzell has filed three lawsuits on behalf of clients who believe lenders broke the law in making their loans. Sometimes, Hartzell says, borrowers are driven by desperation, even if they realize that loan terms are unfavorable. He represented George Cantey, a Raleigh floor finisher who bought a house for his family in 1996. According to court documents, United Companies Lending Corp., a Louisiana-based firm, agreed to loan Cantey the \$30,700 to pay for the house. However, the total loan amount came to \$38,400, reflecting the addition of \$7,716 in fees that included

a \$2,200 "broker fee" and a loan origination fee of \$3,064—almost 10 percent. Cantey's furnace failed a year later, and he asked United Companies for a \$3,700 loan to replace it. The company told him he'd have to refinance his home loan to get more money. This time, the mortgage amount came to \$48,500—\$40,662 to pay off the first loan, \$3,717 for the new furnace, and another \$4,121 in origination costs and other fees. Hartzell sued United Companies, but the corporation filed for bankruptcy while the case was pending.

Hartzell praised the new state law. "It doesn't take care of everything, but I think it will do a lot," he says.

Taking Action

Just two weeks after the legislature approved the predatory lending bill, Attorney General Easley launched an investigation into alleged predatory lending practices by The Associates, the company which Assistant AG Lehman described in an interview as the example of aggressive lending that prompted the legislation. Easley ordered the lender to provide copies of documents within 30 days of his July 22, 1999, order. It was the attorney general's second such probe. In February, his office subpoenaed records from Chase Mortgage Co., of Wilmington, N.C.

Easley's actions caught the attention of the trade press. "Before the ink even dried on the predatory lending legislation, subprime lenders got a taste of just how difficult the operating and regulatory environment in the Tar Heel State has apparently become," one bulletin observed.¹¹

In a statement released at the time, Easley vowed "to aggressively target these lenders in the same way they target their victims. Preying on homeowners that have spent a lifetime building equity in their homes is unconscionable."

The attorney general, who is running for governor in 2000, promised a "three-pronged plan" to attack predatory lenders, including legislation, litigation, and education. In August, his office printed 25,000 copies of a full-color "consumer alert" brochure that warns borrowers about "loan sharks" who attract borrowers with promises of lower monthly payments that mire consumers in debt they can never pay off. "Don't let your home become a house of cards," the front cover of the brochure warns. Inside, it lists and explains "Five warning signs of a home equity scam." Though few have questioned the need for this campaign, critics have said Easley's high profile role was too political in

light of his gubernatorial ambitions. (See p. 38 for more on this topic.)

Other states are also taking action. New York lawmakers are considering a proposal to cap brokers' fees at 3 percent. That legislation also would allow borrowers facing foreclosure to argue in their defense that the lender knew or should have known the borrower did not have the ability to repay the loan. In Minnesota, mortgage lenders must subscribe to standards of conduct that took effect July 1, 1999.¹² The new law bars lenders from entering into loans for the purpose of foreclosing on the property and from steering borrowers who would qualify for a lower-rate conventional loan into a subprime contract.

More Legislation Ahead?

Some North Carolina lawmakers believe they have more work to do on the lending issue. Sen. Wib Gulley (D-Durham) introduced a bill in the 1999 session that would require the licensing of mortgage brokers and mortgage bankers, who now negotiate more than half of all home loans in the state.¹³ Such licensing is favored by the Coalition for Responsible Lending. "Broker offices currently are required to *register* with the state, but enforcement authority is limited," says the coalition.¹⁴ "Individual brokers guilty of misconduct can now go from one mortgage company to another without detection. If they were licensed, it would be possible to trace individuals, penalize any misconduct, and hold them to a higher standard of practice."

Brokers would be required to "act exclusively" on the behalf of the borrower, not the lender. The licensing bill also would prohibit brokers from accepting fees known as "yield-spread premiums," which reward brokers for steering borrowers into higher-interest loans and often amount to thousands of dollars. Gulley suggests that such premiums pose "probably the single worst problem we have in mortgage lending in North Carolina right now, and the predatory lending bill didn't stop it."

Gulley calls the yield-spread premiums "kick-backs" and says they encourage brokers to deceive borrowers, who presume that the broker is working as their ally and, therefore, working to get them the best possible interest rate. "It's a real problem, and I think it's one that when it's taken out in the light of day it becomes indefensible," he says. For that reason, Gulley says his bill "may even [offer] more profound help" than Cooper's in the state's efforts to protect borrowers.

