

Predatory Lending Questions and Answers

1) What is the difference between subprime lending and predatory lending?

Subprime Lending

The prime lending market offers loans to persons with excellent credit and employment history, and an income sufficient to support the loan amount. It generally offers borrowers many loan choices and the lowest mortgage rates. Prime lenders include banks, thrifts and credit unions that are subject to extensive oversight and regulation by federal and state governments. According to HUD, nine out of ten families take out prime loans when purchasing or refinancing their mortgages.¹

Subprime lenders serve high-risk borrowers who would otherwise have difficulty obtaining a loan. Subprime loans usually have higher interest rates and fees than prime loans to compensate the lender for taking on higher repayment risk. Subprime lenders adjust their interest rates and fees according to the risk of the individual loan applicant and any additional loan origination costs.

The subprime market is an important part of the financial system because it provides credit to consumers who would otherwise be unable to borrow money, and allows high-risk borrowers to repair their credit rating by paying back their new loan on schedule. Through home equity lines of credit and refinances, the subprime market can also provide consumers in difficult situations the ability to access part of their housing wealth to get them through bad financial periods.

Predatory Lending

Although there is no set definition for predatory lending, it is generally used to describe a set of practices through which a broker, lender or other participant takes unfair advantage of a borrower, often through deception, fraud or manipulation to make a loan that has terms that are a disadvantageous to the borrower. The predatory nature of the loan is often due to not one loan term or abusive action, but rather a set of features that in combination impose extreme hardship on the borrower.

Most predatory loans are either home equity loans or loan refinances, rather than for home purchases. Elderly persons with substantial equity in their home but with limited incomes are disproportionately targeted and victimized by predatory lenders. Other targeted groups include low income and minority communities, and other communities underserved by legitimate lending institutions, where there is incomplete knowledge of available loans and rates for which they qualify.

It is widely accepted that the overwhelming majority of predatory lending occurs in the subprime market. One reason for the predominance of predatory loans in this market is that subprime loans tend to have a great variety and complexity of risks, unlike the more uniformly priced

¹ “Curbing Predatory Home Mortgage Lending”, The Joint HUD-Treasury Task Force on Predatory Lending, June, 2000.

prime loans. While a loan's fees and costs may be predatory to one person, to another it may reflect their personal credit risk.

Lending practices that are largely recognized to be predatory:

- Frequent refinancing (“flipping”) – Repeated refinancing of a mortgage loan within a short period of time with little or no benefit to the borrower but financial gains to the lender. New costs and fees are rolled into the loan at each refinancing causing interest payments to rise and the total cost of the loan to increase.
- Asset-Based Lending - Loans made solely on the amount of equity a borrower has in property, without regard to their ability to repay.
- “Balloon” Payments –Loans structured with low monthly payments and a large balloon payment at the end of the loan term to pay off the remaining debt. In many cases, the borrower does not know that their loan includes a large balloon payment and are unprepared and unable to pay the amount when due.
- Mandatory Arbitration – A mandatory arbitration clause in a loan agreement requires that the borrower agree to resolve any dispute arising out of the loan through arbitration, rather than in-court litigation. By signing the arbitration agreements, the borrower is limited in choosing the best forum to solve disputes over their loan and in some cases the borrower has to pay large sums for the arbitration.
- Negative Amortization – In a negatively amortizing mortgage, the borrower's regularly scheduled payments do not cover the full amount of interest due, causing the outstanding principal balance to increase and the borrower to lose equity in their home.
- Prepayment Penalties – A prepayment penalty, often 5 to 15 percent of the outstanding amount, is assessed against a borrower who repays their loan before the end of the loan term. Borrowers with a good payment history on their loan are unable to refinance to a lower rate due to the cost of prepayment penalty.
- Steering – Potential borrowers who would qualify for prime loans are steered into high cost loans. This practice is most commonly targeted towards homeowners in predominantly lower-income and minority communities who may lack sufficient access to mainstream sources of credit.
- Aggressive Tactics - These tactics may rise to the level of fraud or illegal deception. Practices include misleading or incomplete disclosures of loan terms; “bait and switch” tactics; pressuring borrowers to apply for much larger loans than they need; discouraging borrowers from reading loan documents; having borrowers sign loan documents in a different language than the conditions were described in and that they are fluent; encouraging the falsification of information and finding co-signers who cannot realistically be considered partners in the loan repayment.
- Excessive and Concealed fees - Predatory lenders may charge points and fees totaling as much 15 to 20 percent of the loan. One popular fee is the “yield-spread premium” in which a mortgage broker is compensated for putting a borrower into a home loan with a higher interest rate than they qualify.
- Home Repair Fraud – This occurs when unscrupulous contractors approach homeowners with offers to do home repairs and match them with lenders that will refinance their mortgages to fund the repairs. The repairs are shoddy or non-existent, and the loans are made at exorbitant costs.

- Single Premium Credit Insurance – Credit insurance is a loan product that repays the lender should the borrower die or become disabled. In single-premium credit insurance, the full premium is paid all at once by being added to the total costs financed by the loan. By increasing the loan, the amount of interest the borrower pays is ultimately raised.

