Minneapolis
City of Lakes

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TO: Council Vice-President Lilligren,
Council Member Johnson Lee
Council Member Zerby
Council Member Zimmerman

FROM: Erik Nilsson ESN
Assistant City Attorney

DATE: April 17, 2003

RE: Predatory Lending - Policy Discussion Framework

MEMORANDUM

INTRODUCTION

This memorandum is in response to your request for additional information on the policy options available to the City with regard to predatory lending. It is intended to serve as a guide to discussion on the topic and does not address every legal issue associated with the City's adoption of a particular policy. Once the City Council determines the course of action it wishes to pursue, further legal analysis of the specific policy choice will be conducted.

BACKGROUND

I. Definition of Predatory Lending

There is no overriding consensus on a standard definition of "predatory lending." Federal law does not contain a definition and state laws characterize it differently according to the prevalence of identified "abusive" practices in association with certain residential mortgage loans. Minnesota law does not contain a definition. However, in jurisdictions with anti-predatory lending provisions, a predatory loan is generally considered to be a "high cost" loan secured by residential real estate made under abusive circumstances. Whether a loan is deemed "predatory," therefore, depends not only on its terms, but also on the context in which it is made.

The "high cost" loan threshold is usually established with reference to two lending "triggers" that implicate the terms of the loan on its face: 1) a rate (APR) trigger and 2) a points and fees trigger. The rate trigger is generally met by first lien loans with an APR of anywhere from 3% - 8% above the yield on Treasury securities with a similar term and 5% - 10% APR + Treasury yield for junior mortgages. The points and fees trigger is generally met by loans with at least 3%

- 8% of the total loan amount in points and fees. The specific trigger amounts, however, vary from jurisdiction to jurisdiction.

Once it is determined that a mortgage loan is "high cost" because it meets one or both of the triggers, focus turns to identification of specific abusive lending practices in conjunction with extension of the "high cost" loan terms. In general, the identified abusive circumstances involve practices that strip equity away from a homeowner. These abusive practices can include lending without regard to the borrower's ability to pay, financing of single premium credit insurance, negative amortization, balloon payment provisions, and increased interest rates upon default. In order for a loan to be deemed "predatory," therefore, it must meet the "high cost" loan threshold as determined by the jurisdiction and contain identified abusive lending practices.

In the context of identifying predatory loans via triggers and the prevalence of abusive circumstances, a predatory lender is commonly identified according to a threshold number of predatory loans extended or as a percentage of the total loans made during a 12-month period.

II. Policy Options to Address Predatory Lending

There is a wide range of policy options available to address the issue of predatory lending. These initiatives can generally be grouped into three broad categories of increasing reach and likelihood of legal challenge: 1) educational campaigns; 2) proprietary policies; and 3) regulatory provisions. None of the following policy options are mutually exclusive and, assuming legal and economic viability, may be pursued in concert if desired.

A. Educational Initiatives

Consumer education initiatives seek to inform borrowers about predatory lending practices and their rights under the law. These initiatives may entail informing the general public about the characteristics and hazards of predatory lending via print and broadcast media sources, as well as loan counseling on an individualized basis by the City and nonprofit organizations to help borrowers recognize and avoid predatory loans. By creating an informed public, the hope is that market forces will drive out predatory lending entities.

B. Proprietary Policies

These initiatives consist of the City adopting a policy not to do business with predatory lenders or parties associated with predatory lenders. This would include not participating in development projects in which predatory lenders participate, or being involved in financial transactions or deposits with such institutions or their parent entities. Proprietary policies place the burden of disassociation from predatory lenders on the financial entities themselves rather than the City through regulatory oversight or the consumer in an educational campaign.

C. Regulatory Provisions

Regulatory provisions seek to comprehensively address the issue of predatory lending through formal legislation by prohibiting certain mortgage lending practices in association with "high cost" loans.

III. Predatory Lending Initiatives in Other Municipalities

Several municipalities have adopted policy initiatives, primarily in the area of education, to address predatory lending. In the proprietary and regulatory categories, municipalities have sought to expand the pool of "high cost" loans subject to regulation by lowering the trigger thresholds in response to perceived deficiencies in federal and state law. In response to the increasing trend toward local legislation, however, many states decided to preempt local initiatives. Ordinances in Philadelphia, Cleveland, Dayton, and Detroit were all subsequently preempted by state law after enactment. There are currently only four major pieces of municipal predatory lending legislation on the books – Oakland, Los Angeles, New York City, and Chicago.

