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Sacramento City Council

CITY HALL
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August 15, 1980

COUNCIL COMMITTEE ON LAW & LEGISLATION
BLAINE H. FISHER
Chairman
LLOYD G. CONNELLY
DOUGLAS N. POPE
JOHN ROBERTS

WILLIAM P. CARNAZZO
Legislative Representative
449-5346

Honorable City Council
City Hall
Sacramento, California 95814

RE: OPPOSITION TO SB 1937 RELATING TO VARIABLE INTEREST MORTGAGE RATES

Members in Session:

SUMMARY

The Law and Legislation Committee recommends that the City Council go on record in opposition to SB 1937.

BACKGROUND INFORMATION

SB 1937 permits lenders to utilize certain types of variable interest rate mortgage loans. The Governor of California has vetoed this bill and the State Legislature will vote upon the override of the Governor's veto during the week of August 18-22. The Governor's veto message and additional information concerning the bill is attached. Under SB 1937 it would be possible for a person, five years after the loan, to owe more money on the principal amount of the loan than was due on principal at the time of making the loan. The monthly payments on the loan five years later could also suddenly increase by more than 50%.

RECOMMENDATION

Approval of the attached Resolution opposing SB 1937 is recommended.

APPROVED
BY THE CITY COUNCIL
AUG 19 1980
OFFICE OF THE CITY CLERK

Very truly yours,

Blaine H. Fisher

BLAINE H. FISHER
Chairman, Law & Legislation Committee

BHF:KMF
ATTACHMENTS

RESOLUTION NO. 80-553

Adopted by The Sacramento City Council on date of

RESOLUTION OPPOSING SENATE BILL 1937

BE IT RESOLVED BY THE COUNCIL OF THE CITY OF SACRAMENTO:

That the Council opposes Senate Bill 1937 relating to variable interest mortgage loans and urges the Sacramento County representatives in the State Legislature to vote to sustain the Governor's veto of SB 1937.

MAYOR

ATTEST:

CITY CLERK

APPROVED
BY THE CITY COUNCIL

AUG 1 9 1980

OFFICE OF THE
CITY CLERK

State of California
GOVERNOR'S OFFICE
SACRAMENTO 95814

916/445-2843

EDMUND G. BROWN JR.
GOVERNOR

July 20, 1980

To the Members of the California Senate:

I am returning Senate Bill No. 1937 without my signature.

I understand the challenge now faced by the savings and loan industry because of the volitility of short term interest rates. The federal government has recognized this problem by approving a new flexible mortgage instrument. Unsatisfied with this approach, the California chartered savings and loans have developed a more radical variable home mortgage, the terms of which are embodied in this bill.

For example, under the provisions of SB 1937, the average homeowner could be faced with a very difficult situation. An $80,000 loan bearing interest at 12% would change over a five year period, assuming interest rates rose 1/2 point every six months, in the following way:

Initial Monthly Payment	Payment After 5 Years
$822.89	$1,287.63

The loan balance, instead of decreasing, would actually increase to $89,559.79. Monthly payments would remain the same for five years, but then would suddenly escalate more than 50%. I believe that this goes too far and would result in many borrowers approaching the sixth year of their mortgage unprepared to deal with the dramatically increased monthly payments.

I am willing to work with the industry to improve our mortgage instruments. Adopting the proposals contained in SB 1937, however, goes way beyond the present federal regulations and would expose the unwary borrower to too great a risk. The backlash from the enactment of this bill would not only affect elected representatives, but would also erode the credibility of some of our finest financial instituions.

Sincerely,

Edmund G. Brown Jr.

EDMUND G. BROWN JR.
Governor

WHAT SB 1937 MEANS TO CALIFORNIA HOMEBUYERS

SB 1937 (FORAN) WOULD ALLOW LENDERS TO OFFER CALIFORNIA HOME-BUYERS A NEW KIND OF FLOATING-INTEREST-RATE HOME MORTGAGE LOAN.