2) What lending practices are illegal?

Even though they may be predatory in nature, the above practices are legal in the majority of cases. The following summarizes the existing laws designed to protect consumers from abusive practices in mortgage lending. All of the laws are federal except for California's Statute.

Section 4970 of the California Financial Code – California law prohibits financing of single premium credit insurance for all home loans. It also regulates high-cost home loans of \$250,000 or less (defined as a loan with points and fees that exceed 6% of the total loan or an annual percentage rate of 8% above the yield on U.S. Treasury securities having comparable periods of maturity. The yields are currently between 1.5% and 4.4%².) For these loans, the law requires that the lender send the prospective borrower a list of loan counselors and a document recommending they obtain loan counseling, at least three days before the loan documents are to be signed. For high-cost loans of \$250,000 or less, the legislation also prohibits the following practices:

- Imposing a prepayment penalty after the first three years of the loan, failing to offer a loan with no prepayment penalty, or charging an excessive penalty
- Raising the interest rate if the borrower defaults
- Making a loan without regard to the consumers ability to repay
- Encouraging the borrower to default on an existing debt in order to refinance their loan
- Refinancing the loan in terms unbeneficial to the borrower
- Steering a consumer towards a less favorable loan than they would otherwise qualify
- Requiring a prepayment fee after 36 months

However, because this law covers only covers loans of \$250,000 or less, it does not protect the vast majority of mortgages in San Jose. The high housing prices in the area result in most households needing mortgages higher than the law's covered amount.

Home Ownership and Equity Protection Act (HOEPA) – HOEPA is the only federal law specifically designed to address predatory lending. The law applies only to very high-cost home refinancing or home equity loans (defined here as a loan where total points and fees exceed the larger of \$499.00 or 8% of the total loan amount or with an annual percentage rate 10% over the rates in U.S. Treasury securities of comparable maturity. The rates are currently between 1.6% and 4.3%³.) HOEPA requires the lender to provide disclosures on the loan costs and provide the potential borrower with information regarding their rights and the risks of borrowing. Prohibited practices include most prepayment penalties; balloon payments on loans with terms of less than five years; negatively amortized loans; interest rates that increase after default and loans made without considering the borrower's ability to repay.

² "Recent Treasury Note and Bond Auction Results", U.S. Bureau of the Public Debt, <http://www.publicdebt.treas.gov/AI/OFNtebnd>, viewed 4/28/04.

³ Ibid.

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Because HOEPA only covers very high-cost loans, it is not applicable to most mortgages made in San Jose. According to the Federal Reserve Board, this law only applies to a very limited number of home loans.

Truth in Lending Act (TILA) – Requires disclosure of loan terms, including the interest rate, fees, and total amount of payments. TILA allows the borrower to cancel their loan within three business days of signing the contract.

Real Estate Settlement Procedures Act (RESPA) – Requires lenders to provide borrowers with a “Good Faith Estimate” of all loan and settlement charges before the loan is agreed to and any fees are paid. RESPA prohibits kickback, referral and unearned fees including “yield spread premiums” in real estate settlement services. The law also sets limits on the amounts that a lender may require a borrower to put into an escrow account for purposes of paying taxes, hazard insurance and other charges related to the property.

The Fair Housing Act – Prohibits discrimination on the basis of race; religion; ethnic background or national origin; sex; disability; familial status; marital status; source of income; age or sexual orientation in residential real estate transactions, which include the making of mortgage loans.

Federal Trade Commission (FTC) Act – Provides the FTC with the authority to prohibit and take action against unfair or deceptive acts or practices affecting commerce including lenders who mislead or deceive borrowers about their loan terms.

Summary of Legal Remedies

Predatory Lending Practice	Governing Statute					
	Sec. 4970 of the CA Financial Code	HOEPA**	TILA	RESPA	Fair Housing Act	FTC
Frequent Refinancing (Flipping)		X				
Lending without regard to ability to repay	X	X				
Balloon Payments		X				
Mandatory Arbitration						
Negative Amortization		X				
Prepayment Penalties	X	X				
Steering	X			X		
Fraud & Deception						X
Incomplete disclosure of loan terms		X	X			
Prohibited fees & payments	X			X		
Home Repair Fraud				X		
Single Premium Credit Insurance	X					
* Except for single premium credit insurance, Section 4970 of the CA Financial Code only covers high-cost loans of \$250,000 or less						
** HOEPA only applies to very high-cost refinancing and home equity loans						

Legal Enforcement

Section 4970 of the California Financial Code – According to California’s Office of the Attorney General, loans made in violation of this statute are generally identified when a consumer comes to them with a complaint. The Office also finds out about violating loans from local public officials, District Attorney’s Offices and the federal government. The Office does not conduct proactive research to identify predatory lenders that violate the statute.

