SUMMARY OF DIVISION II, CONSUMER AFFAIRS COMMITTEE'S COMMENTS ON BILL 5-193

Bill 5-193, the Interest Rate Ceiling Amendment Act of 1983 proposes (1) a 24% interest rate ceiling on second mortgages (now 15%) and (2) repeal of the present restrictions on balloon payment notes secured by second mortgages.

The Division II, Consumer Affairs Committee endorses a 24% APR on second mortgages if consumers are adequately protected from sharp practices. The Committee endorses the following provisions already contained in the Bill: (1) regulation of business purpose loans secured by the business person's residence; (2) identification of unlawful trade practices.

The Committee proposes the following additional protections: (1) preservation of the borrower's defenses against subsequent assignees of second mortgage loans; (2) stating the interest rate ceiling in terms of annual percentage rate or actuarial method; (3) the D.C. Consumer Protection Procedures Act of 1976 should be amended so that it clearly is applicable to second mortgage loans; (4) the bill should not repeal the restrictions on balloon payment notes secured by second mortgages on real estate; and (5) the District should improve the present statute governing mortgage foreclosures by providing better notice of the homeowner's rights, regulating foreclosure costs; liberalizing redemption, and providing effective remedies for failure to follow the statute.

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CONSUMER AFFAIRS COMMITTEE
DIVISION II

June 7, 1983

Honorable John Wilson, Chairman
Committee of Finance & Revenue
Council of the District of Columbia
District Building
14th & E Streets, N.W.
Washington, D.C. 20004

Re: Interest Rate Ceiling Amendment Act of 1983, Bill 5-193 (May 4, 1983)

Dear Mr. Wilson:

On behalf of the Consumer Affairs Committee of the D.C. Bar, Division II, I am writing to express the Committee's opposition to Bill 4-193, "The Interest Rate Ceiling Amendment Act of 1983." The views expressed herein represent only those of Division II (Antitrust, Trade Regulation and Consumer Affairs) of the District of Columbia Bar and not those of the D.C. Bar or of its Board of Governors.

The bill proposes (1) a 24% APR interest rate ceiling on second mortgages and (2) deregulation of balloon payment notes. This Committee already stated its opposition to this Bill's predecessor, Bill 4-290, on June 17, 1982. These comments emphasized that greater consumer protection would be necessary if the Council deregulated second mortgage loans.

THE VIEWS EXPRESSED HEREIN REPRESENT ONLY THOSE OF DIVISION 2'S (ANTITRUST, TRADE REGULATION AND CONSUMER AFFAIRS) COMMITTEE ON CONSUMER AFFAIRS OF THE DISTRICT OF COLUMBIA BAR AND NOT THOSE OF THE D.C. BAR OR OF ITS BOARD OF GOVERNORS.

While Bill 5-193 does set an interest rate ceiling of 24% APR, this Committee still firmly believes that the Council must adopt significantly greater consumer protections than those provided. Necessitous second mortgage borrowers who obtain credit in today's market at the premium price of 24% APR and are required to sign balloon payment notes need effective protections to insure an adequate understanding of these dangerous terms.

The Committee recognizes and endorses the consumer protections which are a part of Bill 5-193. The provisions which should not be deleted from any future draft of this Bill are: the regulation of business loans secured by the businessperson's residence and the prohibition of business purpose affidavits, Section 3301(d)(2)(3); the regulation of unlawful trade practices, Sections 3310 and 3312.

Consumer protections which were present in an earlier version of this bill, Bill 4-509 (September 22, 1982), should be reinstated in this bill. The bill should preserve the borrower's defenses which arise at the outset of the transaction against assignment to a subsequent purchaser, especially with regard to junior mortgage notes. The single, uniform method of calculating the interest rate under this bill should be the actuarial method. Presently, Bill 5-193 would permit the undefined "simple interest" method to be used. This reference should be deleted from the bill. Finally, the definition of "interest" should include all charges required by the lender unless they are necessary expenses and reasonable in amount. Presently the bill restricts interest to "fees or charges retained by the lender" and, therefore, permits the lender to require the borrower to pay expenses to third parties without including those charges in the interest rate. This provision should be deleted from this bill.

This Committee's earlier comments on three topics are still viable. Bill 5-193 should (1) amend the Consumer Protection Procedures Act of 1976 to clarify its application to, and the Department of Consumer and Regulatory Affairs' jurisdiction over, real estate transactions rather than create a new set of unlawful trade practices within the usury statute; (2) permit only individual homeowners and federally regulated lenders to create balloon payment notes; and (3) adopt modern foreclosure procedures. Our specific recommendations concerning Bill 5-193 are as follows:

1. The District of Columbia Consumer Protection Procedures Act of 1976 must be amended to clarify that it was intended to cover real estate transactions.

