

Home Equity Loans: Abusive Lending And How To Avoid It

Home Equity loans were initially designed to allow individuals who had not yet paid off the full amount of their home, the ability to borrow against what portion of the home they had paid for. So for example, a couple who had been making monthly payments for many years on their 30 year lease, could use the money they had already put into their home as collateral when they needed a loan to send their child to college. So, while the initial intent of the loan is regarded by some as noble, in practice it has served as a free-for-all for unscrupulous lenders and other scam artists.

Explaining Sub-Prime Lending

Home Equity Loans fall into a broad category known as sub-prime lending. Unlike prime lending, which is heavily regulated and offered to those living in good neighborhoods with fair to good credit, sub-prime lenders target those in bad neighborhoods with worse credit ratings. Because they offer loans to individuals who otherwise might have difficulty finding a loan, they were and are able to justify to the government the need to have greater free reign when it comes to setting the interest rates and finance charges associated with their loans.

This window, combined with the deep pockets of Home Equity Loan firms able to grease the campaigns of politicians, has prevented the industry from coming under the heavy scrutiny and regulation of prime lending. Consequently, what is seen in this industry is widely varying interest rates, and charges that are completely disproportionate with the risk incurred by the lending institution.

How to Protect Yourself

For the investor interested in taking on a Home Equity Loan, there are a few measures which can be taken to radically diminish the chances of being taken advantage of. The first precautionary step is to request a copy of the loan a full week before you sign it. The lending institution is required by law, to provide you with a copy of the loan many days in advance of you signing it. It is a rather simple task to ask for the loan, and the lending institutions response often reveals much about the quality and legality of the loan. If the lending institution says, that either the loan paperwork is not yet ready, or otherwise fails to produce the paperwork inside of a week prior to the signing, you should walk on the loan.

The catch-22, and consequently the reason why Home Equity Lenders are able to take such advantage of borrowers, is that often they are facing foreclosure and desperately need the loan. While your need may be very real, signing a sub-standard loan will ultimately put you in far worse shape than you ever were before.

Recognizing the Hidden Charges

The second, and potentially most important technique to prevent predatory lending, is to demand that all loan costs not be rolled into the APR, but be listed and paid by you up front. What predatory lenders do to entice individuals into taking a loan, is to soak up the equity in a home and offer you a small kickback on the side. So, taking the example of our couple above, let us imagine that they have \$50,000 in equity in their \$100,000 home and have a fixed mortgage rate of \$650 a month. They then go to a Home Equity Lender who tells them that upon signing the loan they will get \$20,000 in cash and their new interest rate will be \$580 per month. What they do not tell the borrower is that they have also cashed out the other \$30,000 dollars in equity and paid it to themselves in "refinancing fees." In addition, the new mortgage they receive may either be variable, meaning that as interest rates climb so will their new payment, or be back loaded, meaning that by the end of the loan the payments may reach \$1,200 a month.

Can Home Equity Loans be useful? Yes, but only under ideal circumstances. By and large, they are a product designed by unethical lending companies to take advantage of those desperate for a little cash now. If you plan on applying for a Home Equity Loan, it is vital that you take the two steps outlined above as well as have an experienced independent third party go over the loan and its convoluted terms with you.

Short note about the author

Dan Johnson enjoys writing about home equity loans. Visit <http://www.homeequityloanlowdown.com/> to learn more.

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