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THE LOAN TRAP
Lenders prey on unwary
2nd mortgages often put borrowers in poor house

VEJNOSKA, JILL Jill Vejnoska STAFF WRITER STAFF

Report on victims of a predatory lending industry that has been growing in Georgia since the state Legislature took the cap off interest rates in 1983.

Those hurt the most are mostly poor, elderly and black. They frequently end up homeless after high interest and finance charges bleed them of all assets and they can no longer keep up with monthly payments. Most of these loans initially are made by small unregulated mortgage companies that search out homeowners with more equity than knowledge of finance. But the loans and the paper trail they've left in Georgia most commonly lead back to the largest financial institution in New England - Fleet Financial Group. All Lillie Mae Starr wanted was a chance to stay warm.

When the temperature dipped below 40 degrees on Settlement Road in Smyrna, the 62-year-old grandmother didn't have to go out to feel it.

Aging windows in her tidy five-room house let in almost as much cold air as they did light.

Mrs. Starr didn't have the $5,000 a contractor wanted to replace them, but she did own her house free and clear. The contractor's solution was to take her to a second-mortgage company for a loan. She signed where they told her to sign and went home to wait for her new windows and home repairs.

She got her windows. But she may lose her house.

At a 23.3 annual percentage rate, the loan payments were always more than she could afford. When she fell behind, she refinanced. After paying almost $19,000, she was forced to take out another loan that committed her to repay $63,000. Finally, Mrs. Starr was forced to file for bankruptcy.

"I didn't realize [the cost] would be sky-high from the banks' rates," she now says ruefully.

Lawyers representing clients with similar stories say Mrs. Starr is among an estimated 14,000 victims of a predatory lending industry that has been growing in Georgia since the state Legislature took the cap off interest rates in 1983.

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Fleet officials this week announced plans to help borrowers who have problem loans.

In the five-county metro area alone, 1,810 second-mortgage foreclosure notices were filed between July 1991 and June 1992, and nearly 300 of those were filed by the Fleet subsidiary, Fleet Finance Inc., according to a newspaper analysis of data collected by the Atlanta Foreclosure Report.

Some 20,000 Georgia residents make their monthly loan payments to Atlanta-based Fleet Finance, which makes and buys more second-mortgage loans in Georgia than any of its competitors. This subsidiary brought nearly $4.7 million in profits into the Fleet financial empire last year. Fleet officials say it is their size that singles them out. Critics allege it is greed. Whatever the reason, Fleet has become the focal point for those trying to address what they say is massive abuse in Georgia's second-mortgage industry.

So far: Fleet has been accused of breaking laws on fraud, usury, truth in lending and anti-racketeering in lawsuits filed in Atlanta, Marietta and Augusta. It denies the accusations.

One of the half-dozen lawsuits filed in Augusta also accuses Fleet of "reverse redlining" - specifically targeting black neighborhoods for high-interest loans. This month, a Richmond County judge granted class-action status to the case. The plaintiffs' attorney says that could open the door for as many as 4,000 homeowners joining the suit.

Three other homeowners who say their Fleet-owned loans contain an illegal interest rate were also granted class status by the Richmond County court, opening the door for as many as 20,000 homeowners to join the suit.

Investigation under way

On Thursday, Fleet announced an $8 million plan to help three low-income neighborhoods that will be hurt by construction of the Olympic stadium. The company said it had been looking for ways to help Atlanta neighborhoods for more than a year and that the action was not in response to litigation pending against it.

It also committed to providing $30 million nationwide for refinancing "burdensome" loans and finishing incomplete home-repair work. The action was warmly greeted as a fence-mending gesture by those most likely to directly benefit, but it is not likely to end the litigation or scrutiny of the company's Georgia practices.

Shortly after Fleet's plans were announced at City Hall, the Governor's Office of Consumer Affairs announced that it was launching an investigation of Fleet's lending practices.

Deputy Attorney General Stephanie Manis said Friday her office is working closely with consumer affairs and "actively examining the specific complaints."

"If the allegations are true, some very poor, perhaps not very sophisticated people are being ripped off big time," Attorney General Michael J. Bowers said recently.

Trouble in Massachusetts Georgia is not the first state where Fleet has encountered problems with state officials. In Massachusetts, Fleet committed $23 million in 1991-92 to settle accusations and avoid further investigation into high-cost second mortgages it purchased.