HOEPA, TILA and the FTC Act – The Federal Trade Commission enforces HOEPA, TILA and the FTC Act. The FTC generally begins investigations into violations of these acts in response to letters from consumers or businesses, Congressional inquiries, or articles on consumer or economic subjects.⁴ In instances of consumer fraud, the FTC can go directly to court to obtain an injunction, civil penalties, or redress in order to stop the practices quickly before too many consumers are injured. In less extreme situations the FTC may respond by trying to obtain voluntary compliance by the company or person. If a compliance agreement is unfeasible, the FTC will begin a formal proceeding, similar to a court trial, against the offender. In July 1999, the Federal Trade Commission’s Bureau of Consumer Protection settled cases against seven subprime mortgage lenders for violations of HOEPA, TILA and Section 5 of the

⁴ “Guide to the Federal Trade Commission,” The Federal Trade Commission, <http://www.ftc.gov/bcp/online/pubs/general/guidetofc.htm>, viewed 4/30/04.

FTC Act, which covers deceptive and unfair practices.⁵

RESPA – A borrower or a group of borrowers are entitled to bring forward federal lawsuits for some violations of RESPA including the prohibition of unearned fees for services not actually performed and the lender’s failure to resolve loan complaints within sixty days.⁶ HUD, State Attorney Generals or State insurance commissioners may also bring forward single or class action suits against these violations after they receive notice from a borrower(s) or other complainant. HUD also has the authority to impose civil penalties on lenders that do not submit initial or annual escrow account statements to borrowers.

Proposed Legislation

There are currently three bills on the federal level dealing with predatory lending, as detailed below.

Proposed Federal Bills on Predatory Lending			
Bill	Sponsor	Subject	Summary
HR 833	Representative Nye	Predatory Lending	Would preempt state or local law, even if the law is more protective; establish a Consumer Mortgage Protection board; require federal licensing of mortgage brokers in states failing to establish their own uniform licensing scheme; and would create a database of licensed mortgage brokers.
HR 1663	Representative Tubbs Jones	Predatory Lending	Prohibits any person in connection with a subprime federally related mortgage loan from providing mortgage lending or mortgage brokerage services unless such a person is certified by the Secretary of HUD as having been adequately trained with regard to subprime lending. Amends the Truth in Lending Act to require lenders to establish a best practice plan to ensure compliance with the Act for high cost mortgages. Proscribes unfair or deceptive acts or practices in providing mortgage lending services for either a subprime federally related mortgage loan or for mortgage brokerage services for such a loan. Sets forth civil penalties for violations. Amends the Consumer Credit Protection Act to declare unenforceable a written provision in any consumer contract or transaction which requires binding arbitration to resolve any controversy arising out of such transaction or contract, or the refusal to perform all or any part of the transaction, but permits post-controversy arbitration agreements. Amends the Community Development Banking and Financial Institutions Act of 1994 to authorize the Community Development Financial Institutions Fund to make grants to nonprofit community development corporations to educate and train borrowers and community groups regarding illegal and inappropriate predatory lending practices.
HR 1865	Representative Scott	Predatory Lending	Prevention of Predatory Lending Through Education Act – Authorizes the Secretary of HUD to make grants to states, local governments, and nonprofit organizations for counseling, referral and education programs for the prevention of predatory lending. Directs the Secretary to establish a toll-free number for predatory lending complaints. Establishes in HUD a Predatory Lending Advisory Council, which shall: (1) advise the Secretary on issues concerning predatory lending practices, and (2) conduct a study of the causes of home loan defaults and disclosures.

⁵ “FTC Testifies on Enforcement and Education Initiatives to Combat Predatory Lending Practices,” The Federal Trade Commission, <http://www.ftc.gov/opa/2000/05/subprime2.htm>, viewed 4/30/04.

⁶ “More Information About RESPA,” HUD, <http://www.hud.gov/offices/hsg/sfh/res/respamor.cfm>, viewed 4/30/04.

On the State level, there was discussion that Assemblymember Cindy Montanez was going to introduce a bill on predatory lending. However, according to her Office this will not occur this year.

3) Identify existing programs sponsored by Fannie Mae and Freddie Mac for public outreach resources.

The following chart provides information on Fannie Mae and Freddie Mac’s outreach resources for organizations involved in anti-predatory lending efforts.

Fannie Mae & Freddie Mac Outreach Resources			
Organization	Program/Product	Program provides...	City Benefits and Involvement
Freddie Mac	"Don't Borrow Trouble" program: consumer education and counseling	Seed funding up to \$25,000 for participating groups; technical assistance for launching public education campaign; "toolkit" of media and educational materials (adaptable to specific needs of locality); on-site training by the National Consumer Law Center to prepare members to respond to predatory lending questions. Materials in English & Spanish.	If the City decides to initiate a comprehensive anti-predatory lending effort, assistance from this program will be invaluable. In order to increase the City’s chances of being chosen for the program, Freddie Mac representatives recommend the City begin taking the following steps: send Freddie Mac interest letters from the Mayor and Housing Director; create a local coalition to collaborate on the campaign; assemble a referral network; raise additional funds (HUD \$ suggested); and agree to manage day-to day implementation of campaign.
Fannie Mae Foundation	Educational booklets on predatory lending, mortgages and credit	Booklets include "Choosing the Mortgage That's Right For You," "Borrowing Basics What you Don't Know Can Hurt You," "Knowing and Understanding Your Credit," and "Opening the Door to a Home of Your Own." Available in 9 languages.	Booklets can be distributed to the public at educational and outreach events by City staff. Booklets are free to download off of website. With tax exempt or 501(c)(3) status, consumer guides are free of charge up to 1,000 books a year, after that \$1.00 per book.
Fannie Mae Foundation	Competitive grant program	Applicable funding priorities include programs that increase sustainable homeownership and build individual and community wealth through efforts including homeownership counseling and education.	Grants are for organizations with 501(c)(3) status to fund existing programs or new programs with funding sources. Application period occurs once a year. If the City decides to initiate a comprehensive anti-predatory lending program, the grant is one source of funding for partner agencies.