A. Education

Currently operational consumer education initiatives include Freddie Mac's (the Federal Home Loan Mortgage Corporation) "Don't Borrow Trouble" campaign, which was piloted in Boston in 1999 and has expanded to approximately 25 other communities nationwide. Local campaigns are carried out by local government agencies in cooperation with a wide range of local partners, including non-profit housing providers, credit counseling agencies, fair housing associations, and industry groups. These campaigns use brochures, mailings, posters, public service announcements, transit ads, and television commercials to inform the public and provide assistance to consumers if they have already taken out a loan. The campaign is available to all cities that are members of the U.S. Conference of Mayors.. Freddie Mac provides seed funding and technical assistance during the implementation phase. A sampling of various municipal "Don't Borrow Trouble" campaigns:

- Launched on June 7, 2002, Milwaukee's campaign includes outreach through brochures, radio, newspaper ads, and bus signs. The Metro Milwaukee Fair Housing Council provides the bulk of the counseling. Other partners include the Wisconsin Housing and Economic Development Authority and the Milwaukee County Treasurer's Office.
- In conjunction with the city's launch of the campaign in October 2001, the Detroit Alliance for Fair Banking hired a full-time staff member to answer telephone calls and provide counseling as needed.
- In September 2000, the City of Atlanta, Fulton and DeKalb Counties in cooperation with more than a dozen local agencies and nonprofit community organizations launched the campaign. These entities included the AARP, Atlanta Legal Aid Society, Georgia Department of Banking and Finance, United Way of Metropolitan Atlanta, and the Metro Fair Housing Services. Participating agencies respond to consumer telephone calls on the 211 hotline.

In Minnesota, a "Don't Borrow Trouble" campaign initiated by the Family Housing Fund (contact – Lowell Yost, 612/375-9644) launched on or about March 6, 2003, and is currently slated to run for 18 months. Comprised of over 50 individuals, the organizing task force includes individuals from nonprofit organizations (ACORN), banks, churches, realtor groups, and the Attorney General's Office. The Family Housing Fund, Fannie Mae, Mortgage Bankers, Freddie Mac, and Minnesota Association of Realtors have pledged money to date. The group also maintains a telephone contact to answer borrower queries and provide referrals to agencies that can assist borrowers.

In the local area, ACORN Housing conducts outreach and education regarding predatory lending. ACORN provides free counseling to borrowers and produces various leaflets and pamphlets that have been distributed in Twin Cities' neighborhoods with high concentrations of subprime lending.

B. Proprietary Policies

New York City

The key factor with a proprietary ordinance is identifying which loans are predatory. The New York City ordinance identifies predatory loans by the prevalence of certain abusive terms in a "high cost" loan. "High cost" loans are identified by reference to two triggers, a rate trigger and a "points and fees" trigger. The APR rate trigger is met by first liens when it equals or exceeds by 6% the rate on comparable Treasury securities (8% for junior liens). The "points and fees" trigger is met when they constitute 4% or more of the total loan amount.

If a loan is "high cost," it is then considered predatory if any of the following characteristics are present:

- prepayment penalties
- making loans without regard to the borrower's ability to repay
- single premium credit insurance
- yield spread premiums
- aggressive and deceptive marketing
- negative amortization
- balloon payments
- loan steering
- loan flipping

A predatory lender is then defined as a "financial institution that is involved in originating, purchasing, or securitizing of 10 or more predatory loans or 5% of the total number of home loans made in a 12-month period." Once identified, the ordinance prohibits the city from doing business with predatory lenders or their affiliates:

- no contracts with predatory lenders
- no depositing of city funds with predatory lenders
- no city subsidies to predatory lenders
- no city investments in predatory lenders

With regard to enforcement, the ordinance vests the city comptroller with the authority to "investigate whether financial institutions or their affiliates are predatory lenders."

On November 20, 2002, the New York City Council voted to override Mayor Bloomberg's veto of the provision. However, on February 25, 2003, the Manhattan Supreme Court granted the Mayor's request for a preliminary injunction pending the outcome of his lawsuit seeking repeal of the law.