A consumer group that helped expose Massachusetts' problem-plagued second-mortgage industry set up shop here last month to organize Georgia homeowners allegedly victimized by Fleet loans.

The critics complain that Fleet Finance takes advantage - of the law, or the lack thereof; of a boom in property values; and of people who don't know when they sign that they are risking their only real asset: their home.

The difference between the unregulated second-mortgage market where Fleet Finance is most active and traditional lenders has much to do with the more stringent requirements of the federally run markets where banks, savings and loans and credit unions peddle their loans.

Tough competition keeps their interest rates low, and federal regulators help make sure all parties involved live by the rules.

One of the keys is making sure the borrower has sufficient income to repay the loan. However, that requirement also puts loans from those traditional lenders out of the reach of some borrowers.

`It's a desperation thing'

Enter the concept of equity lending, where a borrower's assets, such as his home, traditionally have been given greater weight in determining whether loan applications are approved.

In exchange for more lenient lending rules, the unregulated second-mortgage lenders exact a higher price, both in annual interest charges and front-end fees. Loan documents examined by The Atlanta Journal-Constitution suggest it is not uncommon for the borrower to be charged as much as 20 percent, above the face value of the loan, in front-end fees.

"It's called `junk fees' . . . and people never question it," Craig Soaries, a former second-mortgage broker in Atlanta, said about the upfront costs. "The bottom line is they know they can't get money anywhere else, so it's a desperation thing. They know it, the broker knows it, the lender knows it."

In addition to higher front-end costs, the second-mortgage industry is authorized to charge 5 percent interest per month, or up to 60 percent per year. Monthly payments on a 15-year, $35,000 first mortgage at 7 1/2 percent would be $325. At the 20 percent interest unregulated mortgage companies often charge, the same loan would cost about $600 a month.

Fraud allegations

Most of the furor focused at Fleet Finance concerns the equity-based loans the company buys, which are a considerable portion of the loans it handles.

Fleet buys those loans on what is called the "secondary market" from unregulated mortgage companies. Fleet says it is not responsible for the business practices of those companies, but lawsuits allege they are actually fronts for Fleet.

Michael P. Froman, a lawyer who analyzed the deed records of Fulton, DeKalb, Cobb and Gwinnett counties for a suit filed by Atlanta Legal Aid Society, reported that seven top equity-based lenders were Fleet brokers between Jan. 1, 1988, and April 14, 1992. Three sold more than 90 percent of their loans to Fleet. In fact, court documents refer to "broker agreements" Fleet has with some of these companies.

Lawsuits allege that not disclosing that the loans actually come from Fleet is a violation of truth-in-lending laws.

Many of the fraud allegations stem from home-repair contracts that were allegedly overpriced and never fulfilled. Other lawyers claim that lenders falsified loan applications - showing extra income and forged signatures in order to qualify the borrowers.

Lawyers in Atlanta, Augusta and Marietta allege that Fleet is behind a well-organized scheme to use home-improvement companies and small lenders to cheat homeowners. If true - Fleet denies the allegation - such a scheme would be subject to prosecution under federal racketeering statutes.

Trolling for customers

The second-mortgage deal usually begins somewhat innocuously with a phone call or a knock at the door. Homeowners are offered home-improvement or loan-consolidation services. Sometimes, the approach comes in the mail or over the air.

Residents of certain southeast Atlanta neighborhoods report getting "blind" telephone solicitations several times a day from different people. The contact is so persistent, many refer to them as "bird dogs."

"They troll the neighborhoods," says William J. Brennan Jr., head of Legal Aid's Home Defense Program. "Or they go into black neighborhoods and pick a street with fairly run-down houses. They write down the numbers, then they go to the courthouse and get the homeowner's name and go from there."

Lillie Mae Starr's loan history started with a chill wind and a convincing television ad. Interviews with a number of Fleet customers suggest her story is fairly typical.

Mrs. Starr, who left school after eighth grade, felt certain a bank wouldn't lend her money. She owned a home that her attorney says was worth $40,000, but her income was modest.

`They figured I could pay'

A representative with the repair company she saw on TV recommended a company where Mrs. Starr signed for a $9,200 loan secured by her house.