4) Analyze market data to determine the extent of the predatory lending problem in San Jose:

There is currently no systematic data available to accurately determine the extent of predatory lending in San Jose. The principle source of data on mortgage lending is reported under the

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Home Mortgage Disclosure Act (HMDA). According to the Federal Department of Housing and Urban Development (HUD) and the Federal Treasury Department, this data was not designed to capture information on subprime or predatory lending practices, nor has it proven effective in tracking this information.⁷ Under this Act, financial institutions are required to report information on their loan applications including the property and applicant's characteristics; loan disposition; loan amount; type of loan; purpose and lien status. They do not have to provide information on loan terms; applicant's credit history; interest rates; fees; points or other costs that might be indicative of predatory lending practices. Beginning with mortgages extended in 2003, there will be additional reporting requirements, including information on high cost loans and the pricing of loans, which will enhance our ability to measure the extent of predatory practices.

Completing a reliable data analysis of predatory lending in San Jose would require an intensive analysis of a representative sample of actual loan documents. According to a recent United States General Accounting Office (GAO) study on predatory lending, "given that such records are not only widely dispersed but also generally proprietary, to date no comprehensive data has been collected."⁸

Several studies have tried to capture the degree of predatory lending using HMDA data. In "Quantifying the Economic Cost of Predatory Lending," the Coalition for Responsible Lending used several sources for its data analysis, including a Freddie Mac finding that in one sample of subprime mortgage loans, 10-35% of the borrowers who received the loans would have qualified for a less expensive loan in the prime market. However, when the GAO looked at this study for its own report, it was unable to verify the reliability of the data. Furthermore, when contacting Freddie Mac to confirm the use of its findings as evidence of steering, the representative claimed the data was insufficient to draw this conclusion. In its 2003 analysis of predatory lending in San Jose, the Association of Community Organizations for Reform Now (ACORN) used similar calculations as the Coalition for Responsible Lending, leaving the accuracy of the resulting findings uncertain.

Other studies have used subprime refinance loans or foreclosures of subprime loans as indicators of predatory loans.⁹ These studies acknowledge, however, that their analysis can only provide an indicator of possible predatory lending and not a precise quantification of these practices.

⁷ "The Federal Reserve Board Amends Regulation to Require Reporting of Loan", U.S. Department of Housing and Urban Development, <http://www.huduser.org/periodicals/fieldworks/0403/fworks3.html>, (viewed 12/9/03), "Curbing Predatory Home Mortgage Lending."

⁸ "Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending", United States General Accounting Office, January 2004, pp. 23. Other reports that discuss the problem of insufficient data sources include "Curbing Predatory Home Mortgage Lending", "Understanding Predatory Lending: Moving Toward a Common Definition and Workable Solutions", Neighborhood Reinvestment Corporation and Joint Center for Housing Studies of Harvard University, October 1999; "Predatory Lending: An Overview", James H. Carr and Lopa Kolluri both from Fannie Mae, 2001; "The Community Guide to Predatory Lending Research", Community Reinvestment Association of North Carolina, June 2000; "Credit Risk and Mortgage Lending: Who Uses Subprime and Why", Research Institute for Housing America, September 2000; "Subprime Foreclosures: The Smoking Gun of Predatory Lending?", Bunc, Harold L., Gruenstein, Debbie, Herbert, Christopher, E and Scheessele, presented at the U.S. Department of Housing and Urban Development Conference "Housing in the New Millennium", October 2002; "What is Predatory Lending?", Indiana Legal Services Housing Law Center, 2003 and "Stolen Wealth: Inequities in California's Subprime Mortgage Market", California Reinvestment Committee, November 2001.

⁹ These studies include "Subprime Lending in Indiana: An Analysis of the 2001 Home Mortgage Disclosure Act Data," and "Subprime Foreclosures: The Smoking Gun of Predatory Lending?"

In answer to a request for data on predatory lending for this memorandum, representatives from the mortgage lending and real estate community provided “Subprime Lending in San Jose, California, An Empirical Analysis,” by the Center for Statistical Research.¹⁰ Using a database consisting of U.S. Census information, HMDA data and loan-level data on subprime mortgages from nine American Financial Services Association (AFSA) member companies for the years 1995-2002, this study examines the subprime mortgage market in San Jose, and especially how it compares to markets in the rest of California and nationally. The study concludes that the subprime market in San Jose and nationally is functioning correctly as a competitive market. It also found no evidence that any group of borrowers had loans priced higher than their credit history justified.