- SB 1937 WOULD ALLOW LENDERS TO CHANGE YOUR MORTGAGE INTEREST RATE EVERY SIX MONTHS.
- SB 1937 COULD RESULT IN YOUR OWING MORE AFTER MAKING REGULAR PAYMENTS FOR SEVERAL YEARS THAN AT THE OUTSET.
- SB 1937 COULD SUBSTANTIALLY INCREASE YOUR MONTHLY PAYMENT AFTER A FEW YEARS, IMPOSING AN UNFORESEEN FINANCIAL BURDEN.
- SB 1937 WOULD ALLOW A LENDER TO ACQUIRE THE HOMEOWNER'S EQUITY.
- SB 1937 COULD PUT THE ENTIRE LIVELIHOOD OF A SMALL BUSINESS PERSON AT THE RISK OF FLUCTUATING INTEREST RATES, BECAUSE SMALL BUSINESSES ARE OFTEN FINANCED BY HOME EQUITY.
- SB 1937 WOULD LIMIT TOTAL INTEREST RATE INCREASES TO 5%, BUT WOULD PERMIT THE ENTIRE INCREASE TO GO INTO EFFECT AS EARLY AS THE 7TH MONTH.
- SB 1937 WOULD SHIFT THE BURDEN OF INFLATION TO HOMEOWNERS, MAKING OWNING ONE'S OWN HOME AN IMPOSSIBLE DREAM FOR MANY CALIFORNIANS AND A NIGHTMARE FOR OTHERS.
- SB 1937 WOULD ALSO SUBJECT TENANTS OF APARTMENT BUILDINGS WITH 4 OR FEWER UNITS TO THE RISK OF SUBSTANTIAL RENT INCREASES IF THE OWNER HAS AN SB 1937-LOAN.

LIST OF GROUPS OPPOSED TO SB 1937

SB 1937 is opposed by consumers, small business people, workers, senior citizens, minorities, women, veterans, community groups, and local governments, including the following:

-American GI Forum

-California Labor Federation (AFL-CIO)

-Citizens Action League

-Consumer Federation of California

-Consumers' Union

-Filipino Accountants Association

-Gray Panthers

-Los Angeles City Council and City Attorney

-Mexican-American Chamber of Commerce

-Mexican-American Political Association

-National Association for the Advancement of Colored People

-National Women's Political Caucus (Sacramento)

-Oakland Concerned Citizens for Urban Renewal

-Public Interest Research Group

-San Francisco, City and County

-San Francisco Consumer Action

-Santa Cruz County

-Service Employees' International Union

-Stonewall Democratic Club of San Francisco

-Urban League

-Women in Politics

LIST OF GROUPS IN SUPPORT OF SB 1937

-California Savings and Loan League

-California Association of Realtors

AMENDED IN ASSEMBLY JUNE 23, 1980

AMENDED IN ASSEMBLY JUNE 16, 1980

AMENDED IN SENATE MAY 7, 1980

AMENDED IN SENATE APRIL 14, 1980

SENATE BILL No. 1937

Introduced by Senator Foran

March 11, 1980

An act to add *and repeal* Section 1916.7 ~~to, and to repeal Section 1916.7 of,~~ *of* the Civil Code, to amend Section 5074 of the Financial Code, and to amend Section 12640.025 of the Insurance Code, relating to loans.

LEGISLATIVE COUNSEL'S DIGEST

SB 1937, as amended, Foran. Loans: variable interest rates.

Under existing law no increase in interest provided for in an evidence of debt the purpose of which is to finance residential real property is valid unless it meets specified conditions. Among those provisions is a limitation in both the number of times and the amount by which a variable interest rate may be increased.

This bill would make an exception from the foregoing for a fixed-payment adjustable rate mortgage loan as set forth in the bill*, and would require a lender of such loans to offer a borrower a fixed-rate mortgage loan as specified.* The provisions relating to such loans would be repealed on January 1, 1988.

The bill would provide that such a loan would be an amortized loan for the purposes of the Savings and Loan Law.

This bill would also amend a provision relating to mortgage guaranty insurance to provide that if the loan is of a type permitted by this bill, the loan, in order to be insurable, shall not exceed 100% of the fair market value of the real estate.

