



Mortgage Banking Commentary

APRIL 6, 2001

The City of Philadelphia's Predatory Lending Bill Passed

The City of Philadelphia passed a predatory lending ordinance on April 6, 2001 that will take effect 90 days after the mayor signs it. The mayor can sign the bill anytime until April 26, 2001. Any lender or broker making loans within the City of Philadelphia should pay particular attention to this ordinance, as the penalties are draconian.

Who Must Comply With the Ordinance

The ordinance enacts a new chapter 9-2400 of the Philadelphia Code entitled "Prohibition Against Predatory Lending" that prohibits a person from making, issuing, or arranging a "predatory loan" or assisting others in doing so.

Triggers

A "predatory loan" is a (i) "high cost loan" or a "threshold loan" that (ii) contains any of the "Prohibited Acts and Practices," set forth below. A "threshold loan" or a "high cost loan" is a loan that meets the following criteria:

1. Loan is secured by residential real property located within the City of Philadelphia;
2. Loan is for a consumer purpose;
3. The property is improved with a 1-4 family dwelling, condominium unit, or cooperative unit;
4. Loan amount is \$150,000 or less; and
5. At any time during the life of the loan the APR exceeds by at least 4½ percentage points but less than 6½ percentage points in the case of first-lien loan (or by at least 6½ percentage points but less than 8 percentage points for a junior mortgage) the yield on US Treasury Securities having comparable periods of maturity as of the fifteenth day of the month immediately preceding the month in which the loan application is received by the lender; and

A “high cost loan” has all of the attributes of a “threshold loan” plus the following additional criteria must be satisfied:

6. (a) At any time during the life of the loan the APR equals or exceeds by more than 6½ percentage points for a first-lien loan (8 percentage points for a junior loan) the yield on US Treasury Securities having comparable periods of maturity as of the fifteenth day of the month immediately preceding the month in which the loan application is received by the lender; or
(b) the total points and fees financed in such loan equal or exceed (a) 4 percentage points of the total loan amount less the amount of such points and fees if the loan amount is \$16,000 or greater; or (b) \$800 if the loan amount is less than \$16,000.

Note that a “threshold loan” or “high cost loan” could be a first- or subordinate-lien, open- or closed-end loan, including purchase-money or refinance. As noted above, the APR must be below the threshold rate at all terms during the life of the loan. Thus, for an ARM loan, a lender must look beyond any “teaser” rate, and determine the fully indexed rate. Under the “Points and Fees” Test, the critical issue is the amount of points and fees financed, rather than the total points and fees charged on the loan. Finally, note that loans in excess of \$150,000 are outside the scope of the ordinance.

Prohibited Acts and Practices

As indicated above, a “predatory loan” is a “threshold loan” or “high cost loan” loan that was made under circumstances that involve any of the following acts or practices, or involve any of the following loan terms:

1. Fraudulent or deceptive acts and practices, including fraudulent or deceptive marketing and sales efforts to sell “high cost loans”;
2. Loan Flipping, which is the making of a “threshold loan” or “high cost loan” to a borrower that refinances an existing loan secured by residential property in the City of Philadelphia when any of the following characteristics exist: (i) more than 50% of the prior debt refinanced bears a lower interest rate than the new loan unless the advisability and appropriateness of the new loan is certified by a counselor employed by a housing counselor agency approved by the Office of Housing and Community Development; (ii) the borrower’s payment of prepaid finance charges and closing costs reduces the interest rate such that it will take more than 5 years for the borrower to recoup the transaction costs; or (iii) refinancing a special mortgage originated, subsidized or guaranteed by or through a state, tribal or local government, or nonprofit organization, which bears either a below-market interest rate, or has nonstandard payment terms beneficial to the borrower, such as payments that vary with income, are limited to a percentage of income, or where no payments are required under specified conditions, and where, as a result of the refinancing, the borrower will lose one or more of the benefits of the special mortgage;
3. Balloon payments – a loan that contains a scheduled payment that is more than twice as large as the average of earlier scheduled payments or which contains a provision that gives the lender, in its sole discretion, the right to accelerate the indebtedness in the absence of the default of the borrower;
4. Negative amortization;
5. Prepayment penalties;

