

Prepayment penalties, excessive fees, and other abuses

A. Exorbitant fees include any fees greater than 5% of the loan amount plus any lender or third-party fees charged a borrower who receives no net tangible benefit in a refinancing transaction. The limit on fees, as defined by HOEPA, should be 3% of the loan amount (4% for FHA/VA loans). By contrast, conventional borrowers pay, on average, a 1.1% origination fee (*Quantifying the Economic Cost of Predatory Lending*, 2001, p. 7.)

B. The subprime sector should provide borrowers a bridge to conventional financing as soon as the borrower is ready to make the transition. However, prepayment penalties are expressly designed to prevent this from happening. 80% of subprime loans have prepayment penalties, compared with only 2% of loans in the competitive, more transparent conventional market. (*Quantifying the Economic Cost of Predatory Lending*, 2001, pp. 7-8, quoting *Mortgage Marketplace*, 1999.)

C. In the Model Act, all fees charged to close the loan are included [in the 3% limit], regardless of whether they are paid to a third party. This provision is important because it is usually difficult to determine if the third-party is an affiliate, and the cost of these fees is often very high and a significant cause of equity stripping. Also, by including third-party fees in the definition of points and fees, the lender has a significant incentive to keep the costs of these fees low. (*Home Loan Protection Act: A Model State Statute*, p.11.)

D. The [AARP] Model Act proposes limitations and prohibitions on several practices in connection with high-cost loans:

- a. No financing of fees or charges
- b. Prepayment penalties limited.
- c. No balloon payment [no more than twice as large as the average of earlier scheduled payments]
- d. No negative amortization
- e. No increased interest rate [after default]
- f. No advance payments [no more than 2 periodic payments paid in advance from loan proceeds]
- g. No mandatory arbitration clause
- h. No lending without due regard to repayment ability
- i. No lending without homeownership counseling
- j. Home-improvement contractor payment procedure limitations
- k. No loan modification or deferral fees
- l. Restrictions on foreclosure proceedings

(*Home Loan Protection Act: A Model State Statute*, p.20-21.)

E. *Stolen Wealth* showed that statewide most subprime borrowers are stuck with loans with unjustifiable and onerous provisions, such as excessively high points and fees, and prepayment penalty provisions, which lock borrowers into predatory loans. (H&CD Hearing, 4/17/02, p. 12, lines 1-4.)

F. That same report also found that statewide, most borrowers were subject to “bait and switch” tactics, and saw key loan terms suddenly change for the worse at loan closing. (H&CD Hearing, 4/17/02, p. 12, lines 4-5.)

G. The California Reinvestment Committee's (CRC) 2000 Report, *Stolen Wealth*, also found that statewide, one third of homeowners surveyed felt that they were victims of predatory lending; CRC independent analysis similarly found that over a third of the borrowers surveyed may have been predatory lending victims. (H&CD Hearing, 4/17/02, p. 12, lines 5-9.)

H. Pre-payment penalties should be restricted beyond the current HOEPA standards (excessive prepayment penalties may lock a borrower into a higher interest rate, even when the borrower qualifies for a better loan, and may be unwarranted if the penalties bear little relationship to legitimate costs incurred by the lender). (*Curbing Predatory Home Mortgage Lending*, p. 92, p.95.)

I. Norma Garcia, senior attorney for Consumer's Union, testified at the H&CD hearing on 9/12/02. In a follow up conversation with Sally Richman of LAHD, she offered the following on the topic of prepayment penalties. "It is important to have a limit on the percentage that can be charged in a prepayment penalty as well as a limitation on the time period. Oakland limits the amount of prepayment penalties on loans generally, and bans them on high-cost loans altogether."

J. Lena Jones, victim, was not informed of the prepayment penalties when she took out her loan, which amounted to a five year prepayment penalty of \$2,400 (H&CD Hearing, 2/21/02, p. 13, lines 7 and 16.)

K. Lillian Gil, victim, received a predatory loan with a \$9,000 dollar pre-payment penalty (H&CD Hearing, 2/21/02, p. 16, lines 25-26, p. 17, line 24 and p. 18, line 1.)

