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CITY OF OAKLAND



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February 15, 2005

CITY COUNCIL
Oakland, California

RE: AN INFORMATIONAL REPORT ON THE CALIFORNIA SUPREME COURT'S DECISION IN THE PREDATORY LENDING CASE (AMERICAN FINANCIAL SERVICES ASSOCIATION V. CITY OF OAKLAND), AND A RESOLUTION CALLING ON THE CALIFORNIA LEGISLATURE TO ADOPT STRONGER STATEWIDE ANTI-PREDATORY LENDING PROTECTIONS OR AUTHORIZE LOCAL COMMUNITIES TO ADOPT STRONGER PROTECTIONS TO ADDRESS LOCAL CONDITIONS AND PROTECT LOCAL INTERESTS

Dear President De La Fuente and Members of the Council:

This report summarizes the recent California Supreme Court decision in the litigation that challenged Oakland's Anti-Predatory Lending Ordinance that the Council unanimously adopted in 2001. This report also presents a Council resolution calling on the California Legislature to adopt stronger statewide anti-predatory lending protections, or authorize local communities to adopt stronger protections to address local conditions and protect local interests.

American Financial Services Association (AFSA) v. City of Oakland

On January 31, 2005, the California Supreme Court, in a 4-3 ruling, invalidated Oakland's Anti-Predatory Lending Ordinance.¹ The majority opinion written by Justice Janice Rogers Brown (joined by Justices Baxter, Chin, and

¹ The decision also effectively overturns the predatory lending ordinance passed by the City of Los Angeles in 2003, which is similar to Oakland's law.

Werdegar) found that the Ordinance was preempted by the state's anti-predatory lending statute, AB 489. (The Legislature passed AB 489 in 2001 at about the same time the Ordinance was enacted.) The majority opinion held that, although AB 489 did not expressly preempt local laws, the Legislature impliedly intended to occupy the field of predatory lending regulation to the exclusion of local regulation by adopting a comprehensive legislative scheme over the field. The majority relied in part on the fact that the regulation of home mortgage lending has historically been a function of state government, not of local government. Justice Brown argued that the Ordinance upset the policy balance struck by the Legislature between protecting borrowers and promoting access to loan capital, and described the Ordinance as a "line item veto of those policy decisions by the Legislature with which the City disagrees." In concluding that the Legislature intended to fully occupy the field, Justice Brown dismissed evidence that the Legislature had actively considered but failed to include express preemption language in AB 489 after the lending industry lobbied hard for such a provision.

The dissenting opinion, authored by Chief Justice Ronald George (joined by Justices Kennard and Moreno), would have upheld the Ordinance. The Chief Justice strongly disputed the majority's conclusion that the Legislature intended to occupy the field of predatory lending regulation to the exclusion of further local regulation when it adopted AB 489. The Chief Justice argued that AB 489 was intended to set "a floor, not a ceiling" for predatory lending regulation. The failure of the Legislature to include preemption language in AB 489 shows that the Legislature did not clearly intend to preempt local regulation. "[T]he extrinsic evidence and the concession of the parties demonstrate that the Legislature declined to adopt an express preemption provision because such a provision would not command a majority of the Legislature. A legislative stalemate on preemption is not an indication of a clear intent to preempt local legislation."

The Chief Justice also argued that diverse social and economic conditions between localities and the unique local impacts of predatory lending in communities like Oakland justified local regulation in the field. "In view of the documented evidence that predatory lending is especially pervasive in low-income and minority neighborhoods, it is beyond dispute that Oakland and other similarly situated localities have a more significant interest in regulating subprime lending than localities that, because of demographics and composition, are not targeted in similar ways. Local regulation thus is not only constitutionally valid, but practically vital to the affected communities."

Since the California Supreme Court is the final appellate body, this decision concludes the litigation. Since there were no federal issues presented in this case, there is no recourse to the federal courts.

Resolution calling for the California Legislature to adopt stronger anti-predatory lending protections

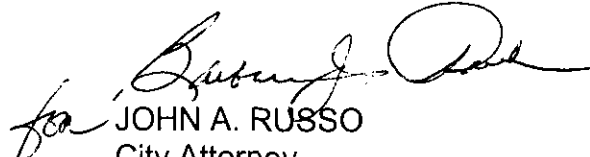
This Office has prepared a Resolution, attached to this report, calling for the California Legislature to adopt stronger anti-predatory lending protections. The Resolution calls on the Legislature either to adopt stronger statewide borrower protections against predatory lending practices in home mortgage lending as part of AB 489, or alternatively to authorize local communities with severe predatory lending problems to adopt regulations over abusive home mortgage lending practices as needed to address local conditions and protect local interests.