FICO scores, which rate borrowers’ credit histories, are widely used by lenders to determine the risk of borrowers. In general, a FICO score of 680 qualifies a borrower for a prime loan. According to the Center for Statistical Research, in the subprime market roughly 15% of San Jose first mortgage borrowers and 54% of second mortgage borrowers had a FICO score of 680 or above. This compares with 14% of first subprime mortgages and 42% of second subprime mortgages made with scores of 680 or above in California and 10% and 45% nationally. The study claims that the high percentage rate of second mortgages to borrowers with high FICO scores may be a result of high debt loads, job instability, or lenders’ perception that these loans are harder to collect on than first mortgages.

Using Census data to identify mortgages on properties that have significant minority populations, the Center for Statistical Research found that nearly 79% of subprime loans made in San Jose were in zip codes with 15-75 % Hispanic residents. The study concludes that the borrowers in the 15-75% Hispanic areas appropriately received subprime loans because “1.89% of loans in this area were 60+ days past due and .43% had foreclosures started as of the end of the first quarter of 2002.”¹¹ The study does not describe the rate of overdue loans and foreclosures in other areas of the City.

The study concludes that subprime lending plays a different role in San Jose than nationally or in California because “relatively well off individuals” are the prime recipients of these loans in the City in contrast to “lower middle to lower income borrowers” in the rest of the nation.¹² According to the authors, over 60% of subprime borrowers in San Jose had incomes over \$75,000 while only 40% of subprime borrowers in California and 20% nationally were in the same income category. Similarly, 86% of San Jose subprime borrowers had incomes over \$50,000 compared to 70.5% for all of California and 56% nationally. However, considering that San Jose has significantly higher incomes than the nation and California as a whole, these differences likely do not represent a dramatic shift in subprime use.

The recent GAO study on predatory lending reports that in the last ten years government enforcement actions and private party lawsuits against institutions accused of abusive home

¹⁰ “Subprime Lending in San Jose, California, An Empirical Analysis,” The Center for Statistical Research, Alexandria, VA, received from Lender/Realtor Predatory Lending Stakeholder members.

¹¹ “Subprime Lending in San Jose, California, An Empirical Analysis,” pp. 19.

¹² “Subprime Lending in San Jose, California, An Empirical Analysis,” pp. 1.

mortgage lending have increased dramatically.¹³ For example, in 2002, Household International agreed to pay \$484 million to borrowers nationwide to settle allegations by states that it used unfair and deceptive lending practices to make mortgages with excessive interest and charges. The study also describes the findings of several federal hearings on predatory lending between 1998-2003 in which legal service agencies nationwide reported an increase in clients facing foreclosure due to mortgage loans that included abusive terms and conditions. According to the GAO, for the first time these agencies “were seeing large numbers of consumers, particularly elderly and minority borrowers, who were facing the loss of homes they had lived in for many years because of high-cost refinancing.”¹⁴

In forums the HUD-Treasury Task Force on Predatory Lending held in 2000 in the cities of Atlanta, Los Angeles, New York, Baltimore and Chicago, there was consistent evidence of abuses within the subprime market including loan flipping, excessive fees, lending without regard to the borrower’s ability to repay, and outright fraud and abuse.¹⁵ In its 2000 report, the HUD-Treasury Task Force describes several cases in which these abusive practices along with other deceptions bilked thousands of dollars away from homeowners; reduced equity in their home; paid for incomplete and inadequate home repair jobs; while providing the borrower with no tangible benefit of any kind.

In its 2001 report on subprime mortgage inequities in Los Angeles, Oakland, Sacramento and San Diego, the California Reinvestment Committee found that over one-third of the borrowers included in its study may have been victimized by predatory mortgage lending.¹⁶ Other findings include:

- One-third of study participants reported that they decided to take out a loan secured by their home only after aggressive efforts by subprime lenders
- Nearly seven in ten interview respondents saw key loan terms suddenly change for the worse at closing
- African-American and Latino respondents were approximately two times as likely as whites to have prepayment penalties in their loans
- Half of all respondents had points and fees more than 5% of the loan amount

ACORN’s 2003 study on predatory lending in San Jose describes a case in which a lender consolidated a couple’s mortgages along with other debts into a twenty-year loan. However, the couple was not told that their loan could only be paid off within twenty years if annually they effectively paid a thirteenth mortgage payment, that the loan had a five year prepayment penalty of \$17,000, nor that the loan amount of \$336,774 was inflated by \$23,646 in lender fees and third-party charges. After the couple refinanced their loan with another lender, the original lender received a payoff amount of \$376,000, thousands more than the originally cited amount of \$358,043. The couple never got an explanation of the extra costs, but the greatly inflated amount led to unaffordable monthly payments, resulting in their house going into foreclosure.

¹³ “Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending”

¹⁴ Ibid pp. 24-25

¹⁵ “Curbing Predatory Home Mortgage Lending”

¹⁶ “Stolen Wealth: Inequities in California’s Subprime Mortgage Market” The authors note that there are limitations to their study due to their sample size and nonrandom sample selection. Only borrowers who agreed to be interviewed and provided their loan documents became study participants.