L. Ben Diehl, attorney for Bet Tzedek Legal Services, stated that senior citizens have called him about refinance opportunities, but the prepayment penalties on their current loans are so high they could not afford the new loan, even with the current market's lower interest rates. He stated that the State Law, AB 489, has very weak limits on prepayment penalties that need to be made stronger with a Los Angeles ordinance (H&CD Hearing, 2/21/02, p. 25, lines 14-16, p. 26, lines 1-5 and lines 5-7.)

M. Annica Gorham, of ACORN, reporting from the ACORN study, gave an example of a predatory lender that in 2000 routinely charged 7% of the loan in points and fees, which is 3 points above the threshold of 4% in the Council Motion, and routinely charged a prepayment penalty equal to six month interest. (H&CD Hearing, 2/21/02, p. 34, lines 4-8.)

N. Barbara Jones, Staff Attorney in the Consumer Unit of the Legal Aid Foundation of Los Angeles, LAFLA, testified to the problem of home improvement contractors who work with predatory lenders. Many of LAFLA's clients are disabled seniors who are homebound. Home improvement contractors show up at their home and promise low rate loans to paint the house, fix the roof, or heater. However the homeowner then finds that the expected \$5,000 roof repair becomes a \$50,000 lien against their property. In the twelve years Barbara Jones has been an attorney at LAFLA, she has not seen any loan obtained by a senior citizen referred by a home improvement contractor that charged market rates. (H&CD Hearing, 4/17/02, p. 26, lines 11-12, lines 16-18, lines 23-25, and lines 11-13.)

O. Barbara Jones, Staff Attorney in the Consumer Unit of the Legal Aid Foundation of Los Angeles (LAFLA), testified that most loans to her senior clients include 8-12% points and fees, loan rates frequently exceed 11%, and many have prepayment penalties and balloon payments. (H&CD Hearing, 4/17/02, p. 27, lines 13-15)

P. Barbara Zeidman, of Fannie Mae, stated that broker loans with 5-7 points cannot be defended by Fannie Mae, and is not a loan that Fannie Mae will purchase. (H&CD Hearing, 4/17/02, p. 35 lines 10-12)

Q. Moises Vasquez, a private attorney with offices in Santa Barbara and Whittier, lives in Eagle Rock and often has community members coming to him who have been victimized by predatory loans. For example, they refinance their homes without realizing the 6% loan was only a six-month introductory interest rate. (H&CD Hearing, 4/17/02, p. 39, lines 9-14 and lines 18-21)

R. Moises Vasquez, private attorney, testified to “bait and switch” tactics that occur where last minute documents are given to the borrower to be signed at the close of escrow – including an example with his father. (H&CD Hearing, 4/17/02, p. 40, lines 2-5)

S. Salvador Gil, victim, Spanish-speaker, stated that his predatory loan has an interest rate of 11.7% with a prepayment penalty of \$9,000 (H&CD Hearing, 4/17/02, p. 42, lines 5-6 and lines 9-10)

T. Therese Brown, victim, ACORN member, testified that predatory loan fees stripped away \$18,000 of her home’s equity; various late fees, called “interest shortages” didn’t show up in her statements; and, the amount she owed on her house increased from \$162,000 in 1999 to over \$280,000 today. (H&CD Hearing, 9/12/02, p. 13, lines 23-26 and p.14, lines 1-7)

U. Ron Willman, victim, testified that the prepayment penalty on his loan was for nearly six months interest. It cost him \$15,000 on top of the \$20,000 in the predatory loan’s original fees, to get out of the 12% interest rate. His monthly payments were over \$2,800. (H&CD Hearing, 9/12/02, p. 21, lines 18-22)

V. John Sorensen, who spoke for his wife, Linda, a Mandarin-speaker, testified that her predatory loan came with bait-and-switch tactics on the interest rates – she was promised an 8% mortgage rate which turned out to be a 12.49% mortgage rate. There was a five-year 5% prepayment penalty on her loan, and there was a high closing cost, about \$15,000, on the \$180,000 loan. She was shown a proposal showing tremendous monthly savings over the reduced 30-year to 17-year mortgage, using their “easy-pay” plan. A last minute second loan turned into a line of credit and carried an interest rate of 22%. They failed to provide her with a good-faith estimate for both loans. (H&CD Hearing, 9/12/02, p. 24) (H&CD Hearing, 9/12/02, p. 24, lines 19-21, lines 25-26, p. 25, lines 1-12)