6. Financing of points and fees in excess of 4 percentage points of the total loan amount less the amount of such points and fees if the loan amount is \$16,000 or greater, or \$800 if the loan amount is less than \$16,000;
7. Increased interest rate after default;
8. Advance payments in which more than two periodic payments required under the loan are consolidated and paid in advance from the loan proceeds provided to the borrower other than a loan issued by or guaranteed by the Commonwealth of Pennsylvania;
9. Modification or deferral fees;
10. Mandatory arbitration;
11. Financing of any credit life, credit disability, credit unemployment or any other life or health insurance, directly or indirectly, into one or more “high cost loans”;
12. Lending without home loan counseling - the making, issuing or arranging of any “threshold loan” or “high cost loan,” or assisting others in doing so is prohibited without first receiving notice from a counselor employed by a housing counseling agency approved by the Office of Housing and Community Development that the borrower has received counseling on the advisability of the loan transaction and the appropriateness of the loan; or
13. Lending without due regard to repayment - for borrowers whose reported income is no greater than 120% of the median family income for the Philadelphia Metropolitan Statistical Area, it is prohibited for a lender to make, issue or originate any “threshold loan” or “high cost loan” if the lender does not reasonably believe at the time the loan is consummated that the borrower(s) will be able to make the scheduled payments to repay the obligation based upon a consideration of their current and expected income, current obligations, employment status, and other financial resources (other than the borrower’s equity in the dwelling which secures repayment of the loan).

Exemptions

The prohibition on making, issuing or arranging “predatory loans”, or assisting others in doing so, does not apply with respect to a licensed lender (presumably to include lenders licensed under the Mortgage Bankers and Brokers Act, the Secondary Mortgage Loans Act or Consumer Discount Company Act) solely because of the presence of a loan term allowing for a balloon payment, negative amortization, or prepayment penalty if the loan is made pursuant to the Alternative Mortgage Transactions Parity Act (21 USC 3803) and such loan is not otherwise a “predatory loan”. Moreover, the prohibition does not apply in the case of a loan made pursuant to the Secondary Mortgage Loan Act or the Consumer Discount Company Act solely because the loan contains a provision authorized by the respective Act, provided that the loan is not otherwise a “predatory loan.”

A partial exemption from the ordinance is available for a state-chartered bank, bank and trust company, savings bank, private bank or national bank, a state or federally chartered savings and loan association, a federally chartered savings bank or a state or federally chartered credit union. This exemption expressly does not extend to affiliates of any of the above-mentioned entities.

The financial institutions listed above are exempt from any of the following four limitations: (i) making, issuing or arranging “predatory loan”, or assisting others in doing so; (ii) lending without home loan counseling; (iii) lending without due regard to repayment; and (iv) payments to home improvement contractor.

Obligations Imposed by the Ordinance

Among other provisions, the ordinance requires a certification of compliance to be recorded with the mortgage, restricts payments to home improvement contractors and imposes limitations on awarding contracts with the City of Philadelphia.

Certification of Compliance

Of significance, a certification of compliance appears to be required with every Philadelphia mortgage, not just a “predatory loan,” “high cost loan” or “threshold loan.” Moreover, there are no exemptions from this provision. Thus, this requirement appears to apply to every mortgage loan made by any lender in the City of Philadelphia.

Specifically, at time of recording a mortgage the lender and, if applicable, the broker must submit a certification of compliance to be recorded along with the mortgage instrument and deed. The certification, in the form set forth in the ordinance and in compliance with formatting requirements from the Philadelphia Department of Records, must indicate (i) whether the loan is a first- or subordinate-lien, (ii) whether it is purchase money or non-purchase money; (iii) the APR; (iv) the applicable Treasury Rate; (v) the total loan amount; (vi) the total amount of points and fees financed; (vii) the percentage of points and fees financed; (viii) whether or not the mortgage is a “high cost loan” or a “threshold loan”; (ix) whether the borrower received housing counseling and whether a certification of housing counseling is attached; and (x) whether the mortgage violates any provisions of the ordinance (Chapter 9-2400 of the Philadelphia Code). The certification also must be signed and dated by the mortgage lender or broker and include the entities’ address, telephone number and Philadelphia Business Privilege License.

