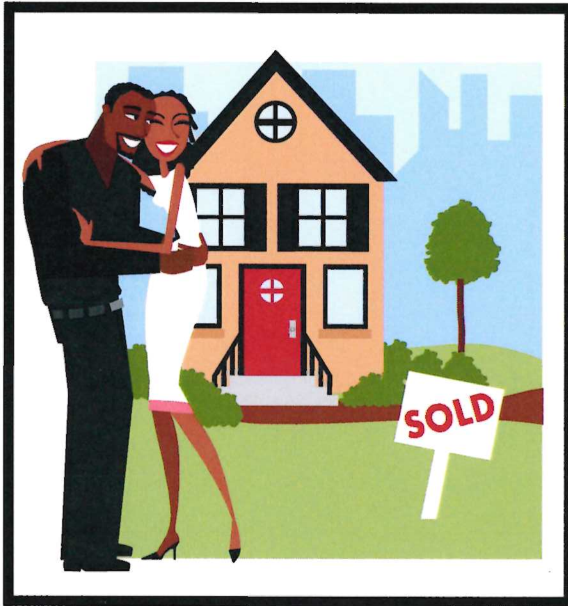
Unlawful Discriminatory Predatory Lending and Reverse Redlining



Guidelines

In Housing and Commercial Property

Prepared by the
Pennsylvania Human Relations Commission

Unlawful Discriminatory Predatory Lending and Reverse Redlining Guidelines In Housing and Commercial Property

(Adopted by the Pennsylvania Human Relations Commission on June 27, 2005)

Introduction

The Pennsylvania Human Relations Commission (hereinafter Commission or PHRC), cognizant of the fundamental guarantee found in the Pennsylvania Human Relations Act (hereinafter PHRA) that the opportunity to obtain any housing accommodation and/or commercial property must be provided irrespective of race, color, familial status, religious creed, ancestry, disability, age, sex or national origin, sets forth the following Guidelines for use by those responsible for providing fair lending opportunities or otherwise involved in the lending of money and/or real estate-related transactions within the Commission's jurisdiction. Those responsible for providing fair lending, include, but are not limited to, the following: lenders; mortgage brokers; appraisers; loan servicers; title companies; home improvement companies; state and local government agencies; and all others involved, whether directly or indirectly, in the mortgage loan process or home finance industry.

The Commission, in proposing these Guidelines, recognizes that all persons are entitled to fair access to credit and the ability to share in the American dream of homeownership. The Commission further recognizes that fair access to credit in housing and commercial property requires the elimination of the policy or practice of engaging in unlawful discriminatory predatory lending and/or reverse redlining based on race, ethnicity or any other protected class. The Commission, also, recognizes that action or inaction, whether direct or indirect, overt or covert, which fosters unlawful discrimination or segregation in the area of housing and/or commercial property, including but not limited to, unlawful discriminatory predatory lending and reverse redlining based on race, ethnicity or any other protected class is contrary to the public interest. Whenever any such action or inaction adversely affects housing and/or commercial property transactions within the Commission's jurisdiction, it is the obligation of those responsible for providing fair lending to correct the situation.

Purpose of Guidelines

In proposing these Guidelines, the Commission has set forth factors that it considers to be important in determining whether, in any given case, a party has engaged in unlawful predatory lending and/or reverse redlining based on race, ethnicity or other protected classification in violation of Section 5 of the PHRA. In so doing the Commission reiterates its longstanding position that these Guidelines are not intended to be hard and fast rules that must be absolutely applied. They are intended to provide guidance and assistance to those who come under the jurisdiction of the Commission as it continues its effort to insure that the right to equal housing and commercial property opportunity as set forth in the PHRA is achieved.

Nothing in these Guidelines shall affect statutory or regulatory requirements. The Guidelines are not an adjudication or a regulation. There is no intent on the part of the PHRC to give the Guidelines that type of binding force or effect. They are nonbinding Guidelines that indicate the manner in which the PHRC intends to exercise its administrative discretion in the future, unless it is convinced otherwise during the course of a specific proceeding. The Commission, as in the past, remains committed to insuring that its adjudicative determinations are made on a case-by-case basis after consideration of all evidence of record in the given matter.

To this end, the Guidelines are not binding and may be deviated from whenever the PHRC believes that any statute or regulation requires it, or that it is otherwise appropriate to do so. The Guidelines may not be cited as authority for any PHRC ruling, adjudication or other binding action. The legal rationales set forth in a policy may be cited as the basis for PHRC action to the extent that the Commission believes the rationale is valid in the context of the specific proceeding.