The Consumer Protection Procedures Act of 1976 ("CPPA") is the District's central consumer protection statute. Until a

recent D.C. Court of Appeals decision, the principal authors and supporters of this law, including this Committee, the D.C. Office of Consumer Protection and the Corporation Counsel, see 1 Op. Corp. Counsel 485 (Feb. 17, 1977), thought that the Act applied to residential real estate sales, home improvement contracts and mortgage credit extended to consumers. Most analagous consumer protection statutes in other jurisdictions apply to real estate transactions. See 15 Clearinghouse Review 399 (Oct. 1981). However, the D.C. Court of Appeals has held that the CPPA's broad application to consumer goods and services is not sufficient indication of an intent to cover consumer transactions involving real estate.

CPPA's proscription of specific kinds of unfair and deceptive practices offers essential and basic relief to consumers subjected to various forms of misrepresentation. Its identification of indicia of unconscionability makes its application to residential second mortgages absolutely vital if creditors are permitted to require necessitous borrowers to sign balloon payment notes and pay interest rates as high as 24% APR. Specifically, the CPPA provides that it is an unlawful trade practice for any person to:

> make or enforce unconscionable terms or provisions of sales or leases; in applying this subsection, consideration shall be given to the following, and other factors;
>
> (1) knowledge by the person at the time credit sales are consummated that there was no reasonable probability of payment in full of the obligation by the consumer;
>
> (2) knowledge by the person at the time of the sale or lease of the inability of the consumer to receive substantial benefits from the property or services sold or leased;
>
> (3) gross disparity between the price of the property or services sold or leased and the value of the property or services measured by the price at which similar property or services are readily obtainable in transactions by like buyers or lessees;
>
> (4) that the person contracted for or received separate charges for insurance with respect to credit sales with the effect of making the sale, considered as a whole, unconscionable;

(5) that the person has knowingly taken advantage of the inability of the consumer reasonably to protect his interests by reasons of age, physical or mental infirmities, ignorance, or similar factors. D.C. Code 1981 §28-3904(r).

Without such specific guidance for the courts, consumers have found it exceedingly difficult to establish a claim or defense of unconscionability. This guidance is required when creditors may legally charge 24% APR and require balloon payment notes. Also, borrowers, who are the victims of high interest rates and balloon notes, are not attractive clients for most attorneys. These consumers must be afforded free access to complaint resolution which is provided by the Department of Consumer and Regulatory Affairs under CPPA.

Therefore, we recommend that the Council ensure that consumer real estate sales, home improvement contracts and mortgage credit be included within the scope of the CPPA. This will require amendment of the definition of the covered "goods and services." D.C. Code 1981 §28-3901(a)(7). We also believe that subsection (3) above, §28-3904(r), should be amended to clarify that "price" includes "interest and credit charges." A parenthetical phrase to this effect should be added at the end of subsection (3).

2. The Council should maintain the prohibition against the taking of a balloon payment note in connection with second mortgage credit, except by federally regulated lenders and owner-occupant sellers.

Bill 5-193 would permit any creditor to take a balloon payment note in connection with second mortgage credit. From August 1, 1974 to November 20, 1979 the usury statute prohibited any lender from requiring a balloon payment note if the interest rate charged exceeded 8% APR. D.C. Reg. 74-21, 21 D.C. Reg. 285. These protections were imposed because experience in the District demonstrates that speculative second mortgage balloon notes cause the displacement of low and moderate income homeowners.

Since November 20, 1979 only owner-occupant sellers and federally regulated lenders have been permitted to create balloon payment notes. D.C. Code 1981 §28-3301(c)(1). This narrow exception to the prohibition of balloon payments was created because these creditors do not create balloon payment notes with the intention of defrauding and displacing homeowners. There is no evidence that suddenly a larger category of creditors can be trusted with this dangerously speculative feature. Bill 5-193 should maintain the present statutory language which prohibits the creation of second mortgage balloon payment notes by all

creditors except howeowner-sellers and federally regulated lenders.

3. The Council should review and improve the foreclosure laws of the District of Columbia.

Second mortgages involve the inherent possibility of foreclosure and loss of the borrower's residence. When creditors are permitted to charge 24% APRs in today's market and create balloon payment notes, the likelihood of foreclosure increases substantially. We recommend that the Council adopt (1) a detailed foreclosure notice, like that required by the Uniform Land Transaction Act; (2) a procedure which allows a homeowner to redeem his or her home by catching up on their payments and paying the lender's costs; (3) regulations which govern foreclosure costs (the Washington Post has a virtual monopoly on advertising foreclosure sales) and (4) effective remedies which will insure that lenders abide by these foreclosure procedures. Although this recommended legislation would permit foreclosure by private sale without judicial intervention, it would provide vital rights for the borrower which are not contained in existing District law.

Sincerely,

CAROL A. COWGILL
Chairperson

Roger K. Davis
Russell B. Kinner

cc: Councilmembers

Russell A. Smith
Secretary to the Council