5) Identify the actions taken by the County Counsel and District Attorney to enforce illegal lending activity:

The District Attorney's Office can take on predatory lending practices that are considered criminal conduct. These practices include fraud (debt by false pretenses); businesses not properly licensed; false advertisement; embezzlement (theft by someone who has been entrusted with money, power of attorney, or other power and then uses it for their own benefit) and elder fraud/abuse or other financial crimes.¹⁷

A cross-departmental effort across multiple divisions addresses these practices. The District Attorneys Office's Economic Crimes Unit has multiple units that work together and with County Counsel on predatory lending issues. They also refer some civil cases to the State Department of Real Estate. The Economic Crimes Unit includes:

- Consumer Mediation Services – mediates disputes between consumers and businesses
- Consumer protection – enforces both criminal and civil license violations as well as false advertising and unfair business practices
- Real Estate Fraud – investigates and prosecutes illegal conduct involving real estate transactions and documents
- Elder Financial Abuse Unit – investigates and prosecutes financial crimes against elderly persons

Many of the predatory lending cases the Economic Crime Unit sees are difficult to prosecute because the borrower signed the loan documents and disclosure forms. Unless there is corroborating evidence, it is difficult to obtain a criminal conviction in many of these cases.

The County Counsel only becomes involved in predatory lending cases in civil actions in which a Public Guardian is appointed to an elder or other dependent adult. In these cases the County Counsel often works with other members of the Financial Abuse Specialist Team (FAST), a collaborative effort between the offices of the County Counsel, District Attorney, Adult Protective Services (APS) and Public Guardian to identify, investigate and prevent financial abuse of elders and dependent adults.

The FAST team initiates investigations when abusive conduct of an elder or other dependent adult, who often has some level of dementia or other lack of capacity, is reported to APS and in need of a public guardian. APS responds and evaluates the status of the elder and whether they may be in need of assistance or a public guardian. Suspects in these cases, which may include family members, typically befriend the elder, gain their trust, begin to help them with their financial and other life needs, and eventually gain access to their assets. They often obtain check writing authority or power of attorney from the elder or dependent adult. This conduct becomes criminal when the suspect takes out a loan, or multiple loans, on the elder person's property and uses the funds for personal gain. Often, by the time these cases get to the County offices, the house is either in foreclosure or lost.

The FAST team has prosecuted cases in which elders did not have the ability to repay a loan, multiple loans had been made, and brokers or lenders continued to finance transactions. In cases

¹⁷ Information is from interviews with Dennis O'Neal, Deputy County Counsel, Steve Gibbons, Assistant District Attorney and Paul Colin, investigator with the District Attorney's office.

where a suspect illegally obtained title to the elder's property, the County works to get the title of the house back in the elder's name so they can continue to have a place to live. The team sees five to ten cases like this a year, but estimates they are only seeing the "tip of the iceberg."¹⁸

The County sees other instances of what they consider predatory lending practices upon which they are unable to act. These practices include:

- Prepayment penalties
- Extremely high interest rates or fees
- Loans made that do not consider the borrowers ability to pay
- Repeated refinancing

Although some of these practices are included under the California State anti-predatory lending law, the County Counsel's office has never found a case that is in violation of the law because of the \$250,000 or less loan eligibility amount. All of the cases the County Counsel's office has seen exceed this amount.

6) Identify any Fannie Mae resources to assist families and individual subject to predatory loans:

As part of its American Dream Commitment, Fannie Mae is developing anti-predatory lending refinance initiatives with housing partners in cities across the nation. Through these efforts, Fannie Mae is working with nonprofit and lender partners to refinance victims out of predatory loans and into loans they can afford.

For example, in Cook County, IL, Fannie Mae created a \$5 million anti-predatory lending refinance initiative to provide payment relief to borrowers who have been victims of abusive mortgage lending practices. Through this initiative, borrowers earning up to 100% of the Cook County area median income can refinance out of high-cost loans into a fixed-rate, fully amortizing loan at current market rates. If a borrower's credit has been negatively affected due to the abusive loan, the homeowner may qualify for a new market-rate mortgage based on their credit rating prior to the abusive loan. The initiative was created through a series of meetings and discussions with the City of Chicago, the Community and Economic Development Association of Cook County, legal assistance groups, nonprofits, and banks.

7) Identify solutions used by cities throughout the nation to address predatory lending practices:

In response to concerns about predatory lending, 25 states, 11 localities and the District of Columbia have passed their own laws to address this issue. In California, in addition to the State law, the cities of Oakland and Los Angeles both passed anti-predatory lending ordinances. (See below for detailed information on these ordinances.) Some states have increased the regulation of and licensing requirements for mortgage lenders and brokers.

Multiple jurisdictions have implemented alternative anti-predatory programs including homeownership counseling, outreach and education, and legal assistance. In California, the cities of Oakland and Los Angeles have implemented such programs, as well as nonprofits in East Palo Alto and Sacramento.

¹⁸ From phone interview with Dennis O'Neal, Deputy County Counsel

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The following chart contains descriptions of eleven anti-predatory lending programs coordinated by city governments. According to the city contacts, none of the programs negatively impacted the subprime lending market. However, the contacts were unable to assess if and how their programs influenced predatory lending practices.