Unlawful Discriminatory Predatory Lending as a Violation of the PA Human Relations Act

Predatory lending is primarily concentrated in the sub-prime mortgage lending market in the area of home refinancing loans. The sub-prime market is intended mainly for people who are unable to obtain a conventional prime loan at a traditional financial institution due to blemished credit histories or some other problem. Such sub-prime lenders may charge more for their loans to compensate for the potentially greater risks and costs associated with lending to such borrowers. In short, sub-prime lenders may use risk-based pricing to serve borrowers who cannot obtain credit in the prime market. The Commission recognizes that by providing credit to borrowers who otherwise would be unable to obtain it, the sub-prime lending market may perform a significant service.

In determining whether a predatory loan or practice constitutes unlawful discrimination and/or reverse redlining in violation of the PHRA, the Commission will evaluate the loan in the context of the totality of the circumstances surrounding the real estate-related transaction. The Commission will examine whether the loan contains any abusive or onerous terms that cannot be justified on the basis of the lender's additional risk and cost; the suitability of the loan for the purposes and interests of the borrower; and the behavior of the parties in relation to the transactional circumstances surrounding the loan. Furthermore, the Commission recognizes that, while predatory lending may violate a number of federal and state laws, these Guidelines are applicable to predatory lending in the context of the Commission's jurisdiction within the dictates of unlawful discrimination in violation of Section 5 of the PHRA.

Reverse Redlining as a Violation of the PA Human Relations Act

Redlining is the practice of denying credit to specific geographic areas due to race, ethnicity or some other protected class of its residents. In contrast, reverse redlining is the practice of extending credit on unfair terms to specific targeted geographic areas due to race, ethnicity or some other protected class of its residents. Such practices lead to the formation and maintenance of racial and ethnic segregation, which the Fair Housing Act and PHRA were designed to combat. Courts and the Commission have held that reverse redlining violates the Fair Housing Act and the PHRA.

In order to prove a claim based on reverse redlining, a complainant must show that a respondent's lending practices and/or loan terms are unfair and/or predatory, and that respondents either intentionally targeted a protected class, or that there is a disparate impact on a protected class. Upon such a showing, a respondent must demonstrate that its loan or lending practices are justified by business necessity. Such lending policies and/or practices render housing "unavailable" to minorities and other protected classes and subjects them to discriminatory loan terms and conditions, thereby reducing their ability to use and enjoy housing. By adopting these Guidelines, the Commission seeks to provide guidance on each of the above-noted relevant factors necessary to examine an unlawful discriminatory predatory loan and/or reverse redlining claim.

Abusive Loan Terms as a Factor in Determining Whether a Respondent Has Engaged in an Unlawful Discriminatory Predatory Lending Practice and/or Reverse Redlining

Abusive loan terms are a factor in determining whether a respondent has engaged in an unlawful discriminatory predatory lending practice and/or reverse redlining based upon protected class membership in violation of the PHRA. Typically, the predatory nature of many loans is not the result of a single loan term or feature, but a series of features that in conjunction with each other impose substantial financial hardships on the borrower. As a result, the Commission will examine the totality of the circumstances surrounding all loan terms when there is a complaint or an allegation of unlawful discrimination. Predatory or unfair loans often include a variety of abusive loan practices, including but not limited to, potential abuses associated with the following:

Balloon Payment: A balloon payment occurs at the end of a loan term when regular monthly payments do not fully amortize the loan principal. As a result, at the end of the loan term the borrower still owes most of or the entire principal. Such balloon payments may consist of 85% or more of the principal amount of the loan forcing the borrower to refinance, incurring additional costs, or risk foreclosure.

Collection or Foreclosure Practices: A lender or servicer of a loan may utilize oppressive tactics such as harassing telephone calls or threats of foreclosure in its efforts to obtain payments or impose unjustified or exorbitant late fees and penalties.

Credit Insurance: Typical insurance products that may be sold in connection with a loan, include: credit life; credit disability; credit property; and involuntary unemployment. Such policies typically provide coverage for the first 5 to 7 years of the mortgage. A lender may charge premiums for credit insurance, which are not justified, based upon the actual loss payout or are not consistent with other applicable state laws or regulations. Furthermore, when the cost of the insurance is financed into the loan, the borrower pays more than he or she would on a monthly installment basis because the 5 to 7 year policy is financed over the 15 or 30-year life of the mortgage.