Vote: majority. Appropriation: no. Fiscal committee: no. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. Section 1916.7 is added to the Civil Code, to read:

1916.7. (a) Section 1916.5 shall not be applicable to any fixed-payment adjustable-rate mortgage loan. A fixed-payment, adjustable-rate mortgage loan is a loan with a 30-year term on the security of real property containing four or fewer residential units, providing for a variable interest rate, and incorporating terms substantially as follows:

(1) The term of the loan shall be divided into a number of fixed-payment periods and the loan shall be repayable in monthly installments which, other than the final installment on the loan, shall be equal and remain fixed during each such fixed-payment period, notwithstanding changes in the interest rate on the loan during the period.

(2) The length of the fixed-payment periods of the loan shall be specified in the note and shall not be changed except by agreement of both the borrower and lender.

(3) To the extent that any monthly installment is less than the amount of interest accrued during the month with respect to which the installment is payable, the difference shall be added to the principal of the loan as of the due date of the installment and thereafter shall bear interest as part of the principal.

(4) The monthly installments payable during each fixed-payment period shall be equal to that amount, or such amount rounded up to the next whole dollar at the option of the lender, required to amortize the loan within the remaining period of the original term thereof at the rate of interest in effect at the beginning of such period.

(5) Changes in the rate of interest on the loan shall

reflect the movement of an index, which shall be the weighted average cost of savings, borrowings and Federal Home Loan Bank advances to California members of the Federal Home Loan Bank of San Francisco as published by the Federal Home Loan Bank of San Francisco. Subject to the limitations otherwise provided herein, changes in the rate of interest shall be effected in such manner as to maintain the same margin above or below the base interest rate of the loan as the most recently published index at the time of any such change is above or below the base index.

(6) Changes in the rate of interest shall become effective at such times, not more frequent than semiannually, as are specified in the note, provided that (i) the rate of interest shall not change for such initial period as is specified in the note, but not less than six months after the date thereof, and (ii) the rate of interest in effect at the beginning of the final fixed-payment period of the loan shall not thereafter be changed.

(7) Notwithstanding any change in the interest rate indicated by a movement of the index (i) no change in such rate of interest shall result in a rate which is more than five percentage points greater or lesser than the rate which is initially applicable to the loan, (ii) increases in the interest rate shall be optional with the lender, while decreases are mandatory, and (iii) the rate of interest in effect at the beginning of any fixed-payment period shall not, subject to the foregoing five percentage point limitation, exceed the lender's market rate if the lender is then offering fixed-payment, adjustable-rate mortgage loans to the public.

(8) A borrower who was an obligor on the note at the time the loan was originally made may elect by instrument in writing delivered to the lender as follows:

(i) Prior to the expiration of any one fixed-payment period selected by the borrower, the borrower may, if the first monthly installment payable after such expiration would be greater than the monthly installments payable during such fixed-payment period, elect to extend such fixed-payment period for an additional period of one year;

(ii) If the election described in subparagraph (i) has been made, the borrower may, prior to the expiration of the one-year period described therein, elect to extend such fixed-payment period for a second one-year period if the first monthly installment payable after such expiration would be greater than the monthly installments then payable;

(iii) If the election described in subparagraph (ii) has been made, the borrower may, prior to the expiration of the second one-year period described therein, further elect to extend such fixed-payment period for a third one-year period if the first monthly installment payable after such expiration would be more than 10 percent greater than the monthly installments then payable; or

(iv) Prior to the first fixed-payment period which begins after such borrower has reached age 65, has been such a borrower for at least 9 years, and occupies the real property which is security for the loan as the borrower's principal residence, the borrower may elect that the interest rate in effect with respect to the first installment payable in such period shall remain fixed for the remainder of the term of the loan, provided that such election and this subparagraph shall cease to be applicable after such borrower who has reached age 65 no longer occupies such real property as the borrower's principal residence.

(9) (i) The borrower is permitted to prepay the loan at any time, in whole or in part, without a prepayment charge, and no charge, fee or other charge is required by the lender of the borrower as a result of any change in the interest rate, any transition from one fixed-payment period to the next, or the exercise of any option or election extended to the borrower pursuant to this section.

(ii) The borrower, after the initiation of the loan, shall not be required to demonstrate his or her qualification for the loan, except that this subparagraph shall not limit any remedy available to the lender by law for default or other breach of contract, nor, with respect to operation of subdivision (b), the rights of the lender if the security of the lender is impaired.