Chicago

The City of Chicago passed a proprietary predatory lending ordinance in August 2000, which applies to city depositories and city contractors. The ordinance states that the city will not do business with these entities if they or their affiliates engage in predatory lending practices. In order to accomplish this goal, city depositories are required to sign a pledge attesting that neither it nor its affiliates is or will become a predatory lender. In addition, the city collects data from depositories and affiliates on their loan practices including:

- total number and amount of all refinance loans and home improvement loans
- interest and points and fees paid on refinance loans and home improvement loans
- total number of loans made or foreclosed by a bank that included single premium credit insurance

As of March 2001, 30 banks had signed the pledge, which included every bank that applied to be a depository.

The Chicago ordinance and state regulations use the same thresholds and definitions of predatory practices to define "high risk" loans. A predatory lender is defined by meeting one of two initial lending triggers with regard to loans secured by residential real estate. An APR rate trigger of 6% + yield on comparable Treasury securities for first lien loans (8% for junior mortgages) and a fee trigger of 5% of the total loan amount. If a loan meets either of the triggers, then the lender cannot engage in any of the following practices:

- prepayment penalties after 3 years
- balloon payments for loans under 15 years
- flipping
- loans not based on borrower's ability to repay
- financing fees accounting for more than 6% of loan amount
- negative amortization
- direct payments to home improvement contractors
- inclusion of credit insurance without disclosure

Predatory lenders are then defined as a financial institution that has made 25 or more predatory loans or 5% of the total number of loans made in a 12-month period. As with the New York proprietary ordinance, the Chicago ordinance vests authority in the chief financial officer or city comptroller to identify predatory lenders.

I am not aware that the ordinance has faced legal challenge. The city received significant input from and worked extensively with the mortgage industry in drafting the final language. This may be the reason for the lack of legal action.

C. Regulatory Provisions

<u>Oakland</u>

The comprehensive Oakland anti-predatory lending ordinance, passed in October 2001, includes protections on all loans and additional protections on identified "high cost" loans. The protections extended to all home loans include a prohibition on the financing of single premium credit insurance into the loan and a prohibition on the encouragement of default when a lender is soliciting to refinance the consumer into a new loan. The ordinance also provides limits on prepayment penalties for loans that do not meet the "high cost" threshold.

In order to identify "high cost" loans subject to the additional protection, the ordinance references the rate trigger and the points and fees trigger. The rate trigger is met by first mortgages with an APR of 3 percentage points over the rate on standard interest loans purchased by Fannie Mae and Freddie Mac (5% for second mortgages). The points and fees trigger is met when the points and fees exceed 5% of the total loan amount or $800, whichever amount is greater. "Points and fees" is defined to include all points and fees that go to the lender or broker, including document preparation charges, prepayment penalties, and yield-spread premiums, but does not include legitimate third-party charges.

Once a loan is identified as "high cost," the ordinance provides additional protections:

- limitation on the financing of points and fees
- prohibition on prepayment penalties
- required loan counseling from a qualified, independent counseling agency
- prohibition on lending without regard to the borrower's ability to repay
- prohibition on lending without a net benefit to the borrower
- prohibition on the refinancing of special low interest rate mortgages, typically obtained through city programs or nonprofit organizations
- prohibition on call provisions, which permit the lender to require the borrower to immediately pay the loan balance
- prohibition on interest rate changes upon default

In order to enforce these substantive protections, the ordinance provides a private right of action to an aggrieved borrower who may seek actual damages, exemplary damages, and costs plus attorney's fees. In addition, the city attorney is authorized to bring a civil action against a lender who violates the terms of the ordinance. The ordinance also provides for liability for purchasers and assignees of predatory loans. Finally, the ordinance provides a private cause of action for a violation of federal law, either the Truth in Lending Act (including the Home Ownership Equity Protection Act) or the Real Estate Settlement Procedures Act.

In June 2002, the Oakland ordinance withstood a legal challenge at the trial court level brought by the American Financial Services Association (AFSA) based primarily on a state law preemption argument. The trial court entered summary judgment in Oakland's favor, denied AFSA's motion for summary judgment, and dismissed AFSA's complaint. The case is now awaiting hearing at the appellate level and the court ordered that the ordinance shall not be effective until the legal challenge is complete.

Los Angeles

In response to the Oakland trial court decision, the Los Angeles City Council passed a predatory lending ordinance on November 22, 2002 (signed on December 10, 2002). The ordinance provides a number of substantive protections on "high cost" loans, including required loan counseling, that the loan provide the borrower with a tangible net benefit, and that the loan be based on the borrower's ability to repay. The ordinance also prohibits the financing of credit insurance as part of a "high cost" refinance home loan transaction and permits prepayment penalties only during the first 24 months following the date of the promissory note.

