

REPORT NO. R02-0476
NOV 21, 2002

**DRAFT ORDINANCE AMENDING LOS ANGELES MUNICIPAL CODE
TO ADD CHAPTER XVI, PROHIBITING CERTAIN PREDATORY LENDING PRACTICES
IN RESIDENTIAL REFINANCE LOANS**

The Honorable City Council
of the City of Los Angeles
Room 395, City Hall
Los Angeles, California 90012

(Council File No. 01-1476 - not transmitted)

Honorable Members:

This office has prepared and now transmits for your action the attached draft ordinance, approved as to form and legality. This draft ordinance adds a new chapter to the Los Angeles Municipal Code prohibiting certain specified predatory lending practices in residential refinance loans.

Background

On July 17, 2001, the Council directed the City Attorney, with the assistance of the Los Angeles Housing Department (LAHD), to draft an ordinance prohibiting certain specified predatory loan practices. The matter was referred to the Housing and Community Development Committee for further action.

When the Committee learned of similar pending legislation in Sacramento (Assembly Bill 489, Migden), the Committee asked LAHD for a report comparing the Council motion to AB 489. The state legislation subsequently became law (Division 1.6 on the Financial Code, §4970, *et seq.*).

The Housing Department presented its report to the Committee. One of the Committee's key concerns was the issue of preemption. This office advised the Committee that as a charter city, Los Angeles could enact stricter prohibitions than state

law in areas of municipal concern. However, to avoid preemption, the City would need to show that Los Angeles had unique problems requiring additional restrictions. To that end, the Committee held a series of public hearings on February 21, April 17, and September 12, 2002.

The evidence gathered at these public hearings, together with additional research, has been summarized by the Housing Department, and has been transmitted to the Committee.

Based on the parameters of the Council motion, as supported by the evidence gathered by the Housing Department, and amendments made by the Committee, this office has drafted an ordinance for the Council's consideration.

CEQA Findings

The General Manager of LAHD has recommended that the City Council adopt a Categorical Exemption for the requirements of the California Environmental Quality Act (CEQA). Article II, Section 2, Subsection (m) of the City's CEQA Guidelines provide a categorical exemption for an ordinance that does not, by itself, have an impact on the physical environment. If the City Council concurs, and finds that no significant impacts on the physical environment are apparent from the implementation of this ordinance, it should adopt this Categorical Exemption, prior to, or concurrent with, its action on the ordinance.

Preemption Issues

The legislative history of AB 489 indicates there was controversy over whether to expressly preempt local jurisdictions from enacting more restrictive measures. Ultimately, the Bill contained no such language, nor consensus of legislative intent.

The City of Oakland enacted an anti-predatory loan ordinance with similar provisions to those found in the Council motion. That ordinance was immediately challenged by American Financial Services, a trade association representing lenders, claiming that the Oakland ordinance was preempted by state law. The City of Oakland agreed it would not enforce its ordinance until the litigation and appeals had concluded. The Plaintiffs lost both their Motion for Preliminary Injunction, and their Motion for Summary Judgment, however an appeal is pending.

The LAHD has researched issues surrounding predatory lending. Its research and evidence gathered at the public hearings show unique factors in Los Angeles that result in a higher incidence of predatory refinance loans than occurs in the rest of the state. The

Department's report has been transmitted to the Committee. Should the Council adopt these conclusions as findings of fact, the City should be legally qualified to enact legislation regulating predatory refinance loans beyond the regulations required by state law.

The Oakland ordinance, like the draft ordinance attached to this report, does not apply to federally chartered banks, credit unions, or savings and loans. If the ordinance applied equally to federally chartered institutions, it is likely that much of it would be preempted by federal law. However, in the Oakland litigation, Plaintiffs argued that Civil Code §1916.12 requires Oakland to include federally chartered institutions. That code section requires that regulatory guidelines for lenders must promote parity between federally chartered and state chartered institutions. In the Oakland litigation, the trial judge agreed with the Plaintiffs, and modified the ordinance to apply equally to federally and state chartered institutions. This aspect of the judge's decision is also being appealed. In its appellate brief, Oakland argued that Civil Code §1916.12 applies only to rules and regulations promulgated by the Secretary of Business, Transportation and Housing Agency. While we agree with Oakland's argument, the issue has not yet been finally resolved by the courts.

Council Rule 38 Referral

A copy of the draft ordinance was sent, pursuant to Council Rule 38, to the Mayor, the Chief Legislative Analyst, the City Administrative Officer, the Treasurer, the General Manager of LAHD, and the General Manager of the Community Development Department (CDD). Their comments have been incorporated and/or noted in this transmittal. Copies of their responses have been transmitted to the Committee.

Summary of Ordinance Provisions

To prevent needless foreclosures, and consequential urban blight, this ordinance regulates predatory lending practices used in residential refinance loans. The ordinance focuses on a subset of loans most susceptible of predatory lending practices. The ordinance calls these loans, "High-Cost Refinance Home Loans," and they are characterized by high interest rates and expensive points and fees. Under the ordinance, "High-Cost Refinance Home Loans," are still allowed, but additional regulations prescribed by the ordinance are imposed. Thus, to make a "High-Cost Refinance Home Loan," the lender must:

- ? Receive written certification from an independent loan counselor that the borrower has either received or waived loan counseling in the borrower's native language.