(10) The note and any mortgage or deed of trust securing the note, shall contain a statement printed or written in a size equal to at least 12-point bold type, consisting of the following language:

~~Notice~~

"Notice to Borrower: This document contains provisions for: (1) a variable interest rate which can change at semiannual intervals; (2) changes in the monthly payments at periodic intervals; and (3) increases, under certain circumstances, in the principal amount owed on the loan."

(11) At least 60 days prior to the beginning of each fixed-payment period, other than the first such period, (30 days in the case of a borrower who does not have the right to make an election described in subparagraph (i), (ii), or (iii) of paragraph (8)) notice shall be mailed to the borrower of the following:

(i) The base index;

(ii) The most recently published index at the date of the notice;

(iii) The interest rate which will be in effect at the beginning of the next fixed-payment period and whether such rate results from application of the index or is the lender's market rate;

(iv) A statement that the interest rate may change at semiannual intervals during the ensuing fixed-payment period;

(v) The amount of the monthly installment payable in the next fixed-payment period;

(vi) The amount of the unpaid principal balance;

(vii) The borrower's right to prepayment under paragraph (9);

(viii) The borrower's right to extend the expiration of the fixed-payment period, if the requirements of subparagraph (1) of paragraph (8) are met;

(ix) The borrower's right to extend the ~~fixed~~ *first* expiration of the fixed-payment period, if the requirements of subparagraph (ii) of paragraph (8) are met.

(x) The borrower's right to extend the fixed-payment period for a third year if the requirements of subparagraph (iii) of paragraph (8) are met;

(xi) The borrower's right to elect that the interest rate not thereafter be changed, if the requirements of subparagraph (iv) of paragraph (8) are met;

(xii) The address and telephone number of the office of the lender to which inquiries may be made.

(12) On or before the due date of the first monthly installment following each change in the interest rate, notice shall be mailed to the borrower of the following:

(i) The base index;

(ii) The most recently published index at the date of the change in the rate;

(iii) The interest rate in effect as a result of the change;

(iv) The amount of the unpaid principal balance;

(v) If the interest scheduled to be paid on such due date exceeds the amount of the installment, a statement to that effect and the amount of the excess; and

(vi) The address and telephone number of the office of the lender to which inquiries may be made.

(b) A lender may not accelerate the maturity date of the principal and accrued interest on a fixed-payment adjustable-rate mortgage loan made pursuant to the provisions of subdivision (a) solely by reason of a transfer in the title to the real property which is security for the loan, unless the security of the lender is impaired by the transfer. Any waiver of this subdivision by a borrower is void, unenforceable and is contrary to public policy. This subdivision is not intended to affect the application of any other provision or principle of law to any type of acceleration provision other than one contained in a loan described in that subdivision.

(c) As used in this section:

(i) The term "fixed-payment period" means each of the successive five-year periods of a loan, or such shorter periods as may be specified in the note, commencing one month prior to the due date of the first monthly installment of principal and interest payable on the loan, except that (A) any one (but not more than one) such period selected by the borrower may be extended as provided in paragraph (8) of subdivision (a), (B) the last fixed-payment period shall terminate 30 years after the beginning of the first fixed-payment period, and (C) the note shall not specify a fixed-payment period of less than five years unless the borrower is also given the option to select a five year fixed-payment period; and (D) the note may extend to the borrower the option prior to the expiration of any fixed-payment period of selecting a term of five years or a specified lesser term for the subsequent fixed-payment period.

(ii) "Base index" means the last published index at the date of the note, and "base interest rate of the loan" means the interest rate initially applicable to the loan as specified in the note, except that if the rate of interest in effect at the beginning of any fixed-payment period is reduced to the lender's market rate by reason of paragraph (7) of subdivision (a), base index shall mean the last published index at the beginning of such fixed-payment period and the lender's market rate shall be deemed to be the base interest rate of the loan for purposes of future interest rate adjustments pursuant to paragraph (5) of subdivision (a) but not for purposes of the five percentage point limitation specified by paragraph (7) of such subdivision, in each case until such time, if any, as the rate of interest is again reduced to the lender's market rate;

(iii) "Lender's market rate" means the lowest rate offered to the public by the lender at the time the notice specified by paragraph (11) of subdivision (a) is given, on fixed-payment adjustable-rate mortgage loans secured by residential property of a nature similar to that of the property securing the loan, made for purposes other than purchase of or construction on the security property and not made pursuant to a government related housing or loan program;

(iv) "Note" means the note or other loan contract evidencing a fixed-payment adjustable-rate mortgage loan.