In order to identify "high cost" loans subject to these substantive protections, the ordinance includes an APR rate trigger of 6% above the yield on comparable Treasury securities and a "points and fees" trigger of 4% of the total loan amount.

The ordinance provides for civil enforcement and remedies by "an aggrieved party." It does not authorize the City Attorney's Office to enforce the ordinance by criminal prosecution.

IV. ACORN's Proposed Model Ordinance

The proposed model ordinance provided by ACORN (A copy is attached) appears to be modeled, in part, after the Oakland ordinance. The model ordinance also is structured to provide protection for all home loans and additional protections for those loans that are deemed "high cost" based on the triggers. The rate trigger is met when the APR on a first lien loan exceeds by more than 6 percentage points the rate on comparable Treasury securities (8% for junior liens). The points and fees trigger is met when the points and fees equal or exceed 3% of the principal amount or $900, whichever is greater. The ordinance prohibits any loan that violates existing state or federal law related to residential mortgage lending.

The substantive protections extended to "high cost" loans include the following:

- no financing of credit insurance as part of the bona fide principal amount
- no refinancing without borrower benefit
- no lending without regard to repayment ability
- no financing of excessive points and fees
- no "high cost" lending without counseling
- no increased interest rate upon default
- no advance payments
- no prepayment penalties
- no balloon payments
- no payments directly to contractors
- no call provisions
- no refinancing of special low-rate mortgages
- required oral and written notice of "high cost" loan

The ordinance provides for civil enforcement and remedies by an aggrieved borrower and/or the City Attorney. It also provides for criminal liability for any person who willfully violates the ordinance.

Finally, the model ordinance also contains educational and proprietary provisions. It prohibits the City from doing business with predatory lending entities or their affiliates, including a ban on contracting, depositing funds, or investing in a predatory lender or affiliate. With regard to education, the ordinance provides that all funds recovered from enforcement shall be dedicated to the funding of a comprehensive program of neighborhood based and City-wide anti-predatory lending education, outreach prevention, and counseling.

V. Current Legislative Initiatives

A. Federal Legislation

U.S. Rep. Bob Ney (R-Ohio), a member of the House Financial Services Committee, introduced a bill (H.B. 833) on February 13, 2003, entitled the "Responsible Lending Act." The bill, which is co-sponsored by Rep. Ken Lucas (D-Ky.), would preempt all state and local laws aimed at curbing predatory lending practices. The comprehensive federal preemption provision of the bill expressly states that it "shall pre-empt any law" of any state or political subdivision that regulates any type of mortgage, "irrespective of whether such laws afford additional substantive protections."

The Ney bill maintains the same APR rate triggers as current federal law (TILA/HOEPA) – 8% above comparable Treasury security yield for first lien loans and 10% for junior liens. However, it lowers the "points and fees" trigger from 8% of the loan amount to 6%.

Under the bill, a federal watchdog board would be formed to oversee housing counseling programs and establish a national database for mortgage originators. It would also set uniform national standards and regulations for mortgage lenders and states would be required to implement corresponding license requirements for all mortgage brokers.

On March 10, 2003, the bill was referred to both the Subcommittee on Financial Institutions and Consumer Credit and the Subcommittee on Housing and Community Opportunity.

B. State Legislation

On February 3, 2003, Sen. Sandy Pappas (DFL-St. Paul) introduced S.F. 244, the "Home Loan Protection Act", designed to curb predatory lending practices. The bill would prohibit, among other practices, lending without regard to the ability to repay, providing "high cost" loans without counseling, providing financing for credit insurance and points and fees, encouraging borrowers to default on existing credit card debt and mortgages, and negative amortization loans. These substantive protections would be triggered by an APR threshold of 6% above comparable Treasury securities for first liens and 8% for junior liens. At the current rate of 5%, therefore, a first mortgage would be deemed "high cost" if the interest rate exceeded 11%. The "points and fees" threshold would be met by fees equal to or exceeding 3% of the total loan amount.

The bill was referred to the Commerce and Utilities Committee. There is no corresponding House bill.