Resources

Center for Community Self-Help
301 West Main Street
Durham, NC 27701
Tel: 919-956-4400
website: www.self-help.org

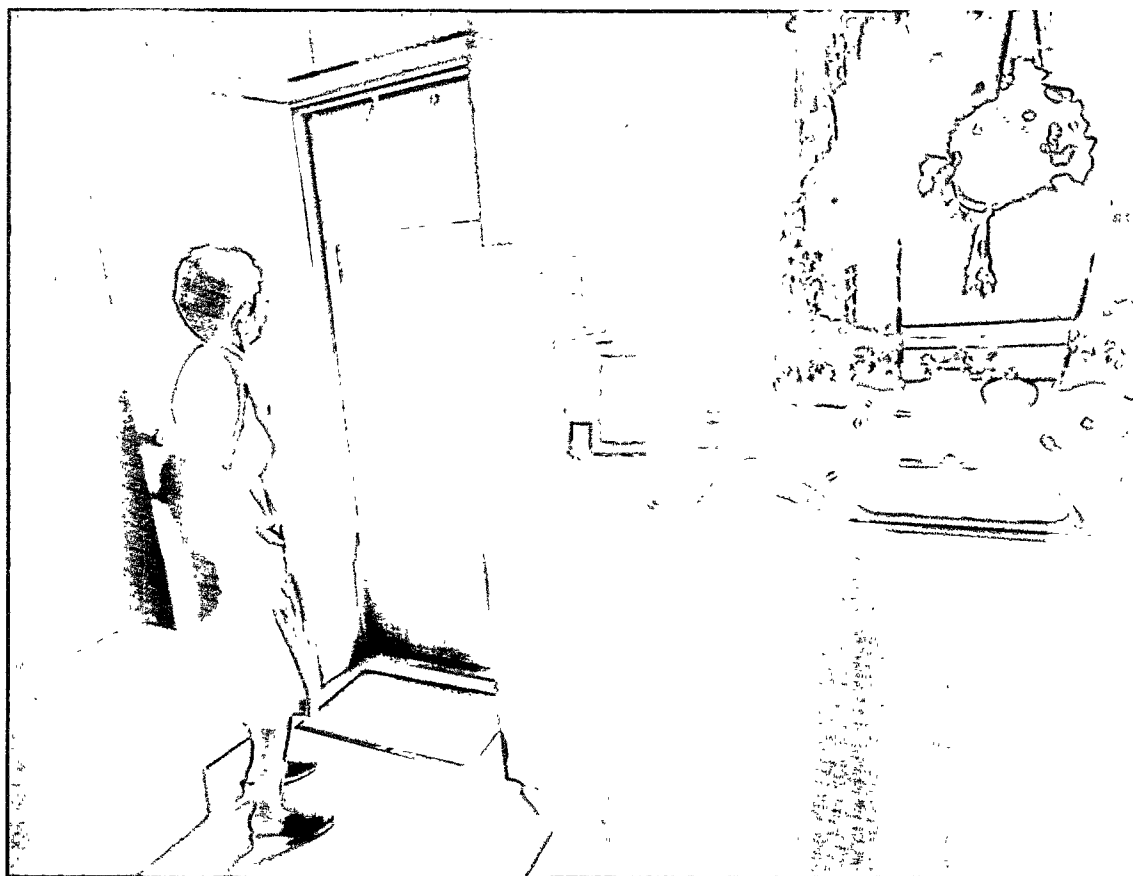
North Carolina Attorney General's Office
Consumer Protection Section
Old Education Building
114 West Edenton Street
Raleigh, NC 27602
Tel: 919-716-6000

North Carolina Banking Commission
702 Oberlin Road
Raleigh, NC 27605
Tel: 919-733-3016

State Banking Commissioner Hal Lingerfelt agrees that his office needs a licensing requirement to give teeth to the predatory lending legislation, and he has helped bring together the parties involved to work on building a consensus in support of Gulley's legislative initiative for the 2000 session of the General Assembly. About 600 mortgage brokers and lenders have registered with Lingerfelt's office. But Lingerfelt estimates that two or three times that many brokers operate in the state. He's not sure how many, because out-of-state firms are exempt from the registration requirement. As the number of brokers has increased, so have complaints to his office, and Lingerfelt says more staff time is absorbed in handling complaints.

"I think overall the consumer will benefit tremendously if we have licensing in the brokerage process."

—STATE BANKING COMMISSIONER
HAL LINGERFELT, PROPONENT OF
LICENSING MORTGAGE BROKERS



Because brokers are not licensed, the state lacks authority to discipline individual employees of brokerage or lending firms. "We'd like more accountability for the individual who's doing wrong," Lingerfelt says.

