New Jersey Law Journal

VOL. CLXXV – NO. 4 – INDEX 267 JANUARY 26, 2004 ESTABLISHED 1878

Commentary

Hold the Line Against Diluting Anti-Predatory Lending Law

By Baher Azmy and David Reiss

Last month, the New Jersey Legislature held off an attempt by certain elements of the lending industry to eviscerate the recently enacted Home Ownership Security Act, a law that put into place important protections for homeowners applying for mortgages.

Those same elements, however, are regrouping as the new legislative session begins, hoping to take another swipe at the act. Legislators should oppose this assault, because the measure maintains a good balance between reducing mortgage abuses and preserving a healthy residential mortgage market.

Signed last May by Gov. James McGreevey, the act had substantial support from Democrats, Republicans, a broad coalition of consumer-advocacy organizations and lending industry representatives. It was designed to control the increasingly pervasive problem of predatory lending, where unscrupulous mortgage brokers and lenders, often through fraud and deception, extend credit at outrageously disadvantageous terms to trap borrowers in a cycle of debt and foreclosure.

Predatory lenders, who represent a small percentage of the market, have managed to wring enormous profits from New Jersey's most vulnerable borrowers and, as studies have demonstrated, have left predominantly minority, low-income and elderly communities with trails of foreclosed and abandoned homes. This tragedy is compounded by the victims' lack of awareness that they are eligible for loans at far better terms.

We have undertaken a detailed study, soon to be published in the *Rutgers Law Journal*, of the Home Ownership Security Act. Our article, while acknowledging some minor ambiguities in the legislation, finds that it should achieve its intended effects of reducing predatory lending and protecting access to credit.

The act does this by designating certain practices as abusive where they have little or no market justification when made in connection with already expensive residential mortgage loans and where they cause an unreasonable risk of foreclosure. Studies have found that these practices are pervasive in New Jersey.

Our article also describes how factions within the lending industry argued that a similar law in North Carolina would cut off credit to homeowners. The article also documents how those concerns were vastly overstated; recent studies of the North Carolina law suggest that it is a market-savvy solution to predatory lending.

Taken together, the North Carolina studies indicate that the implementation of predatory lending laws will result in some decline in subprime lending, but not enough to substantially affect the overall legitimate subprime marketplace. While New Jersey's act has not been in effect long enough to conduct an empirical study of its impact on the residential mortgage market, there is no reason to believe that the results will be materially different from those found in North Carolina.

Responsible market participants seem to agree. Before the act took effect last November, Standard & Poor's, Moody's and Fitch agreed to rate most New Jersey loans that fell within the act's scope, ensuring that New Jersey would continue to have a vibrant secondary mortgage market of benefit to consumers and lenders. Moreover, major secondary market purchasers of residential mortgages, such as Fannie Mae and Freddie Mac, have indicated they would continue to buy New Jersey mortgages.

While the support of such responsible market participants demonstrates that the act is a workable solution to the problem of predatory lending, certain subprime lenders are lobbying to change the law.

Their first attempt, in December, was marked by the introduction of bills that would significantly reduce the number of loans subject to the act's most protective provisions. Now there is a less extreme, but no less wrongheaded, attempt to weaken the act in

Azmy, an associate professor at Seton Hall University School of Law, teaches constitutional law and civil litigation. Reiss, an assistant professor at Brooklyn Law School, teaches real estate transactions and property.

This article is reprinted with permission from the JANUARY 26, 2004 issue of the *New Jersey Law Journal*. ©2004 ALM Properties, Inc. Further duplication without permission is prohibited. All rights reserved.

one important respect — by allowing lenders to profit through their affiliates in ways that they might not be able to profit directly themselves.

The act includes in the definition of "points and fees" certain fees (for items such as appraisals, inspections and credit reports) paid to the lender and its *affiliates*. The composition of "points and fees" is important because it is used to determine when a loan falls into the act's most heavily regulated category of loans.

The proposed amendment, known as the Household Bill, excludes from the definition certain fees paid to a lender's affiliates, decreasing the number of loans subject to the most protective provisions.

Those favoring this change will argue that the act must be watered down to prevent lenders from fleeing the New Jersey residential lending market.

This claim is false and highlights the potential profit some predatory lenders extract from such seemingly innocuous items as appraisals and credit reports that they generate or are generated by their corporate affiliates.

Our study concludes that many of the original industry concerns reflected overreactions and misunderstandings. This new attack is more of the same. The fact that responsible market participants like Fannie Mae would continue to purchase mortgages undercuts the argument that the change is necessary to protect the mortgage market's health. Indeed, the Division of Banking has indicated that legitimate lenders are complying with the act's requirements.

At present, the act will protect homeowners. The only lenders who should fear the act are those who wish to continue taking advantage of New Jersey homeowners. ■