It was the finding of the Council when it adopted the Ordinance in 2001 that the borrower protections in AB 489 were inadequate to address the predatory lending problem in Oakland. The differences between the Ordinance and AB 489 (as well as the federal predatory lending law known as "HOEPA") are outlined in the attached chart (which was presented to the Council in September 2001 prior to the passage of the Ordinance). The major differences between the two laws are: (1) the Ordinance covers more loans than AB 489²; (2) the Ordinance imposes liability for violations on purchasers of high-cost loans, while AB 489 exempts such purchasers from liability; (3) the Ordinance requires borrower counseling for high-cost loans, while AB 489 does not; (4) the Ordinance prohibits financing points and fees more than the greater of 5 points or \$800, while AB 489 sets these limits at the greater of 6 points or \$1,000; and (5) the Ordinance bans prepayment penalties entirely for high-cost loans, while AB 489 allows prepayment penalties, with certain restrictions, within the first three years. The remedies and penalties under the Ordinance are also generally stronger than those under AB 489.

² The interest rate threshold for determining whether a loan is "high-cost" is 2 to 4 points lower in the Ordinance than in AB 489, the points and fees threshold in the Ordinance is 5 points or above, not the 6 points set in AB 489, and the Ordinance covers loans less than the FNMA conforming amount (now \$359,650), while AB 489 covers only loans less than \$250,000 (CPI adjusted). The Ordinance also covers loans on condominium and cooperative units, while AB 489 does not.

In view of the invalidation of the Oakland Ordinance by the Supreme Court, the need for the Legislature to adopt stronger borrower protections has become more pressing. There is no evidence that the predatory lending problem in Oakland or the state as a whole has improved since AB 489 became effective in July of 2002. Many states have enacted anti-predatory lending statutes since the California law was adopted; while some of these laws are weaker than California law, many of these statutes include borrower protections that are stronger than AB 489, including purchaser/assignee liability. Studies have shown that the number of loans with predatory features have decreased in states like North Carolina that have adopted strong laws, while the availability of legitimate subprime loans in those states has not been significantly impaired. Therefore, this Office is recommending that Council adopt the attached Resolution and direct staff to pursue state legislation strengthening borrower protections in California.

Respectfully submitted,


JOHN A. RUSSO
City Attorney

Attorney Assigned:
Daniel Rossi

Attachments:

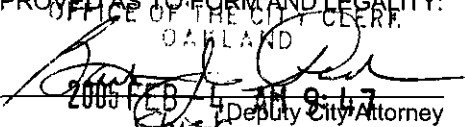
- (1) Resolution calling for the California Legislature to adopt stronger anti-predatory lending protections
- (2) Chart outlining differences between anti-predatory lending laws

Anti-Predatory Lending Legislation

Provisions	City	AB 489/AB 344	HOEPA
Coverage			
<ul style="list-style-type: none"> Covered loan – minimum interest rate <u>Current rates (30 year)</u> Treasury: 5.390% Fannie Mae (FNMA): 6.60% Freddie Mac (FHLMA): 6.8% 	“High-Cost Loan” APR = <ul style="list-style-type: none"> >= 3% over FNMA/FHLMA for a 1st mortgage: 9.6% >= 5% over FNMA/FHLMA for a junior mortgage: 11.60% 	“Covered Loan” APR => 8% over Treasury: 13.390%	“Ultra-High-Cost Loan” APR = > 10% over Treasury: 15.390%
<ul style="list-style-type: none"> Covered loan - minimum points & fees 	= / > the greater of 5% of loan or \$800	> 6% of loan	> the greater of 8% of loan or \$400 (\$451 in 2000, adjusted)
<ul style="list-style-type: none"> Loans included 	<ul style="list-style-type: none"> Loan amount < FNMA-conforming Secured by 1 to 4 units, or condos or coops Personal, household uses 	<ul style="list-style-type: none"> Loan amount < \$250,000 (CPI adjusted) Secured by 1 to 4 units 	<ul style="list-style-type: none"> Secured by 1 to 4 units Personal, household uses
<ul style="list-style-type: none"> Loans excluded 	<ul style="list-style-type: none"> Reverse mortgages 	<ul style="list-style-type: none"> Reverse mortgages Open lines of credit Construction loans 	<ul style="list-style-type: none"> Reverse mortgages Open lines of credit Purchase loans Construction loans
<ul style="list-style-type: none"> Lenders covered 	Excludes federally-chartered lenders	All	All

Prohibits:			
• Excessive prepayment penalties	Prohibited for high cost loans, limited for other loans to 3% in year one, 2% in year two, 1% in year three	Limited for covered loans first 3 years, prohibited for covered loans after 3 years	Prohibited for ultra high cost loans after 5 years
• Financing of credit insurance	YES	YES	NO
• Recommending default	YES (all loans)	YES (covered loans only)	NO
• Violations of federal lending laws	YES	NO	YES
• Lending without home loan counseling	YES	NO (requires notice)	NO
• Negative Amortization	NO	YES (junior mortgages)	YES
• Lending without regard for repayment ability	Limited to 50% debt-to-income ratio	Limited to 55% debt-to-income ratio	Limited (no standard)
• Excessive financing of points & fees	Limited to the greater of 5% of loan or \$800	Limited to the greater of 6% of loan or \$1,000	NO
• Advance payments	YES	YES	YES
• Modification or deferral fees	YES	NO	NO
• Balloon payments	NO	YES (<5 year term)	YES (<5 year term)
• Call provisions	YES	YES	NO
• Increased rate upon default	YES	YES	YES
• Refinancing without borrower benefit	YES	YES	NO
• Refinancing special mortgages	YES	NO	NO
• Direct payments to contractors	NO	YES	YES
• Steer to a higher cost loan	NO	YES	NO

