

USURY: (1) Consideration paid by buyer
REAL ESTATE MORTGAGES: to lender for bona fide services
FHA GUARANTEED LOANS: is not interest. (2) Consideration by seller to lender to induce making of loan is not interest unless shown to be subterfuge to establish artificially high purchase price. (3) Mortgage insurance premiums collected by lender and paid to FHA do not constitute interest. (4) Section 362.195, RSMo 1959, purporting to exempt FHA guaranteed loans from usury laws is unconstitutional.

OPINION NO. 506

December 18, 1969



Honorable Edward E. Ottinger
Representative - 60th District
5912 Loughborough
St. Louis, Missouri 63109

Dear Mr. Ottinger:

This official opinion is issued pursuant to your telegraphic request in which you ask questions about the application of the Missouri usury statutes to certain payments which are made in connection with mortgage loan transactions involving loans guaranteed by the Federal Housing Administration. We understand that the payments you ask about are as follows:

(a) A payment by a buyer-borrower to a lender of a percentage of the face amount of the loan, one time and not annually, as a "service fee." The current rate is apparently one percent of the principal amount of the loan (one point).

(b) A payment by the seller to the lender of a percentage of the face amount of the loan, ostensibly as additional consideration in order to induce the lender to consummate the loan transaction with the buyer. The current rate for these payments appears to be eight percent of the face amount of the loan (eight points).

(c) We also understand that borrowers pay an additional sum of one half of one percent of the principal of the loan per annum as a mortgage insurance premium. The borrower pays the premium as a part of his regular monthly payments. The insurance payments

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are used to create a fund from which lenders who suffer loss through default and foreclosure are reimbursed. Under some circumstances a portion of the premium is refunded to the borrower on payment of the loan. We consider that it would be helpful to discuss the question whether these mortgage insurance premium payments constitute interest within the Missouri usury statutes.

We also understand that the current interest rate on FHA loans is the maximum allowed by FHA, and that this is seven and one-half percent.

Description of Typical Transaction

Our understanding of a typical transaction is that the lender does not come into the picture until the seller and the buyer have agreed upon a price.

The buyer will normally have to borrow a substantial portion of the purchase price. He may not be able to buy the house unless he can find either a seller who is willing to carry a large loan, or a lender who is willing to lend on the basis of a FHA or Veterans' Administration guarantee.

In order to obtain a guaranteed loan, there must be an independent appraisal which sets forth a maximum loan value. The buyer may not obtain a guaranteed loan for more than the appraised value. He could agree to pay more than the market value as indicated by the appraiser, provided that he could obtain the additional cash.

We are advised that the "prime" interest rate, which is the rate charged by major metropolitan banks to their most secure customers, is now eight and one-half percent. Corporations are not subject to the usury laws, and there are other transactions which do not involve interest. It would be assumed that a lender would place its money where the highest return could be obtained.

At the present time it is therefore necessary for the seller to make a payment to the lender to induce the lender to make a loan to the buyer at an interest rate authorized by the FHA. Such payment is usually described as a payment of a certain number of "points" each part being one percent of the loan. We construe your reference to an eight percent discount as referring to a payment of eight points to the lender by the seller.

If the face amount of a mortgage loan is \$20,000. the seller would pay \$1600. to the lender. At the closing of the transaction the buyer would pay the down payment and sign a \$20,000. note. The sum of these figures is the purchase price which he agreed to pay. He would also pay \$200 to the lender, that is one percent of the amount of the loan as a "service fee," and would receive a deed. The seller would receive a net of \$18,400. from the loan

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transaction, and would also receive the down payment. We understand that it is the practice of lenders to disburse the full loan proceeds which in this case would be \$20,000. to the seller or his agent, and to receive a check back for the points.

The Usury Laws

Section 408.030, RSMo provides as follows:

"The parties may agree, in writing, for the payment of interest, not exceeding eight per cent per annum, on money due or to become due on any contract."

(a) Payments by borrower (buyer)

It would appear that the payment of interest at the rate of seven and one-half percent per annum, plus a one percent "service fee," paid only one time, would not raise the rate of a long-term loan above the lawful rate of eight percent. For purposes of completeness, however, we will consider the question whether this service fee constitutes interest.

A payment by a borrower to a lender for services actually rendered is not invalid, and it does not necessarily constitute interest. *Cuendet v. Love, Bryan & Co.*, 57 S.W.2d 701 (St.L.Mo. App. 1933). Where the services are unsubstantial or illusory, however, then the additional payment will constitute interest. *Hecker v. Putney*, 196 S.W.2d 442 (St.L.Mo.App. 1946). If the services given in exchange for the one percent service fee are substantial, then the fee could be justified without partaking of the nature of interest.

Whether a particular payment constitutes interest or not is a question of fact. *Stewart v. Boone County Trust Co.*, 230 Mo.App. 120, 87 S.W.2d 223 (St.L.Ct.App. 1935).