MUNICIPAL AUTHORITY

I. Charter Authority

Minneapolis is a home rule charter city. The Charter of the City of Minneapolis, Chapter 4, § 5, provides as follows:

> The City Council shall have full power and authority to make, ordain, publish, enforce, alter, amend or repeal all such ordinances for the government and good order of the City... as it shall deem expedient and in any by the same to declare and impose penalties and punishments, and enforce the same against any person or persons who may violate the provisions of any ordinance, passed and ordained by it, and such ordinances are hereby declared to be and have the force of law.

This provision is known as the "general welfare" provision of the City Charter. Following the provision is an enumeration of the various businesses and professions and other activities that may be regulated and licensed. There is nothing in the specific listing of the businesses that may be regulated under Chapter 4, § 5, of the Charter to indicate that the City Council's powers extend to the banking industry or lending businesses. However, the Minnesota Supreme Court has held that the specific enumeration therein does not limit the things that may be regulated pursuant to the general welfare clause. *See* Crescent Oil Co. v. City of Minneapolis, 175 Minn. 276, 221 N.W. 6 (1928). The Court also held that a general welfare clause, such as that contained in the Minneapolis Charter, "is intended to make the powers of the council sufficiently expansive to enable them to meet and provide for new conditions as they arise." State v. Morrow, 175 Minn. 386, 387 (1928). A general welfare clause will be construed liberally to allow self-protection by the municipality. Mangold Midwest Co. v. Village of Richfield, 247 Minn. 347, 143 N.W.2d 813 (1966). The general welfare clause, therefore, would arguably give the City power to regulate targeted businesses whose activities adversely affect the welfare and good order of the City and its inhabitants.

II. Preemption

If a court were to determine that the City has authority to adopt a regulatory ordinance, the next issue would be whether state or federal law preempts it.

A. Federal Preemption

The doctrine of federal preemption provides that states or local governments may not pass laws inconsistent with federal law. There are three possible categories of federal preemption: (1) "express preemption," where a federal statute expressly prohibits state or local regulation; (2) "conflict preemption," where compliance with both federal law and the local law is impossible; and (3) "implied preemption," where the federal regulatory scheme is so pervasive that it is assumed to preclude enforcement of state or local laws on the same subject. *See* Cipollone v. Liggett Group, Inc., 505 U.S. 504 (1992).

Particularly relevant federal legislation in the residential mortgage lending area with respect to federal preemption includes the Truth in Lending Act (TILA) and the Home Ownership Equity Protection Act (HOEPA). TILA requires that lenders provide certain disclosures to borrowers in connection with mortgage loans, including the total amount financed, finance charge, and annual percentage rate. 15 U.S.C. § 1638(a). TILA also grants the borrower a qualified right of recision for loans secured by a principal residence, not including home purchase loans. 15 U.S.C. § 1635.

HOEPA subsequently amended TILA to prohibit certain predatory terms in "ultra-high-cost" loans. HOEPA's protections are triggered by loans at least 8 percentage points above the yield on Treasury securities of comparable maturity for first-lien loans or with points and fees comprising at least 8 percent of the loan amount. 15 U.S.C. § 1602(aa). The protections provided include additional disclosure requirements, limitations on prepayment penalties, a prohibition on higher interest rates after default, limitations on balloon payments, a prohibition on negative amortization, and certain restrictions on home improvement scams. 15 U.S.C. § 1639.

Congress has not expressly or impliedly occupied the entire field of predatory lending regulation with either piece of legislation. In addition, the inclusion of an express federal preemption provision in H.B. 833 supports the conclusion that Congress has not previously preempt state or local law with respect to predatory lending. As long as a proposed ordinance would operate within the scheme and scope of federal law and not create an impediment to the achievement of the goals and purposes of any federal action, a court may not find it preempted.

B. State Preemption

Even if passed pursuant to legitimate municipal authority and not preempted by federal law, state law may preempt a municipal ordinance. State preemption occurs in four situations: (1) when a conflict exists between a state statute and a local ordinance; (2) where the legislature intended to occupy the field; (3) where the statutory scheme includes implicit preemption of the subject matter; and (4) where the legislature explicitly preempts the field. See Mangold Midwest Co. v. Village of Richfield 247 Minn. 347,143 N.W.2d 813 (1966).

Conflict preemption generally occurs when a statute and an ordinance contain "express or implied terms that are irreconcilable." Id. A conflict exists if an ordinance "permits what the statute forbids" or if the ordinance "forbids what the statute expressly permits." Id. No conflict exists, however, if the ordinance is simply complementary or in furtherance of the statute. Id. Further, there is no conflict when a city or other local government entity adds regulations that provide for greater consequences than those covered by the state. City of Duluth v. Evans, 158 Minn. 450, 197 N.W. 737 (1924).