"I think overall the consumer will benefit tremendously if we have licensing in the brokerage process," Lingerfelt added. "You should have a set of expectations when you talk to a mortgage broker or mortgage banker, no matter who you talk to or where you go."

Hayes Hyman works as a mortgage broker at Raleigh-based Capital Savings Co. He is immedi-

"They're [Hiring a mortgage broker is] not like you're hiring an attorney or a realtor."

—HAYES HYMAN,
MORTGAGE BROKER AND
OPPONENT OF LICENSING

ate past president of the N.C. Association of Mortgage Brokers, which supported Cooper's bill. While his organization supports some form of licensing, he thinks Gulley's bill goes too far. Brokers should represent neither lenders nor borrowers, he argues. "They're not like you're hiring an attorney or a realtor," he says.

Hyman also says his association has reservations about limiting a broker's right to accept yield-spread premiums. He compares brokers to retailers who sell lenders' wholesale products to borrowers, and he thinks that they are entitled to profit on the products they sell. Hyman says the market should control the mark-up. "It's just like selling any product—if you overprice the product, nobody's going to buy your services," he says.

Eakes and the coalition of consumer advocates he helped assemble will be ready to go to work on Gulley's bill when legislators take it up again. But for now, the Self-Help CEO is satisfied that North Carolina has taken a decisive first step toward driving predatory lenders out of the state. Indeed, *Mortgage Banking*, the national trade publication of the residential mortgage industry, describes North Carolina's predatory lending law as "the most sig-

nificant legislation enacted this year . . .” to regulate the industry.¹⁵ “We can’t solve everything at the state level,” says Eakes, “But we tried in [Cooper’s] bill to do what we could.”

Dezell Wiley, the Durham homeowner who lost \$40,000 in equity in her home, offers some simple advice to others who would mortgage their homes to pay off consumer debts. “Leave it alone,” she warned. “It’s too late now, but that’s what I’m doing.” ■■

FOOTNOTES

¹ For more on the issue of credit life insurance, see Bill Finger, “To Your Credit or To Your Debt? Credit Insurance,” *North Carolina Insight*, Vol. 8, No. 2 (November 1985), pp. 28–47.

² Session Law 1999-332 (Senate Bill 1149), which rewrites N.C.G.S. 24-1.1A-10.2.

³ “N.C. Predatory Lending Bill Passes, Sets HOEPA Rules,” author not indicated, *Inside B&C Lending*, IMF Publications Inc., Washington, D.C., July 26, 1999, p. 22.

⁴ Robert E. Lamy, “Point of View: Drying Up Useful Lending,” *The News & Observer*, Raleigh, N.C., June 2, 1999, p. 19A.

⁵ Carol Frey, “Some Habitat clients risk losing equity for cash,” *The News and Observer*, Raleigh, N.C., May 2, 1999, p. 1A.

⁶ Coalition members included the N.C. Bankers Association, representing 128 community banks and thrifts; the N.C. Credit Union Network, representing 180 credit unions; the N.C. Mortgage Bankers Association; the N.C. Association of Financial Institutions, representing Bank of America, First Union, BB&T, First Citizens, and, until July 1, 1999, Wachovia; N.C. Mortgage Brokers; and the Coalition for Responsible Lending,

whose 73 organizational members included North Carolina members of the NAACP, AARP, and N.C. Association of Realtors, among others.

⁷ Dennis Patterson, Associated Press, “NAACP targets predatory lending,” *The News & Observer*, Raleigh, N.C., June 10, 1999, p. 3A.

⁸ Associated Press (author’s name not published), “Credit Unions Lobby for Predatory Lending Law,” WRAL5 OnLine, Raleigh, N.C., May 7, 1999.

⁹ ABC News, “PrimeTime Live,” April 23, 1997.

¹⁰ “Fox 5 News Investigation,” WAGA-TV, Atlanta, Ga., May 4, 1998.

¹¹ *Inside B & C Lending*, note 3 above.

¹² Chapter 58 of the Minnesota Statutes, “Standards of Conduct.”

¹³ Senate Bill 866 of the 1999 session.

¹⁴ “Questions & Answers: The N.C. Predatory Lending Law,” Coalition for Responsible Lending, Durham, N.C., August 31, 1999, p. 4.

¹⁵ Robert S. Lotstein and Ray Christian Witter, “Looking Through the Maze,” *Mortgage Banking*, Mortgage Banking Association of America, Washington, D.C., November 1999, p. 16.

“Leave it [predatory lending] alone. It’s too late now, but that’s what I’m doing.”

—DEZELL WILEY

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