Anti-Predatory Lending Programs			
Jurisdiction	Description of Program	Organizations Involved	Funding Source
Philadelphia	Assistance hotline; informational inserts in water bills; low interest loans; loan counseling; consumer education; dedicated lawyers; larger marketing effort in the works	City; local nonprofit and for-profit organizations; housing counseling and legal assistance agencies; lending institutions	City; CDBG; Freddie Mac; banks; Redevelopment Agency
Chicago	Fund to replace loans by predatory lenders; consumer education campaign (door hangers, inserts in water bills, transit stops, etc.); assistance hotline; agency referrals; refinance assistance; legal assistance	City; state regulators; private lenders; Neighborhood Housing Services; housing counseling agencies; legal assistance organizations	City; CDBG; Neighborhood Housing Services; Banks; Fannie Mae; Freddie Mac;
New York City	Outreach & education campaign; legal services; loan renegotiation assistance; grants and loans to reduce bad loans; senior fund; training & technical assistance to neighborhood organizations	City; Fannie Mae; Parodnec Foundation; legal services agencies; lending institutions; non-profit groups	Fannie Mae; Ford Foundation; banks; foundations
Seattle	Don't Borrow Trouble program; education & outreach (fairs, inserts in property tax bills, TV ads; senior centers; etc.); refinance and legal assistance	City; County; Fannie Mae; Freddie Mac; legal assistance and housing counseling agencies; lending institutions	City, HUD counseling grant, Freddie Mac
Boston	Don't Borrow Trouble program (founding program); homebuyer education & counseling; credit counseling; community outreach (billboards; bus shelters; posters; neighborhood ads; mailings in water & sewer bills); assistance notices to homeowners threatened with foreclosure; rehab assistance to seniors	City; Massachusetts Community Banking Association; local nonprofit neighborhood development groups; community & housing organizations; Freddie Mac; ACORN	City, CDBG, Freddie Mac
Washington DC	Community education workshops	City	City
Baltimore	Property Flipping & Predatory Lending Task Force; loan pool (Fannie Mae buys mortgages after they are refinanced); legal assistance; flipping victims clearinghouse; community education; media campaign (newspaper articles & ads, PSA's, video)	City; banks; Fannie Mae; nonprofit housing and legal assistance organizations; Federal Housing Authority; Community Development Financing Corporation; ACORN; realtor association; AARP	City; HUD; Banks; Annie E Casey Foundation; SEEDCO (foundation); Fannie Mae
San Antonio	Housing counseling; community education; financial literacy training; reverse mortgage loan product for seniors	City; financial institution; schools; nonprofits	City, HUD
Los Angeles	Don't Borrow Trouble program; predatory lending hotline; referrals to legal assistance and counseling; marketing campaign (public events, bus signs, PSA's)	City; Freddie Mac; nonprofit fair housing agencies; public interest law firms	City; Freddie Mac
East Palo Alto (non-profit EPA CAN DO)	Homebuyer education classes; housing counseling; financial literacy program; loan refinancing; referrals to legal assistance; budget classes; community outreach	Fannie Mae Foundation; Community Legal Services	Fannie Mae Foundation; loans for refinancing through Fannie Mae and Chase Manhattan Bank
Oakland	Don't Borrow Trouble program; referral hotline; legal assistance; counseling; education; outreach	City; nonprofits; legal assistance agency	City, Freddie Mac

Anti-Predatory Lending Ordinances

Besides Los Angeles and Oakland, only two of the surveyed jurisdictions, Chicago and the District of Columbia, currently have their own predatory lending laws. Neither of the city/district contacts has found that their jurisdiction's ordinance has had an impact on the subprime market. Because Chicago's ordinance only covers financial institutions that do business with the City and deceptive actions by home-repair contractors, the City of Chicago Housing Department's Coordinating Planner did not think the law had much impact on the area's predatory lending. The Washington DC attorney who regulates the district's ordinance was unsure of its impact on predatory lending because only one loan had been filed under the law. He did not know if this meant that loans in violation of the law were not being reported or if only loans within the parameters of the law were being made. Other cities, including New York City, Boston, and Philadelphia had similar laws that were rescinded because of state preemption or other issues.

Chicago – Chicago's ordinance prohibits the City from doing business with financial institutions engaged in predatory practices, precludes home-repair contractors from receiving payments directly from lenders, and authorizes the Chicago Department of Consumer services to take action against contractors engaging in consumer fraud, unfair competition, or deceptive practices.

Washington DC – The District's law only covers high cost loans. It requires the lender to inform a borrower of their right to receive homeownership counseling, limits balloon payments and restricts financing of single-premium credit insurance. The law's prohibited acts include:

- Loans to borrowers with insufficient repayment ability
- Encouraging defaults
- Refinancing a loan to the same borrower within 12 months
- Unfair steering
- Improper use of credit scores
- Increase in interest rate upon default
- Bad faith charges (ex. for services not performed)
- Failure to timely send a disclosure notice
- Prepayment penalties
- Negative amortization
- Mandatory arbitration clauses

8) Track and evaluate the effectiveness of local ordinances passed in California:

The cities of Oakland and Los Angeles are the only local jurisdictions in California to pass anti-predatory lending ordinances. However, neither of these ordinances has been implemented due to immediate legal challenges from the American Financial Services Association (AFSA), a trade group for the subprime lending industry. AFSA has argued that the ordinances were preempted by State legislation that took effect in 2001. Oakland's ordinance was upheld in the Alameda County Supreme Court and the State Court of Appeals, and is currently being briefed for the California Supreme Court. The implementation of both ordinances is pending the Court's decision.