Local ordinances also may be preempted where the legislature has fully and completely covered a subject matter, indicated that the field is solely of state concern, or that the subject matter itself is such that local regulation would have an unreasonably adverse effect on the state population. Mangold. This can fairly be divided into two distinct areas: occupation of the field or preemption by implication. Occupation of the field exists where the subject matter has been fully and completely legislated on the state level, leaving no room for local governments to operate. Implied preemption occurs where the scheme itself, or some other language by the legislature implies that local action would be unwanted and against the goals of the legislation. The legislature could do so by stating that the legislation is being passed in order to bring regularity or consistency to a subject matter.

Minnesota law includes a number of provisions that attempt to address certain lending practices. Minn. Stat., § 58.13 (2002) prescribes certain "standards of conduct" for any person acting as a "residential mortgage originator or servicer" and prohibits various misleading and deceptive actions with regard to mortgage lending. These prohibitions include extending a loan without regard to the borrower's ability to repay. The statute does not indicate, however, how or if the "standards of conduct" are enforced. Minn. Stat., § 58.137 (2002), which took effect on January 1, 2003, regulates interest, points, fees, and other charges in home mortgages, including prepayment penalties and lender fees. It also includes a verbal and written disclosure requirement for prepayment penalties in certain circumstances. Minn. Stat., § 58.137, subd. 2 (2002).

Although these state statutes address certain aspects of residential mortgage lending, it does not appear that the state has taken a patterned or comprehensive approach to the issue. This might indicate that the field of residential mortgage lending is not solely a matter of statewide concern. Local government units tend to be given more leeway in preemption issues where the matter primarily affects the local populace. American Dog Owners Ass'n. Inc., v. City of Minneapolis, 453 N.W.2d 69, 72 (Minn. Ct. App. 1990). In American Dog Owners, the court held that the City had a particular interest in taking appropriate measures for animal control. Id.

The court did not imply that there was no interest on the state level in animal control, but rather that the City of Minneapolis had a particular interest that warranted further protection and regulation. Id. This case illustrates the importance of including Minneapolis-specific findings regarding predatory lending in any regulatory ordinance, which would support the contention that the issue is one of particular local interest and urgency.

POLICY OPTIONS

I. Consumer Education

There are no legal constraints on the authority of the City to develop or support a public relations educational campaign. There is very little risk of a lawsuit because an ordinance is not required. In addition, an educational campaign can be developed and implemented with input from all interested parties, including governmental entities, the mortgage industry, and community-based nonprofit organizations. The likelihood of legal challenge is further decreased by this inclusive participation because competing interests are able to voice their concerns during the developmental phase and must often cooperate with each other after implementation.

A disadvantage to consumer education initiatives is that they put the onus on consumers to avoid predatory loan tactics rather than focusing on the predatory lenders themselves. In addition, there is no guarantee that targeted consumers will hear and understand the message. These individuals are often not actively in the market for loans to begin with and; therefore, the campaign message may simply be ignored. Effectively reaching these individuals may ultimately prove labor-intensive and costly. Finally, it must be kept in mind that educational outreach of any kind will require the commitment of both personnel and monetary resources. In order to stage an effective campaign, there must be a permanent contact person or entity within the City.

In summary, educational initiatives could include:

- Development of City efforts to educate and counsel borrowers on predatory lending practices through print and broadcast media sources
- Development of an educational and counseling pilot project to assess the scope of the problem and propose solutions
- Cooperation with any currently operational educational efforts by local entities, which may include the Family Housing Fund ("Don't Borrow Trouble" campaign) and ACORN
- Provision of a contact agency or consumer hotline in several languages that answers questions and provides referrals
- Advocacy for stronger state and federal anti-predatory lending legislation and regulations

II. Proprietary Policy

Proprietary policies can include a requirement that banks that seek City business certify via affidavit that neither they nor their affiliates engage in predatory lending practices. The City also could require banks to sign a "best practices" agreement that commits the bank not to engage in various predatory lending practices. If the City adopted a proprietary policy, a lawsuit would be a distinct possibility.