The amount included about $5,000 for her new windows; the rest was mostly for loan fees. The mortgage company was represented by an attorney at closing; Mrs. Starr was not.

Mrs. Starr said she did not understand why she'd have to pay back $19,420.56 over nine years, or why an itemization erroneously claimed she'd been given $1,000.

And how did anyone think she could pay $179.82 per month on her weekly tea packer's salary of less than $300? "I tried to tell them I didn't bring that much home, but I guess they figured I could pay that much," Mrs. Starr said.

And she tried. Several years and some $3,500 in payments later, Mrs. Starr's work hours decreased and she fell behind on her loan. That's when the phone calls started coming from Fleet Finance, which owned the loan.

"I offered to pay part, but they said they could only take the whole payment and they threatened to foreclose," said Mrs. Starr, who looked out one of those costly windows one day, saw her house being photographed and remembered seeing pictures of foreclosed-on properties. "I didn't know then that they couldn't foreclose so quick."

Frightened, Mrs. Starr refinanced the loan through another small lender for still more money. Several years later, she fell three months behind and, desperate, phoned a number she found on a coupon and refinanced again.

When she realized she'd be paying $353.25 a month for 15 years, Mrs. Starr thought, "I'm in worse shape than before."

At the time of the loan, though, she asked only, "Don't sell it to Fleet Finance."

But the lender did sell to Fleet.

Within a year, Mrs. Starr had heart surgery, took in a grandchild -and missed three payments. She filed for bankruptcy in November 1991, which stalled Fleet's foreclosure, but not the monthly loan obligations.

She couldn't keep up and Fleet scheduled foreclosure for April. Now only a temporary injunction from a lawsuit she filed against Fleet allows Lillie Mae Starr to remain in the house for which she simply wanted new windows.

`The last thing we want to do'

Fleet insists foreclosure is not its objective.

"The last thing we want to do is go into foreclosure," said Fleet Finance's executive vice president, B. David Scruggs.

Mr. Scruggs ticks off the many costs he says contributed to a $5.4 million loss Fleet suffered on the sale of foreclosure properties in Georgia in 1991: uncollected payments, both past and future; attorneys' fees; unpaid utility bills; painting and carpeting houses, and paying off other liens as well as the real estate agent's 7 percent commission.

Yet in metro Atlanta, Fleet files seven times more second-mortgage foreclosure notices than the next biggest lender, according to the newspaper analysis of Atlanta Foreclosure Report data.

According to a newspaper analysis of 297 foreclosures, Fleet sold properties for more than it paid about two-thirds of the time. They made an average apparent profit before expenses of $31,587 on 194 homes and had an apparent loss of $16,987 on 101 homes. They broke even on two. The total apparent profit: $4.4 million.

Fleet's legal setback

Although Fleet has faced numerous lawsuits over the years, Richmond County Superior Court delivered the first serious legal setback to Fleet last month by granting class status in a lawsuit accusing the loan company of usury violations.

Judge William M. Fleming Jr. ruled that a Georgia law prohibiting class-action suits against real estate-based loans was unconstitutional, so for the first time, attorneys and borrowers from across the state will be able to combine forces.

Should homeowners win the suit, second-mortgage lenders probably will be forced to change the way they make loans, which could drive many out of business, some attorneys and bankers say.

As Fleet awaits a Georgia Supreme Court ruling on its appeal of the class certification, it must defend itself on other fronts. A lawsuit filed by an Augusta couple claims Fleet's lending practices are racist.

The couple says Fleet and the small companies it buys loans from recruit borrowers in black communities at rates and fees significantly higher than those charged to homeowners in white communities.

Mr. Scruggs says Fleet Finance fills a vital need for customers with low income or bad credit who cannot qualify for loans from traditional lenders. He says race is never a factor in its loan purchases. He adds that although Fleet has no connection to the home-improvement and small loan companies from which it purchases loans, it has been willing to make the promised repairs after it buys such a loan.

"It means a lot to me to have a clean reputation," said Mr. Scruggs.

`House of cards'

In fact, Mr. Scruggs says, Fleet stopped buying loans last year that it knew were from home-improvement contracts, believing them to be high risk, although legal.

"Loans with those purposes weren't performing as well as others," explained Mr. Scruggs. "Because they have a third party involved, we didn't want to be involved."

