

Department of Business Oversight, Legal Division

Attn: Mark Dyer, Regulations Coordinator

1515 K Street, Suite 200

Sacramento, California 95814-4052

Re: Comments on Proposed Rulemaking: Commercial Financing Disclosures
(PRO 01-18)

Dear Mr. Dyer:

Thank you for providing the opportunity to comment on proposed rulemaking relating to the passage of SB 1235 (Chapter 1011, Statutes of 2018). Our client, the California Mortgage Association, was involved in legislative discussions during the pendency of SB 1235, and is pleased to offer comments as the Department considers proposed rules to implement the required disclosures.

Members of the California Mortgage Association are typically licensed by the Department of Business Oversight as California Finance Lenders, and/or by the Department of Real Estate as real estate brokers. As a general rule, CMA members specialize in private money lending, bringing investors and borrowers together in real property-secured lending. For this reason, CMA was pleased with language included in Financial Code Section 22801 which exempted commercial financing transactions secured by real property.

Our comments are limited to two subjects: refining the exemption for real property-secured lending, and suggestions relating to the annualized rate disclosure required by SB 1235.

Exemption for Real Property-Secured Loans

The vast majority of loans made or arranged by CMA members are secured directly by deeds of trust on real property. A small percentage of loans however, sometimes described as “mezzanine loans”, are secured by equity interests in a single purpose/asset entity formed to hold title to the underlying property. The direct security is, in fact, personal property, such as a limited partnership interest or membership interest, but the loan is truly a real property-secured loan and is underwritten based upon the value of the real estate collaterally securing the loan.

We believe that clarifying the exemption for commercial financing transactions secured directly or collaterally by real property is consistent with the intent of the

legislature which broadly exempted real property-secured loans. The inclusion of loans secured directly or collaterally by liens secured by real property is already contained in California law (see Business and Professions Code Section 10131 (d) including these transactions in the definition of real estate broker).

To effectuate the intent of the Legislature, therefore, we recommend language in proposed regulations which exempt from the disclosure requirements “commercial financing transactions secured *directly or collaterally* by real property.”

Annualized Rate Disclosure

As noted in the Department’s Invitation to Comment, SB 1235 initially required disclosures expressed as an Annual Percentage Rate (APR) calculated consistent with the Federal Truth-in-Lending Act and Regulation Z. This requirement was later amended to require a calculation known as an Annualized Cost of Capital, or “ACC”. The final bill simply delegated authority to the Commissioner to adopt a disclosure requirement by regulation.

CMA strongly believes that it is inappropriate to graft the federally-required APR disclosure, developed expressly for consumer transactions, into state law on commercial financing. APR disclosure is complicated, not well understood by consumers, contains elements not relevant in commercial transactions, and has spawned extensive litigation and attendant liability.

Instead, CMA recommends adopting regulations which carefully define those origination fees and charges necessary to obtain the loan, but excluding post-origination charges relating to enforcement of the obligation, and creating a simple formula which can be expressed narratively as follows:

Aggregate interest plus fees and charges, divided by the principal amount of the loan, divided by the term or estimated term of the loan, multiplied by 12 to obtain an annualized rate.

We believe that the formula described above can be easily understood by commercial borrowers as the annual cost of the financing, without the complexity and difficulties inherent in the federal APR calculation designed for consumer transactions.

As noted above, an indispensable element of the formula we are suggesting is fees and charges necessary to obtain the financing. We suggest the following definition of such fees and charges, as follows:

Fees and Charges Included in an Annualized Rate Calculation are defined as the aggregate interest, fees, bonuses, commissions, brokerage, discounts, expenses, and other forms of costs charged, contracted for, or received by a

provider or broker in connection with the investigating, arranging, negotiating, procuring, guaranteeing, making of a commercial loan, commercial financing transaction, or account, as those terms are defined in Financial Code Section 22800, but excluding charges for servicing, collecting, and enforcing of, or any other service rendered in connection with a commercial loan, commercial financing transaction, or account, as those terms are defined in Financial Code Section 22800.

We appreciate the opportunity to respond to the Commissioner's Invitation to Comment, and would be happy to answer any questions you may have.

Sincerely,

Michael D. Belote