Flipping: Flipping refers to the practice of repeated loan refinancing in a short period of time charging additional fees and points with little or no benefit to the borrower due to the financing of points, fees, and prepayment penalties that may accompany such loans. A borrower may receive modest additional funds or a slight reduction in the interest rate, however, such gains may be offset by the points and fees associated with such a transaction.

High Interest Rates and Annual Percentage Rates (APR) Not Justified By Risk: A loan with an APR 6 percentage points above Treasury securities for first liens and 8 percentage points above Treasury securities for second liens may reflect abusive characteristics if it is not justified by the risk or cost associated with such a loan. The fact that a loan has an interest rate or APR above or below such a threshold, however, is not dispositive of whether or not a loan is predatory. Rather, it reflects a single variable to be considered in the totality of the circumstances surrounding a loan.

Home Improvement Scams: A contractor, acting as a mortgage broker or in conjunction with a lender, may refinance a borrower's mortgage in order to fund a home improvement project. The loan arranged by the contractor or lender may contain abusive terms and/or the contractor's work may be incomplete or of poor quality.

Loan Padding: Unreasonable high and/or illegitimate settlement fees and charges are charged to the borrower and are paid with the loan proceeds thereby increasing the principal loan amount on which the borrower must pay interest.

Mandatory Arbitration Clauses: A mandatory arbitration clause in a loan agreement requires, as a condition to receiving a loan, that the borrower agree to resolve any dispute arising out of the loan through an arbitration process, rather than in court, possibly limiting the ability to obtain judicial relief. While arbitration clauses are not per se abusive, they may contain terms and conditions that are abusive. For example, such arbitration clauses may require the borrower to pay all arbitration costs, fail to specify who will pay arbitration costs, or require the arbitration to take place in a location far removed from the borrower's residence.

Mortgage Broker Fees: Mortgage brokers may receive unreasonably high compensation as a result of inflated up-front fees paid by borrowers and indirect fees paid by lenders. A mortgage broker may not furnish any service to the borrower or the compensation may not be reasonably related to the value of the goods or services that were actually furnished to the borrower. A mortgage broker fee in excess of 3 percent of the total loan amount may reflect abusive characteristics, if it is not justified by reasons.

Negative Amortization: In a negatively amortized mortgage, a borrower's regularly scheduled payments do not cover the full amount of interest due, causing the outstanding principal balance to increase during the loan term.

Points: A borrower may pay discount points in order to buy down the interest rate on a mortgage loan. A predatory lender, however, may charge discount points with no corresponding reduction in the borrower's interest rate. The discount points may be financed as part of the loan and, thus, increase the amount borrowed.

Prepayment Penalties: A lender assesses prepayment penalties when a borrower either pays the remaining loan balance before the end of the loan term or refinances with another financial institution. Prepayment penalties lock a borrower into a loan and prevent a borrower from shedding a high interest loan in favor of a prime loan and/or a lower interest rate loan.

Yield Spread Premium: A yield spread premium is a payment that a mortgage broker receives from the lender based on the difference between the interest rate and points of the loan the broker entered into with the borrower, and the par rate offered by the lender to the mortgage broker for a particular loan. The broker receives payment for the value of the extra increment of interest, while the lender receives the higher interest rate over the life of the loan.

The above-mentioned potentially abusive factors do not represent an exhaustive list. Furthermore, the Commission's examination of any potentially abusive factors will consider any relevant or applicable state or federal laws. To the extent that the Guidelines are inconsistent with any federal or state law, the Commission may deviate from said Guidelines. The Commission will examine any non-discriminatory reasons or business necessities offered by the Respondent for a loan term in an effort to determine if the loan was unfair and/or predatory.

The Manner in Which a Loan Is Made as a Factor in Determining Whether a Respondent Has Engaged in an Unlawful Discriminatory Predatory Lending Practice and/or Reverse Redlining

The manner in which a loan is made is a factor in determining whether a respondent has engaged in an unlawful discriminatory predatory lending practice and/or reverse redlining based upon a protected class in violation of the PHRA. In determining whether a loan is unfair or predatory, it must also be examined in the context of the transactional circumstances surrounding the loan or real estate-related transaction. Predatory lending is as much a function of the manner in which the loan is made as the oppressive terms that it may contain. Furthermore, predatory lending may involve making of a loan that, on its face, lacks the appearance of abuse but which may be completely unsuitable for the particular borrower. Therefore, the Commission will attempt to understand the borrower's knowledge and understanding of the implications of the loan transaction; the suitability of the loan for the borrower in light of his or her financial circumstances; whether the borrower was represented during the loan transaction; and whether the borrower had any infirmities or vulnerabilities that would have been apparent to the lender, broker, or any other person participating in the loan transaction.