Recently, Fleet Finance said it also was getting out of the business of buying loans from small mortgage companies. That decision, to take effect in December, is "part of our normal adjustment to changes in the marketplace," said Mr. Scruggs.

Some lawyers and community activists say Fleet knows the heat is on from courthouses to the attorney general's office and is trying to put as much distance as possible between itself and companies that may have broken the law.

"They know the house of cards is about to tumble in on them," said Howard **Rothbloom**, a lawyer who represents Mrs.

Starr.

To this day, Lillie Mae Starr can't figure out why Fleet bought her loan a second time when she refinanced it, especially given their troubled history together.

"We would have to look at the record and the credit history, but that certainly should have been taken into consideration," Mr. Scruggs conceded.

If it's her house Fleet Finance wants, Mrs. Starr has a message for the company. "I'm not getting put out," Mrs. Starr said as she sat on her front porch. "If I chose this . . . if I sold to someone it would be different. But just to get kicked out . . .

"I was thinking," she continued, "if you have a little place that's all your own, how can you lose it just like that? That can't happen, can it?" Database editor Hal Straus contributed to this article.
Chart: A better deal for older homeowners

-A reverse mortgage may be older homeowners' best hope for getting a loan and not losing the roof over their heads in the process. -Restricted to people who are at least 62 and whose homes are paid for or substantially debt-free, reverse mortgages trace the opposite path from conventional mortgages: Now, the homeowner is paid a certain amount of money, either monthly or as a lump sum or line of credit. The money is repaid when the borrower dies, sells the home or moves, usually from home-sale proceeds. -Income and credit rating are not considered when making reverse mortgages. Only age and home values are taken into account: The older the borrower and the more valuable the home, the larger the monthly payments to the owner. -The U.S. Departme nt of Housing and Urban Development oversees the program, approving lenders and agencies. Applicants must first attend a counseling session. The loans are government-backed, insuring the lenders against loss and guaranteeing payments to the borrower if t he lender goes out of business. Two HUD-approved Georgia lenders offer reverse mortgages: Unity Mortgage in Atlanta and Homestead Mortgage in Columbus. -Where to call for information about second-mortgage or home-repair loans: -Reverse mortgages: Unity Mortgage (Atlanta) - 493-1041; Homestead Mortgage (Columbus) - (706) 324-2274 -The Home Defense Program of the Atlanta Legal Aid Society - 377-0701 -Atlanta Mortgage Consortium: For information about its finance, rehabilitation loans and refinance, rehabilitation loans and its education program - 577-2222-Fleet Finance Inc.'s toll-free number for customer inquiries: (800) 972-1201 Chart: Fleet Financial Group Inc. Headquarters: Providence, R.I. Business: Diversified financial services company with 1,300 offices in 42 states.

Employees: 25,000

Ga. offices: 33

Ga. employees: 336

Assets: $45 billion

1991 earnings: $98 million

Chart: Second mortgage merry-go-round

-Homeowner is approached by contractor offering to sell him home improvement. -The homeowner is taken to a local mortgage company to obtain a second mortgage on his house.

-The lender then sells the loan to a larger finance company. -If the homeowner defaults, the lender can foreclose, buy the house at a foreclosure and resell it.

Socked by a second mortgage

Atlanta homeowners Julia Mae and J.C. Clark signed a contract for about $4,400 of home repairs. On Oct. 12, 1989, they signed for a loan of $36,550 for the repairs and consolidation of other debts. The following shows the actual charges and interest rate that went into the loan and similar costs on a conventional mortgage. The Clarks' loan

-Given directly to the Clarks: $0

-Paid to others on their behalf: $34,300

How the loan broke down:

-Appraisal, credit check, title insurance, other closing costs: $1,006 -Debt consolidation: $28,906

-Home repairs: $4,388

-Prepaid finance charge: $2,250

The Disclosure Statement they received and signed included the following figures:

Total financed: $34,300

Annual percentage rate: 19.98%

Payment Schedule: 180 montly payments of $601 *

Finance charge (credit cost): $74,024

Total of scheduled payments: $108,324

A conventional loan

A $35,000 loan would have about $900 in prepaid finance charges. -Total financed: $35,000

-Annual percentage rate: 7.5%

-Payment schedule of 180 monthly payments: $325

Total of scheduled payments: $58,500

* Number has been rounded / staff