Oakland

Oakland’s ordinance prohibits a number of abusive terms and practices for home mortgage loans made in the city and provides victims with legal recourse, including civil fines and penalties. The ordinance provides “assignee liability” or legal recourse, for an unspecified amount of punitive damages, against not just the originator of a predatory loan, but also any person who purchases or is otherwise assigned the home loan. The ordinance:

- Limits pre-payment penalties
- Prohibits the financing of credit insurance
- Prohibits a lender from recommending that a borrower default on a loan
- Prohibits lenders from violating Federal lending laws
- Provides an opportunity for home loan counseling on high-cost loans
- Prohibits lending without regard to repayment ability
- Prohibits the financing of excessive points and fees
- Prohibits increased interest rates upon default
- Prohibits refinancing without a tangible net benefit to the borrower

Los Angeles

Los Angeles’ ordinance provides “assignee liability” similar to that of Oakland’s ordinance. For high-cost home refinance loans the ordinance prohibits¹⁹:

- Lending without home loan counseling
- Lending without reasonable belief in the borrower’s ability to repay the loan
- Lending without net benefit to the borrower
- Prepayment penalties after the first 24 months of the loan
- Financing single-premium credit, life or health insurance premiums
- Lending without disclosure to the borrower of credit scores and appraisals
- Failing to report loan repayment to credit agencies
- Mandatory arbitration clauses without full disclosure

Because neither ordinance has been implemented, their effectiveness in stopping predatory lending practices while not hampering the legitimate subprime market is unclear.

There have been rumors that subprime lending institutions have threatened to leave both cities if the ordinances are enacted. However, only one lending institution, Ameriquest, has officially stated it will not serve the City of Oakland.

The rating agencies Fitch and Standard & Poor have stated that mortgage loans that fall under either Oakland’s or Los Angeles’ ordinance will be excluded from the transactions they rate because of the assignee liability issue and the rewarding of unspecified punitive damages. The

¹⁹ Los Angeles’ ordinance defines high-cost loans as either having an annual percentage rate that exceeds by more than six percentage points the yield on Treasury securities having the period of maturity typically used by lenders within the industry as the basis for Home Loans, or points and fees that exceeds four percentage points of the total loan amount.

rating agencies claim that, because of these issues, they will be unable to measure potential punitive damages into the credit analysis of loans covered by the ordinances.²⁰

If the Supreme Court upholds Oakland's ordinance, the City plans on changing the wording of the document to make it more flexible and acceptable to rating agencies and the lending community. To deal with the rating problem, the City plans to put language into the document that, in other areas such as North Carolina, has made agencies comfortable to rate loans despite the predatory lending ordinance. Other planned changes include covering only high-cost loans, allowing lenders to charge more in points if the borrower gets a break in the interest rate, and prepayment penalties in some instances.

Upon the passage of its ordinance, the City of Los Angeles set up working groups to solve any problems with the new law. The working groups are currently on hold until the Supreme Court makes its decision on Oakland's ordinance.

9) Submit an application for Community Block Grant Funding to seek funding for homeownership counseling and other related consumer services.

In the fall of 2003, the Housing Department in coordination with Neighborhood Housing Services of Silicon Valley; Bay Area Legal Aid; Law Foundation, ProBono Project and ACORN submitted a Community Development Block Grant (CDBG) application for a comprehensive predatory lending education, outreach and assistance program. Facing significant competition, the program received no funding under the 2004 CDBG funding allocations.

10) Monitor and evaluate the education and outreach activities related to predatory lending in San Jose:

The City will track the progress of activities related to predatory lending in San Jose and report back to the City Council on an annual basis.

11) Track and evaluate legislation regarding predatory lending practices at the federal and state level:

The Housing Department will continue to track and evaluate legislation regarding predatory lending practices at the federal and state level.

²⁰ "Standard & Poor's Addresses Oakland, CA Anti-Predatory Lending Ordinance", Standard & Poor's, 10/10/03, www.cba.com/brochures/OC_19408_1.pdf, (viewed April 12,2004) and "Fitch Addresses Predatory Lending Legislation of Oakland, CA", Mortgage Bankers Association, 10/24/03, www.mortgagebankers.org/industry/news/03/1024b.html (viewed April 12, 2004.) "Standard & Poor's Addresses Los Angeles, CA Anti-Predatory Lending Ordinance", Standard & Poor's, 11/10/03, www.oomc.com/Good/Govt/Communications/articles/SP2.html (viewed 4/16/04), "Fitch Addresses Predatory Lending Legislation of Los Angeles, CA", Mortgage Bankers Association, 10/24/03, <http://www.mortgagebankers.org/industry/news/03/1024a.html> (viewed 4/16/04)