The Minneapolis City Charter and Minneapolis Code of Ordinances provides required criteria governing the selection of depositories by the City Council. Charter Chapter 5, § 27, mandates that the City Council "at the beginning of each calendar year, and from time to time as may be necessary, designate or redesignate, so far as consistent with the best interest of the city, sufficient depositories . . ." The City Council is to evaluate the "best interest" of the City by considering specific criteria outlined in MCO, Chapter 16.10(b). Although not an exclusive list, these criteria include:

- The willingness of the depository institution to make adequate public disclosure of its lending and investment practices.

- The performance of the depository institutions in providing mortgage and home improvement loans to Minneapolis residents.

- The performance of the depository in helping meet the credit needs of its entire community, including low-and-moderate-income neighborhoods, consistent with safe and sound operation of the bank.

- The past participation by any depository institution in any program for the betterment of Minneapolis.

- Current commitments by depository institutions to participate in public supported housing and economic development programs including those sponsored by the Minneapolis Community Development Agency, neighborhood organizations and local nonprofit developers.

- The performance of the depository institutions in providing student loans to Minneapolis residents.

MCO, Chapter 16.110 also includes mandatory disclosures by financial institutions concerning their "lending policies and practices." MCO, Chapter 16.110(A)(2).

In evaluating potential depositories according to these criteria, the City Council could presumably consider evidence of a financial institution's predatory practices. This would require a codified definition of the practices that constitute "predatory" lending, which may prove difficult in light of the varying definitions across the country. Nevertheless, once a threshold is established, the above-stated criteria appear to allow City Council consideration of these defined practices.

As part of a proprietary policy, the City also could consider barring the award of a municipal contract to any entity associated with predatory lending practices. A municipality can require that a bid contain various desired specifications in order for it to be considered in the competitive bidding process. Bids for municipal contracts must substantially comply with all requirements regarding them contained in statutes, charter provisions, ordinances, and advertisements. Bud Johnson Construction Co., Inc. v. Metropolitan Transit Commission, 272 N.W.2d 31 (Minn. 1978). A bid that does not meet the RFP specifications can be rejected as a "nonresponsive" bid. Carl Bolander & Sons Co. v. City of Minneapolis, 451 N.W.2d 204 (Minn. 1990). As part of the bid specifications for municipal contracts, therefore, the City could require every bidder to submit an affidavit certifying that neither it, nor any of its affiliates, is a predatory lender.

In brief, proprietary policies could include:

- Certification requirement and/or "best practices" agreement from financial institutions desiring to conduct business with City attesting to their disassociation from predatory lenders
- City policy not to subordinate its first-time homebuyer and other mortgage assistance loans, if available, to predatory first loans
- City and redevelopment agency (MCDA) policy not to participate in any development projects in which a predatory lender, or a parent company of such lender, also participates
- Requirement of affidavit attesting to lack of predatory lending practices in bid specifications for municipal contracts

III. Regulatory Provision

Regulatory provisions, such as the model ordinance, seek to comprehensively address the issue of predatory lending by prohibiting certain mortgage lending practices in association with "high cost" loans. These provisions are the most susceptible to legal challenge and a lawsuit is a guarantee.

The Oakland anti-predatory lending ordinance and other ordinances modeled on it usually include the following regulatory protections:

- Limiting points and fees on junior mortgage loans
- Limiting prepayment penalties
- Prohibiting single premium credit insurance
- Prohibiting negative amortization loans
- Prohibiting or eliminating balloon payment loans
- Limiting loan refinancing only to those that benefit the borrower
- Limiting or prohibiting mandatory arbitration clauses
- Limiting direct loan payments to contractors

The Oakland ordinance, which contained these policies, survived a state law preemption challenge. California state law, however, is different from Minnesota state law.

In summary, regulatory initiatives could include:

- Ordinance providing various protections on the terms of high cost home loans
- Mandatory borrower counseling on high cost loans
- Expansion of required disclosures by lenders regarding loans made within the City
- Extension of the loan rescission period

CONCLUSION

There is a wide range of policy options available to address the issue of predatory lending, ranging from educational programs to formal legislation. Each of the three main categories of initiatives can be pursued in isolation or at the same time. Depending on the policy pursued, several legal issues may arise. Once the City Council determines whether it will pursue a specific course of action, therefore, further legal analysis will need to be conducted.

If you need additional information or wish to discuss this memorandum in greater detail, please contact me at (612) 673-2192.

Attachment

cc: John Moir, City Coordinator