(d) *Every lender who offers a fixed-payment adjustable-rate loan to a borrower who occupies or intends to occupy the property which is security for the loan shall also offer to such borrower a fixed-rate mortgage loan in the same amount with a term of at least 29 years; provided, that nothing herein shall require that the terms of such alternative fixed rate loan, including the fixed-rate of interest thereon, must be the same as those terms offered with respect to the fixed-payment adjustable-rate loan. This subdivision does not apply to any lender who makes less than ten loans per year.*

(e) This section shall remain in effect until January 1, 1988, and on such date is repealed, except as to loans made prior to such date.

SEC. 2. Section 5074 of the Financial Code is amended to read:

5074. An amortized loan is a loan which provides for payments to be made of interest and on the principal in monthly installments. The installments as to the combined principal and interest shall be at least of a sufficient amount so that the smallest installment provided in the note evidencing the loan, other than the last installment, if continued at such monthly intervals would result in paying the entire principal within the maximum legal term for the particular loan. The first installment which includes principal on each amortized loan must fall due within the time limits specified in Section 7151.

For the purposes of this division the following are amortized loans:

(a) A loan made to finance the construction of real property if it meets the requirements set forth above or if such loan provides for payment in full on or before 36 months have elapsed from the date of the loan.

(b) A loan which conforms to the provisions of Section 1916.5, 1916.6, 1916.7, or 1916.8 of the Civil Code whether or not the provisions of such sections are applicable to the loan.

SEC. 3. Section 12640.025 of the Insurance Code is amended to read:

12640.025. Notwithstanding the other loan or security requirements or definitions under subdivision (b) of Section 12640.02, a mortgage guaranty insurer shall be permitted to insure any type of loan which a bank, savings and loan association, mortgage banker, credit union, or an insurance company, which is supervised and regulated by a department of this state or an agency of the federal government, is authorized to make, or would be authorized to make disregarding any requirement applicable to such an institution that the amount of the loan not exceed a certain percentage of the value of the real estate.

A loan insured by a mortgage guaranty insurer shall not exceed 95 percent of the fair market value of the real estate. However, if the loan is secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate in conjunction with a pledge or lien on personal property in the form of cash, or equivalent, or is a loan of a type authorized by Section 1237, or 7153.9 of the Financial Code, or is a loan conforming to the provisions of Section 1916.7 of the Civil Code, the loan insured shall not exceed 100 percent of the fair market value of the real estate. Moreover, if the loan is of a type authorized by Section 1239 or 7153.10 of the Financial Code, the loan may exceed 95 percent of the fair market value of the real estate so long as it does not exceed the limits of the amount, percent of appraised value, and percent of sales price if applicable, specified in such section.

Nothing herein contained shall be deemed to permit mortgage guaranty insurance on a loan secured by a mortgage, deed of trust, or other instrument unless it is (a) a first lien or charge, and (b) the improvement is on real estate and consists of a residential building or buildings designed for occupancy by not more than four families.

The commissioner may adopt, pursuant to the provisions of Chapter 4.5 (commencing with Section

11371) of Part 1 of Division 3 of Title 2 of the Government Code, such reasonable rules and regulations as may be necessary to limit the amount of mortgage guaranty insurance in force on loans of the type authorized by Section 1237, 1239, 7153.9, or 7153.10 of the Financial Code or on loans conforming to the provisions of Section 1916.7 of the Civil Code. Such rules and regulations, if adopted, shall apply to any insurer authorized to write and writing mortgage guaranty insurance in this state and shall be predicated on the total volume of such insurance written anywhere. Full compliance with such rules and regulations shall be a condition for the renewal of the insurer's certificate of authority.

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