Home Equity Scams

Do you own your home? If so, it's likely to be your greatest single asset. Unfortunately, if you agree to a loan that's based on the equity you have in your home, you may be putting your most valuable asset at risk.

Homeowners—particularly elderly, minority and those with low incomes or poor credit—should be careful when borrowing money based on their home equity. Why? Certain abusive or exploitative lenders target these borrowers, who unwittingly may be putting their home on the line.

Abusive lending practices range from equity stripping and loan flipping to hiding loan terms and packing a loan with extra charges. The Bureau of Consumer Protection urges you to be aware of these loan practices to avoid losing your home.

The Practices

Equity stripping

You need money. You don't have much income coming in each month. You have built up equity in your home. A lender tells you that you could get a loan, even though you know your income is just not enough to keep up with the monthly payments. The lender encourages you to "pad" your income on your application form to help get the loan approved.

This lender may be out to steal the equity you have built up in your home. The lender doesn't care if you can't keep up with the monthly payments. As soon as you don't, the lender will foreclose, taking your home and stripping you of the equity you have spent years building. If you take out a loan but don't have enough income to make the monthly payments, you are being set up. You probably will lose your home.

Hidden loan terms: Balloon payment

You've fallen behind in your mortgage payments and may face foreclosure. Another lender offers to save you from foreclosure by refinancing your mortgage and lowering your monthly payments. Look carefully at the loan terms. The payments may be lower because the lender is offering a loan on which you repay only the interest each month. At the end of the loan term, the principal—that is, the entire amount that you borrowed— is due in one lump sum called a balloon payment. If you can't make the balloon payment or refinance, you face foreclosure and the loss of your home.

Loan flipping

Suppose you've had your mortgage for years. The interest rate is low and the monthly payments fit nicely into your budget, but you could use some extra money. A lender calls to talk about refinancing, and using the availability of extra cash as bait, claims it's time the equity in your home started "working" for you. You agree to refinance your loan. After you've made a few payments on the loan, the lender calls to offer you a bigger loan for, say, a vacation. If you accept the offer, the lender refinances your original loan and then lends you additional money. In this practice—often called "flipping" the lender charges you high points and fees each time you refinance, and may increase your interest rate as well. If the loan has a prepayment penalty, you will have to pay that penalty each time you take out a new loan.

You now have some extra money and a lot more debt, stretched out over a longer time. The extra cash you receive may be less than the additional costs and fees you were charged for the refinancing. And what's worse, you are now paying interest on those extra fees charged in each refinancing. Long story short—with each refinancing, you've increased your debt and probably are paying a very high price for some extra cash. After awhile, if you get in over your head and can't pay, you could lose your home.

"Home Improvement" loan

A contractor calls or knocks on your door and offers to install a new roof or remodel your kitchen at a price that sounds reasonable. You tell him you're interested, but can't afford it. He tells you it's no problem, he can arrange financing through a lender he knows. You agree to the project, and the contractor begins work. At some point after the contractor begins, you are asked to sign a lot of papers. The papers may be blank or the lender may rush you to sign before you have time to read what you've been given. The contractor threatens to leave the work on your house unfinished if you don't sign. You sign the papers. Only later, you realize that the papers you signed are a home equity loan. The interest rate, points and fees seem very high. To make matters worse, the work on your home isn't done right or hasn't been completed, and the contractor, who may have been paid by the lender, has little interest in completing the work to your satisfaction.

Insurance packing

You've just agreed to a mortgage on terms you think you can afford. At closing, the lender gives you papers to sign that include charges for insurance or other "benefits" that you did not ask for and do not want. The lender hopes you don't notice this, and that you just sign the loan papers where you are asked to sign. The lender doesn't explain exactly how much extra money this will cost you each month on your loan. If you do notice, you're afraid that if you ask questions or object, you might not get the loan. The lender may tell you that this insurance comes with the loan, making you think that it comes at no additional cost. Or, if you object, the lender may even tell you that if you want the loan without the insurance, the loan papers will have to be rewritten, that it could take several days, and that the manager may reconsider the loan altogether. If you agree to buy the insurance, you really are paying extra for the loan by buying a product you may not want or need.

Mortgage servicing abuse

After you get a mortgage, you receive a letter from your lender saying that your monthly payments will be higher than you expected. The lender says that your payments include escrow for taxes and insurance even though you arranged to pay those items yourself with the lender's okay. Later, a message from the lender says you are being charged late fees. But you know your payments were on time. Or, you may receive a message saying that you failed to maintain required property insurance and the lender is buying more costly insurance at your expense. Other charges that you don't understand like legal fees are added to the amount you owe, increasing your monthly payments or the amount you owe at the end of the loan term. The lender doesn't provide you with an accurate or complete account of these charges. You ask for a payoff statement to refinance with another lender and receive a statement that's inaccurate or incomplete. The lender's actions make it almost impossible to determine how much you've paid or how much you owe. You may pay more than you owe.