- ? Have a reasonable belief in the borrower's ability to repay the loan, no matter how much the property is worth. A borrower is presumed to be able to repay the loan if the monthly payments do not exceed 50% of the borrower's monthly gross income. If the monthly payments are more than 50% of the borrower's gross monthly income, and the lender nevertheless reasonably believes the borrower can make the payments, the lender must provide a written statement to the borrower justifying the decision.
- ? Make the loan only if the borrower receives a reasonable and tangible benefit from the refinance loan.
- ? Make any pre-payment penalties applicable only during the first 24 months of the loan.
- ? Finance no single-premium credit life, credit disability, credit property, credit insurance, or any other life or health insurance premiums as part of the principal of the loan.
- ? Disclose to the borrower all credit scores and appraisals prior to the required loan counseling.
- ? Report repayments to credit reporting agencies.

Any lender who makes a loan in violation of the ordinance is liable for actual damages and attorneys fees. Furthermore, an aggrieved borrower could sue for injunctive relief to reformulate the loan to conform to the requirements of the ordinance.

Since it is known that additional rules and regulations will be necessary to implement this ordinance, LAHD is authorized to propose rules, regulations, and a funding mechanism, subject to approval by the Council and the Mayor. The ordinance becomes operative thirty (30) days after publication of the rules and regulations.

Differences Between the Council Motion and the Draft Ordinance

The draft ordinance is slightly different from the provisions in the Council motion. These differences were dictated by existing law, evidence produced at the hearings or through research and discussions with Council staff regarding Council intent. The differences may be summarized as follows:

- ? The Council motion sought to cover all loans, whether purchase loans or refinances loans. Statistically, Los Angeles has about the same percentage of subprime purchase loans as the rest of the state. Due to existing state law, and the principles of preemption, it would be ill-advised for the City to regulate subprime purchase loans beyond state restrictions. However, Los Angeles has a significantly higher percentage of subprime refinance loans than the rest of the state. Thus, the evidence supports a legal basis for Los Angeles enacting further restrictions in this area.
- ? The Council motion sought to regulate all loans initiated, transacted, or secured by real estate in Los Angeles. However there would be no legal authority to regulate loans unless the real estate were located within the City. Consequently, the draft ordinance covers only loans that are secured by real estate in Los Angeles.
- ? In addition to injunctive relief, actual damages, and attorney's fees, the Council motion sought to establish other penalties for violating the ordinance. These other penalties were omitted only after extensive discussions with Council staff to determine Council intent:
- ? The Council motion sought to revoke a violator's City business tax registration. However, this would have little effect, other than preventing the offender from becoming a City contractor. A revoked City business tax registration would not prohibit the offender from conducting business within the City. Furthermore, by law, the City may not collect business taxes from financial institutions.
- ? The Council motion sought to punish violators with fines and jail. However, misdemeanor prosecution would necessitate additional staff and resources for both investigation and prosecution. Since the motion contained no direction on this point, misdemeanor prosecution was omitted. Should the Council wish to include provisions for misdemeanor prosecution, including resources and staff, this section can be added to the ordinance.
- ? The Council sought to have violations reported to State and Federal regulatory bodies. However, the motion contained no direction on responsibility for staffing such a program. Furthermore, those who violate state law, are already reported to regulatory bodies. It is unclear how much weight State and Federal regulatory bodies would give to the violation of a municipal ordinance.

- ? The Council sought to have violations of the ordinance constitute a basis for an action under California Business and Professions Code §17200 (Unfair or deceptive business practices). However, no language is necessary in the ordinance to accomplish this. Any pattern of illegal or unfair business practices can be prosecuted under this Business and Professions Code .

Amendments To Draft Ordinance Made By The Committee

In the course of the public hearings, the investigation by LAHD, and comments pursuant to Rule 38 from affected City Departments, suggestions were made that the provisions in the draft ordinance be augmented beyond those set forth in the Council motion. Based on direction from the Committee, the following provisions have been incorporated into the draft ordinance.

- ? Permitting statutory damages in addition to actual damages. The draft ordinance provides for statutory damages equal to the amount of the points and fees, plus 10% of the loan.
- ? Permitting punitive damages if the court determines by clear and convincing evidence that the lender showed reckless disregard for the rights of the borrower.
- ? Permitting the borrower to assert a violation of the ordinance as a defense to a foreclosure action.
- ? Requiring assignee liability.
- ? Limiting mandatory arbitration.

The Committee also requested the City Attorney to change the definition of High-Cost Refinance Loan to include loans where the Points and Fees exceed four percentage points of the total loan amount or \$1,500, whichever is greater. After discussing Council intent with Council staff, and determining that the wording was subject to misinterpretation, the language was changed to cover loans where, " The Points and Fees exceed four percentage points of the Total Loan Amount, however Points and Fees of up to \$1500 shall not subject a Home Loan to the provisions of this chapter."

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of the City of Los Angeles
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If you have any questions, please contact Richard Bobb at 213.485.4073. Either he or another member of this office will be available when you consider this matter to answer any questions you may have.

Very truly yours,

ROCKARD J. DELGADILLO, City Attorney

By

TERREE A. BOWERS
Chief Deputy City Attorney

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Attachment
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