

# Legal Briefs

*News You Can Use from the City of Oakland Office of the City Attorney*

*Legal Briefs is a series of essays by City Attorney John Russo to update the community on key projects, major initiatives and important legal developments in the Office of the City Attorney.*

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## **Landmark Anti-Predatory Lending Ordinance Upheld in Court Oakland Becomes First City in America to Defeat Lending Industry Challenge**

**By John A. Russo**

Maddie Akins, a 75-year-old widow on a fixed income, had lived in her Oakland home for 25 years. When she inquired about a loan to pay for about \$40,000 in minor repairs, lenders told her she would need a loan of about \$75,000. Then, using bait-and-switch techniques common to the subprime lending business, these lenders gave Ms. Akins a loan for \$160,000, with a balloon payment due in one year and an effective interest rate of 25%. When the loan came due, Ms. Akins could not pay. The lender foreclosed on her home; she died a short time later.

Ms. Akins was a victim of predatory lending, an unconscionable and malicious practice that targets the most vulnerable members of our community: often elderly, minority, and low-income borrowers. Predatory lenders seek to sell high-interest, high-cost loans to borrowers who—like Ms. Akins—are perceived to be "house rich and cash poor." Their aggressive and deceptive tactics are designed to persuade homeowners to refinance their homes or take out construction loans beyond their means, trapping them in a downward spiral of indebtedness. Predatory lenders assess inflated up-front fees and excessive interest rates, thereby guaranteeing extortionate profits even if the borrower defaults.

Examples of predatory lending practices include:

- Loan amounts that exceed the borrowers' ability to repay
- Financing exorbitant up-front fees into loans (3 - 4% fees compared to less than 1% for traditional loans)
- Charging higher interest rates than a borrowers' credit warrants (10 - 12% compared to about 8% for conventional loans)
- Loan amounts that exceed the value of the residence used as collateral
- Tactics to increase the cost of the loan such as credit insurance, balloon payments, and pre-payment penalties
- Aggressive and deceptive marketing techniques such as mailing "live checks" to potential borrowers to lure them into a debt arrangement

Redlining is also at work here with its whiff of institutionalized racism. Studies by Freddie Mac (Federal Home Loan Mortgage Corp.) and Standard & Poors reveal that 20% to 30% of these borrowers could qualify for conventional loans were they not pressured and deceived by unscrupulous lenders, who refuse to make traditional loans available to those on whom they are preying.

## **Oakland Tackles the Scourge of Predatory Lending**

Subprime lending has grown exponentially in recent years—more than 10-fold since 1993. Predatory lending practices are a significant drain on lower-income families and communities in Oakland. These tactics lead to an increased number of foreclosures, resulting in abandoned houses and blighted neighborhoods; the loss of affordable housing; increased displacement and economic dislocation; depressed property values; an eroded tax base; poverty, and increased strain on city services.

In October 2001, to curb the impact of this widespread, significant, and escalating problem, the Oakland City Council unanimously passed a landmark anti-predatory lending ordinance which prohibits a number of abusive lending terms and practices for home mortgage loans made in Oakland. Oakland's ordinance also provides victims with legal recourse, including civil fines and penalties. This ground-breaking ordinance:

- Limits pre-payment penalties
- Prohibits the financing of credit insurance
- Prohibits a lender from recommending that a borrower default on a home loan or other loan
- Prohibits lenders from violating Federal lending laws
- Provides an opportunity for home loan counseling on high-cost loans
- Prohibits lending without regard to payment 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

## **Oakland Defeats Legal Challenge by Subprime Lending Industry**

On the heels of its passage, Oakland's anti-predatory lending ordinance was immediately challenged in court by American Financial Services Association (AFSA), a trade group for the subprime lending industry, which argued that the ordinance was preempted by state legislation passed into law last year.

In late June 2002, Alameda County Superior Court Judge James A. Richman denied the industry's claims, upholding Oakland's anti-predatory lending ordinance and ruling that the City Council had a right to protect its citizens if state law does not.

In defeating this industry challenge, Oakland has become the first city in America to successfully defend an anti-predatory lending ordinance in court. Oakland's legal victory is shared by cities across the nation which are similarly attempting to protect the economic interests of their low-income, elderly, and minority residents, including Los Angeles, San Francisco, Berkeley, Richmond, East Palo Alto, Albuquerque, and New York City.

Once again, we in Oakland are on the leading edge of progressive legislation designed to protect the interests of its citizens and enhance our collective quality of life. In the Office of the City Attorney, we continue our commitment to fulfilling our motto, "law in service of the public," by defending Oakland's policies and protecting the legal rights of our community.