Payments to Home Improvement Contractors

Among other provisions, the ordinance restricts payments to home improvement contractors. First, no more than 25% of the total proceeds of the high cost loan may be disbursed at time of closing. Second, all home improvement disbursements made from the loan proceeds must be made (i) payable to the borrower or (ii) at the election of the borrower, through a third-party escrow agent in accordance with the terms established in a written agreement signed by the borrower and the home improvement contractor prior to disbursement.

Contracts/Licensing with the City of Philadelphia

Similar to the Chicago ordinance that went into effect in November, 2000, the ordinance prohibits persons and business entities from being awarded a contract with the City of Philadelphia or a City agency if the person or business entity or any of its affiliates is a high cost lender or a predatory lender. In fact, every contract with the City must contain a provision requiring that the person or business entity with which the City is contracting certify that neither the person or business entity, nor any of its affiliates, is a high cost lender or a predatory lender. A “predatory lender” or a “high cost lender” is a business entity that, through itself and/or an affiliate has made, issued or arranged, or assisted others in so doing, within any 12 month period “predatory loans” or “high cost loans”, respectively, that comprise either: (i) 5% of the total annual number of loans made, issued or arranged or 5% of the total annual number of loans which the business entity has assisted others in so making, issuing or arranging; or (ii) 10 individual loans or less.

Aside from enacting this new chapter, the ordinance also would amend certain sections of Philadelphia's Licenses, City depository and Investment provisions. Of note is that each City depository will be required to provide the City with an affidavit certifying that neither it, nor any of its affiliates, is, and none will become a high cost lender or a predatory lender. Furthermore, City depositories will be required to provide the City with predatory lending information, which shall include, but is not limited to the market share ratio of the depository's refinance loans in minority census tracts in Philadelphia to non minority census tracts in Philadelphia, and the market share ratio of the depository's refinance loans in low and moderate income census tracts in Philadelphia to middle and upper income census tracts, and considering each affiliate separately in calculations.

Penalties Imposed by the Ordinance

Violations made under the ordinance are steep and could include (i) monetary fines for any person who violates the ordinance of not less than \$100 nor more than \$300 per day of violation; (ii) loss of city contracts; (iii) loss of business privilege license; and (iv) forfeiture of government funded housing assistance. Each day in which a borrower is assessed with interest on the principal loan amount of a "predatory loan" constitutes a separate violation of the ordinance.

The ordinance also empowers individuals with a private right of action if such individual became obligated on a "predatory loan."

The Director of the Office of Housing and Community Development is charged with enforcing the ordinance. The Director will maintain a listing of those business entities which have been determined to meet the definition of high cost lender and predatory lender and shall regularly distribute this listing to all City agencies and City-related agencies. This listing will be made available to the public free of charge by request of the Office of Housing and Community Development.

Please contact me at 202-778-9314 or nweissgold@kl.com should you have any questions. Thank you.

MORTGAGE BANKING/CONSUMER FINANCE GROUP

Kirkpatrick & Lockhart LLP was founded in 1946, and, with more than 600 lawyers, is one of the thirty-five largest law firms in the United States. K&L attorneys are based in ten offices in key US cities – Boston, Dallas, Harrisburg, Los Angeles, Miami, Newark, New York, Pittsburgh, San Francisco, and Washington. Our firm represents a broad range of clients in a wide variety of matters, including corporate and securities, e-commerce, investment management, insurance coverage, financial institutions, mortgage banking and consumer finance, creditors' rights, intellectual property, tax, labor, environmental, antitrust, health care, and government contracts. More than half our attorneys are litigators. We litigate class actions on a range of financial issues, generally defending financial institutions, broker-dealers, public companies, and investment companies and their officers and directors against claims of violations of securities laws, consumer credit laws, and common law tort and contract claims. You can learn more about our firm by visiting our Internet website at www.kl.com.

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