Requires disclosures	NO	YES (by 3 business days before closing)	YES (by 3 days before closing)
Remedies & penalties:			
• Right of enforcement	<i>Borrowers or City Attorney</i>	<i>Borrowers or state licensing agency</i>	<i>Borrowers, federal agencies, or states</i>
• Damages	Actual damages, plus points and fees, plus 10% of loan	Greater of actual damages or \$15,000 (if willful)	Twice finance charge (\$200 - \$2000)
• Civil penalties	\$500 - \$50,000	Maximum \$25,000	None
• Attorneys fees	Recoverable	Recoverable	Recoverable
• Equitable remedies	Reform loan, bar enforcement or foreclosure, rescind loan	Reform loan, bar enforcement	Reform loan
• Loan purchasers & assignees	Liable	Not liable	Liable
Effective Date	November 1, 2001	July 1, 2002	Exists

APPROVED AS TO FORM AND LEGALITY:
OFFICE OF THE CITY CLERK
OAKLAND
By: 
2005 FEB 4 AM 9:17
Deputy City Attorney

OAKLAND CITY COUNCIL

RESOLUTION No. _____ C.M.S.

INTRODUCED BY COUNCIL PRESIDENT DE LA FUENTE

A RESOLUTION CALLING ON THE CALIFORNIA LEGISLATURE TO ADOPT STRONGER STATEWIDE ANTI-PREDATORY LENDING PROTECTIONS OR AUTHORIZE LOCAL COMMUNITIES TO ADOPT STRONGER PROTECTIONS OR AUTHORIZE LOCAL COMMUNITIES TO ADOPT STRONGER PROTECTIONS TO ADDRESS LOCAL CONDITIONS AND PROTECT LOCAL INTERESTS

WHEREAS, the City Council enacted Ordinance No. 12361 C.M.S., the Anti-Predatory Lending Ordinance, on October 2, 2001, which prohibited certain abusive lending practices for high-cost home mortgage loans in Oakland; and

WHEREAS, due to a legal challenge to the Ordinance from the subprime lending industry, the Ordinance never became effective; and

WHEREAS, prior to the enactment of the Ordinance, this Council heard testimony from community organizations and victims of predatory lending practices that predatory lending is a widespread, significant and growing problem in low-income Oakland neighborhoods; and

WHEREAS, in enacting the Ordinance, this Council found that because of the high number of minority and low-income homeowners in Oakland and the pressures of gentrification in certain neighborhoods that increase property values and home equity, Oakland residents in low-income areas have been perceived to be "house rich and cash poor" and thus are prime targets for predatory lending practices; and

WHEREAS, this Council further found that (1) predatory lending is a significant economic drain on low-income families and communities in Oakland, (2) predatory lending practices increase foreclosures, which results in abandoned houses, blighted neighborhoods, and the physical and economic deterioration of

low-income, minority and inner-city communities in Oakland, (3) predatory lending increases displacement and economic dislocation, and reduces the availability of affordable housing in Oakland, and (4) predatory lending reduces property values in Oakland, erodes the tax base, and increases the strain on City services; and

WHEREAS, the state anti-predatory lending statute, AB 489, enacted in 2001, does not adequately address the problem of predatory lending in Oakland; and

WHEREAS, over half of the states have adopted anti-predatory lending statutes, many of which have stronger borrower protections than AB 489; and

WHEREAS, the problem of predatory lending persists in Oakland; and

WHEREAS, on January 31, 2005, the California Supreme Court, in a 4-3 ruling, invalidated the Ordinance, ruling that the California Legislature impliedly preempted local predatory lending laws by enacting AB 489; now, therefore, be it

RESOLVED: That the City Council hereby calls on the California Legislature to adopt stronger statewide borrower protections against predatory lending practices in home mortgage lending, or alternatively to authorize local communities with severe predatory lending problems to adopt regulations over abusive home mortgage lending practices as needed to address local conditions and protect local interests; and be it further

RESOLVED: That the City Council hereby authorizes the City Administrator and the City Attorney to take whatever action they deem necessary or appropriate to support this position consistent with this Resolution and its basic purposes.

IN COUNCIL, OAKLAND, CALIFORNIA, _____, 2005

PASSED BY THE FOLLOWING VOTE:

AYES- BROOKS, BRUNNER, CHANG, NADEL, QUAN, REID, AND PRESIDENT DE LA FUENTE,

NOES-

ABSENT-

ABSTENTION-

ATTEST: _____
LATONDA SIMMONS
Interim City Clerk
of the City of Oakland