Signing over your deed

If you are having trouble paying your mortgage and the lender has threatened to foreclose and take your home, you may feel desperate. Another "lender" may contact you with an offer to help you find new financing. Before he can help you, he asks you to deed your property to him, claiming that it's a temporary measure to prevent foreclosure. The promised refinancing that would let you save your home never comes through.

Once the lender has the deed to your property, he starts to treat it as his own. He may borrow against it (for his benefit, not yours) or even sell it to someone else. Because you don't own the home any more, you won't get any money when the property is sold. The lender will treat you as a tenant and your mortgage payments as rent. If your "rent" payments are late, you can be evicted from your home.

Loan Modification

Be especially cautious if you are contacted by a foreclosure consultant who promises to help you arrange a loan modification. Many are scam artists who collect fees upfront but then don't provide the promised service. Ask the foreclosure consultant to explain their fees and to provide you with a written contract. Do not pay in advance any fees for loan modification services. Wisconsin law prohibits a foreclosure consultant from collecting any fees for loan modification services until after the foreclosure consultant has fully performed each and every loan modification service that they contracted to perform.

If you are seeking assistance with a loan modification, the website www.hud.gov for the U.S. Department of Housing and Urban Development has a list of approved housing counselors.

Protecting Yourself

You can protect yourself against losing your home to inappropriate lending practices. Here's how:

Don't:

- Agree to a home equity loan if you don't have enough income to make the monthly payments.
- Sign any document you haven't read or any document that has blank spaces to be filled in after you sign.
- Let anyone pressure you into signing any document.
- Agree to a loan that includes credit insurance or extra products you don't want.
- Let the promise of extra cash or lower monthly payments get in the way of your good judgment about whether the cost you will pay for the loan is really worth it.
- Deed your property to anyone. First consult an attorney, a knowledgeable family member, or someone else you trust.

Do:

- Ask specifically if insurance is required as a condition of the loan. If it isn't, and a charge is included in your loan and you don't want the insurance, ask that the charge be removed from the loan documents. If you want the added security of insurance, shop around for the best rates.
- Keep careful records of what you've paid, including billing statements and canceled checks. Challenge any charge you think is inaccurate.
- Check contractor's references when it is time to have work done in your home. Get more than one estimate.
- Read all items carefully. If you need an explanation of any terms or conditions, talk to someone you can trust, such as a knowledgeable family member or an attorney. Consider all the costs of financing before you agree to a loan.

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Consumer Alert!

Home equity loans: Three-day cancellation rule

If you're considering applying for a personal loan and using your home to guarantee repayment, you should know that a federal credit law gives you three days to reconsider a signed credit agreement and cancel the deal without penalty. Your "right to rescind" or "right to cancel" is guaranteed by the Truth In Lending Act. You can rescind for any reason, but only if you are using your principal residence— whether it is a condominium, mobile home, or house boat—as collateral, not a vacation or second home.

Under the right to rescind, you have until midnight of the third business day to cancel the credit transaction. Day one begins after all three of the following occur:

- You sign the credit contract;
- You receive a Truth In Lending disclosure form containing certain key information about the credit contract, including the annual percentage rate; finance charge; amount financed; and payment schedule; and
- You receive two copies of a Truth In Lending notice explaining your right to rescind.

For rescission purposes, business days include Saturdays, but not Sundays or legal public holidays. For example, if the events listed above take place on a Friday, you have until midnight on the next Tuesday to rescind.

During this waiting period, activity related to the contract cannot take place. The creditor may not deliver the money for the loan. If you're dealing with a home improvement loan, the contractor may not deliver any materials or start work.

If you decide to rescind, you must notify the creditor in writing. You may not rescind by telephone or in a face-to-face conversation with the creditor. Your written notice must be mailed, filed for telegraphic transmission, or delivered if by other written means, before midnight of the third business day.

If you cancel the contract, the security interest in your home is also canceled, and you are not liable for any amount, including the finance charge. The creditor has 20 days to return all money or property you paid as part of the transaction and release any security interest in your home. If you received money or property from the creditor, you may retain it until the creditor shows that your home is no longer being used as collateral and returns any money you have paid. Then, you must offer to return the creditor's money or property. If the creditor does not claim the money or property within 20 days, you may keep it.

If you have a bona fide personal financial emergency; such as damage to your home from a storm or other natural disaster, the law allows you to waive your right to rescind and eliminate the three-day period. To waive your right, you must give the creditor your own written statement describing the emergency and stating that you are waiving your right to rescind. The statement must be dated and signed by you and anyone else who shares in ownership of the home. But remember: If you waive your right to rescind, you must go ahead with the transaction.

The right to rescind does not apply in all situations when you are using your home for collateral. Among the exceptions are:

- When you apply for a loan to buy or build your principal residence;
- When you refinance your loan with the same creditor who holds your loan and you don't borrow any additional funds; or
- When a state agency is the creditor for a loan.