

PREDATORY LENDING

Position Statement

NASW, Iowa Chapter, believes that lending practices known to take advantage of financially vulnerable Iowans should be regulated and monitored by the state.

Discussion

According to Bruner and Elias (2005), “The term ‘predatory lending’ encompasses a variety of lending practices that take advantage of people seeking credit by charging excessive fees, selling unnecessary products, or establishing terms that perpetuate the debt and cause additional financial hardship. Predatory lenders often pressure consumers into loans they cannot afford or simply are not in their best interests, often employing deceptive practices and failing to disclose the true nature of the loan.” (p. 1) In Iowa, consumers are able to borrow from a variety of predatory lenders:

Payday Loans

In 1995, Iowa legalized payday loans in amounts up to \$500 with very few safeguards for consumers. On a \$100 loan, payday loan companies can charge \$15 for a two-week period, amounting to an effective annual interest rate of almost 400%. Once into a payday loan, borrowers often become trapped into rolling over those loans, as their continuing basic living expenses make it difficult for them to fully pay off the loan. In 1995, there were 7 payday loan licenses in Iowa; as of October 2008, there were 272 licenses (36 in Des Moines alone) with more than half of the licenses held by companies with out-of-state corporate offices (Iowa Division of Banking, n.d.).

Tax Refund Anticipation Loans

Terms such as “rapid refund” refer to the practices of tax preparation companies offering to prepare and file taxes for individuals and then to pay them the pending refund up front for an exorbitant interest rate and/or fee. The loans usually run for 1 – 2 weeks and the fees translate into triple digit annualized interest rates. The working poor are targeted by these loans, especially those receiving the Earned Income Tax Credit (National Consumer Law Center, 2006).

Subprime Mortgage Loans

Subprime loans are typically three percent or more above the prime lending rate. The U.S. Department of Housing and Urban Development (n.d.) describes subprime lending as practices conducted by lenders, appraisers, mortgage brokers, and home-improvement contractors who sell properties above value through false appraisals, encourage borrowers to misrepresent their financial status to get a loan, lend more money than a borrower is able to repay, charge high interest rates based on race or characteristics other than credit worthiness, charge fees for unnecessary or nonexistent products, pressure borrowers to take out high-risk loans with balloon payments, and strip equity by persuading borrowers to repeatedly refinance.

Although lenders commonly argue that subprime loans, especially those made to low-income, first-time borrowers, have helped increase homeownership, the data suggests otherwise. Analysis by the Center for Responsible Lending shows that the majority of subprime mortgage loans made between 1998-2006 were used to refinance existing homes or to purchase a second home, meaning that they did not contribute to new home ownership. Annually, an average of only 9% of all subprime loans went to first-time homeowners. In addition, the Center points out that since a much larger percentage of subprime loans end in foreclosure compared to prime loans, subprime loans actually contributed to the loss of homeownership. The Center estimates that 15-16% of all subprime loans originating since 1998 have or will end in foreclosure, resulting in a projected net loss of home ownership for some 2.4 million families across the nation.

The recent wave of home foreclosures, stemming from the subprime mortgage fallout, has had a significant impact on Iowa. The Center for Responsible Lending ranks Iowa 35th in the nation in the rate of home foreclosures, with a projected 10,592 homes in foreclosure by the end of 2009. The projected number of homes in foreclosure is double what the Center predicted two years ago. In Polk County, 51% of the homes in foreclosure were valued below \$100,000, 43% were

valued between \$100,000-\$200,000, and only 6% were valued above \$200,000, suggesting that low and middle income borrowers are most affected. Moreover, foreclosures don't just affect the families involved, they change the face of neighborhoods and communities, erode the local tax base, and impact the retirement savings of those who invested in mortgage-backed mutual funds.

According to the Coalition Against Abusive Lending, Iowa is the only state that does not allow a private right of action for persons harmed by violations of the consumer fraud act. This means that the Attorney general is the only person in the state of Iowa who is allowed to bring suit under Iowa's Consumer Fraud Act, so an individual cannot go to court to recover damages from fraudulent acts. While Iowa's Attorney General has publicly stated his opposition to predatory lending, his office simply does not have the resources to assist every victim in this way.

Recently, the state has made some progress in limiting predatory lending practices. HF 5 was signed into law on March 27, 2007, limiting car title loan interest rates to 21% APR and essentially removing the practice from the state. SF 137 was signed on April 17, 2007, curtailing misappraisal of real property, very often a feature of predatory home mortgage lending. On April 27, 2007, SF 347 was signed, allowing Iowa credit unions to develop and offer alternative lending options to vulnerable Iowans.

Current Situation

As of August 2008 the Center for Responsible Lending estimated that from the fourth quarter of 2008 through 2009 almost 2.2 million subprime mortgages will end in foreclosure, double what the Center predicted in October 2006. These foreclosures have not only effected homeowners but renters as well. In some cases when these properties are foreclosed, renters who are current on their rent are being evicted.

The NASW Iowa Chapter favors strategies to assist homeowners in making their mortgage payments on their homes through working with their lending agencies and other programs, and allowing renters to stay in their homes when the property is foreclosed.

The lack of financial literacy curriculum present in schools is also of concern. Young adults spend a significant amount of time in a retail environment, or watching advertisements targeted at their age group, and very little time learning how to make good financial decisions, leaving young adults to learn good financial decision making through trial and error. Currently only three states, including Missouri, require that personal finance is taught as a stand alone course. Seventeen other states, including South Dakota and Illinois, require personal finance is taught as part of the curriculum of another course (JumpStart Coalition for Personal Financial Literacy). The NASW Iowa Chapter favors a measure like these be incorporated into the required curriculum for Iowa schools.

Recommendations

The state of Iowa should enact legislation that would protect vulnerable Iowa citizens and maintain wealth in our communities through policies that would:

- Limit interest rates, close lending-limit loopholes, and regulate the lending industry by imposing restrictions and penalties through the Iowa's Consumer Fraud Act.
- Provide public education through the Attorney General's office to inform citizens of their rights and protection under consumer law, and the risks of borrowing from predatory lenders.
- Develop a mechanism through which the public and private sectors can work collaboratively to provide vulnerable Iowans access to alternative financial resources.
- Work with the federal government to provide protections and assist families and communities affected by the subprime lending fallout.
- Legalize a private right of action for violations of Iowa's Consumer Fraud Act, allowing victims of predatory lending to be protected and compensated for losses.
- Encourage Financial Literacy becoming part of required High School curriculum.

References

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