In addition, the Commission will examine the lender's behavior in the transaction and in other similar situations. Furthermore, the Commission will examine the lender's sales and underwriting practices and policies. The Commission will regard as relevant any indications of the following conduct, including, but not limited to: making loans without regard to a borrower's ability to pay; utilizing high pressure sales tactics to induce the borrower to enter into a loan; obstructing borrowers from refinancing with other loan or finance companies which offer better terms; misrepresenting the loan terms; misrepresenting a borrower's income or debt level on loan documents; forging a borrower's signature; steering a borrower to a high cost lender, even though the person may be eligible for a prime loan; utilizing bait and switch tactics by changing the loan terms at or near settlement; backdating loan documents; failing to disclose to the borrower all material information regarding the terms of the loan; falsifying information on loan applications or other loan documents. Such factors possibly reflect a respondent's intent to engage in unlawful discriminatory predatory lending practices.

Abusive Loan Practices That Target or Have a Disparate Impact Upon Certain Identifiable Groups as a Factor in Determining Whether a Respondent Has Engaged in an Unlawful Discriminatory Predatory Lending Practice and/or Reverse Redlining

In determining whether a respondent has engaged in an unlawful discriminatory predatory lending practice and/or reverse redlining based upon protected class in violation of the PHRA, abusive loan practices that target certain identifiable groups are a factor. In conjunction with the above-mentioned abusive lending practices, predatory lenders often target and prey upon certain protected classes under the PHRA, including but not limited to, females, elderly, and minorities. Certain identifiable groups, such as African Americans, may be targeted by such predatory lenders due to existence of a duel housing finance market, which is inextricably linked to the practice of redlining. Historically, numerous financial institutions engaged in the practice of redlining minority communities, resulting in a credit vacuum in such areas. Where mainstream financial institutions abandoned entire communities, the residents of those areas were forced to turn to other sources of credit. This process resulted in the creation of a dual housing finance market. Such a dual market presented attractive prey to unscrupulous predatory lenders who exploited such circumstances through the practice of unlawful discriminatory lending practices and/or reverse redlining.

Several factors are relevant in determining whether certain identifiable groups are being targeted for unlawful discriminatory predatory or unfair loans or subjected to policies and practices that have a disparate impact upon a particular protected class. Statistics, such as the Census Bureau statistics and Home Mortgage Disclosure Act statistics, are relevant for determining possible patterns of segregation in the housing and credit market, thereby offering insight into a vulnerable market segment. Furthermore, statistics relating to a respondent's lending activities in certain racially or ethnically identifiable neighborhoods may offer evidence of targeting based upon protected class status. In addition, the respondent's marketing polices and practices may reflect an intent to target certain identifiable neighborhoods for unlawful discriminatory predatory loans and/or practices. For example, a respondent's exclusive utilization of minority media outlets such as radio, television, and newspapers may be relevant in determining whether there is a pattern of targeting based upon a protected class.

The Commission recognizes that there is a substantial gap in the rates of homeownership between white households and minority households and seeks to encourage minority homeownership. The Commission recognizes that homeownership is a source of stability for families and communities and it represents the primary store of personal wealth for American families. As a result, the Commission seeks to encourage access to credit in minority communities and recognizes that marketing polices and tools aimed at minorities or other protected classes are not, in and of themselves, a violation of the PHRA. Rather, the combination of targeting of a protected class for predatory or unfair loans, also know as reverse redlining, may violate the PHRA.

Remedies For Unlawful Predatory Lending and Reverse Redlining In Violation Of The PHRA

Following a finding of discrimination, the Commission has broad discretion in fashioning awards to effectuate the purposes of the PHRA. Any remedy awarded under the PHRA has three purposes. The first is to insure that the unlawful discriminatory practice is eradicated.

The second is to restore the injured party to pre-injury status and make him or her whole. The third is to deter future discrimination. The Commission's specific authority to award relief is found in Section 9 of the PHRA. In the context of reverse redlining, the Commission may award a remedy that seeks relief for any actual damages caused by a predatory loan. Furthermore, the Commission has the authority to award damages for humiliation and embarrassment and assess civil penalties of $10,000 to $50,000. Finally, the Commission has the authority to award relief to injured individuals who are not identified in the complaint.