The charge on FHA loans is provided for in Section 203.27, Vol. II, Regulations and Rulings, Federal Housing Administration which provide in part:

" (a) The mortgagee may collect from the mortgagor the following charges, fees or discounts:

* * *

" (2) A charge to compensate the mortgagee for expenses incurred in originating and closing the loan, the charge not to exceed:

" (i) \$20 or 1 percent of the original principal amount of the mortgage, whichever is the greater; . . ."

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Under the precise facts presented, whether the services are substantial or not, the charging of this fee would not appear to violate the usury laws, since a one-time charge of one percent on a long-term loan bearing interest at the rate of seven and one-half percent per annum would not result in an over-all rate in excess of eight percent per annum.

(b) Payment by the seller to the lender

The payment of eight "points" by the seller to the lender is more substantial, in amount, and apparently would render the transaction usurious if it were considered to be a payment of interest by the buyer-borrower.

91 C.J.S., Usury, Section 47, page 630, reads as follows:

"Ordinarily, a bonus given or paid by a stranger to a contract of loan or forbearance, for his own purposes or reasons sufficient to himself, to induce the making of a contract by the lender, does not affect the contract with usury, . . . the purpose underlying usury statutes, which is the protection of debtors against hardship and oppression, . . . having no relevancy where the only loss or detriment is to a stranger. The rule is otherwise, however, where the person paying or promising to pay the bonus, while nominally a stranger to the transaction, is in fact the real beneficiary of the loan or forbearance, or where the debtor reimburses such person, or is in any way obligated to reimburse him, for the amount of such bonus, . . ."

The law looks to substance rather than to form in detecting usury. *General Motors Acceptance Corporation v. Weinrich*, 262 S.W. 425 (Mo.App. 1924); *Webster v. Sterling Finance Co.*, 195 S.W.2d 509 (Mo. 1946). The courts will not, however, rely on mere suspicion in order to find that a transaction is different from what it purports to be.

A seller may sell at one price for cash and at a different and higher price on time. *Wyatt v. Commercial Credit Corporation*, 341 S.W.2d 348 (K.C.Mo.App. 1960). This is the general law, applicable except where changed by specific statute.

If a seller of real estate takes the buyer's note for all or a part of the purchase price, he may sell the note to anyone who is willing to buy it for a price that the two agree upon. A discount under these circumstances is not interest. *Webster v. Sterling Finance Co.*, *supra*. The case would be different if there was no bona fide sale transaction, as in *Anderson v. Curls*, 309 S.W.2d 692 (K.C.Mo.App. 1958) where an intermediary obtained a

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\$400 note from a borrower, purportedly sold it to a knowing person for \$200, and remitted \$175 to the borrower. The court said that there was no sale, but simply a loan by the party paying the \$200.

A payment of a commission to a stranger for the obtaining of a loan through his efforts is not interest. *Fischman v. Schultz*, 55 S.W.2d 313 (St.L.Mo.App. 1932). The case would of course be different if the borrower paid the commission to a person who was not a true broker but simply an agent for the lender. *Hecker v. Putney*, supra.

We conclude from the foregoing that a seller of real estate could properly make a payment to a lender in order to induce that lender to make a loan to the buyer, without constituting the seller's payment interest paid by the buyer. The seller has a proper interest in the making of the loan which would support a consideration moving from him. The making of the loan is not necessarily a benefit to the buyer, who would be willing to have the seller as his lender. The transaction is not far removed from one in which the seller takes the buyer's note and then discounts it in a sale transaction to which the buyer is a stranger. There is no indication that the buyer is obliged to reimburse the seller, for the amount of the consideration paid by the seller to the lender. It is of no significance that the lender is acquiring a guaranteed loan. This simply means that the consideration asked is based on the money market, and not on any risk of noncollection.

The lender, concededly, receives more than an eight percent return on his money. This is not significant. One who lends to a corporation may receive more than eight percent, as may one who purchases negotiable paper owned by others. The purpose of the usury statutes is to protect debtors, *Coleman v. Cole*, 158 Mo. 253, 59 S.W. 106 (1900); *Missouri Real Estate Syndicate v. Sims*, 179 Mo. 679, 78 S.W. 1006 (1904). The statutes do not exist to limit the return which lenders may obtain.

It might be possible to conceive of a transaction in which a seller and a buyer created a fictitious price in order to enable the buyer to negotiate a loan which was otherwise usurious. By the holding in *Webster v. Sterling Finance Co.*, supra, such a result would not be presumed and one asserting it would have to prove his case. The claim of a fictitious price is effectively rebutted in a case in which the buyer has agreed to a price, prior to the consummation of any lending transaction, and in which the buyer pays no more than the price he has previously agreed to, together with interest on the deferred payments. While wider availability of mortgage money might stimulate purchases and therefore tend to increase the purchase price, the effects are remote from a particular transaction and do not, in our opinion, convert "points" paid by the seller into interest attributable to the buyer.

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(c) Mortgage insurance premium

The mortgage insurance premium (presently one-half of one percent per annum) is collected by the lender or his assignee from the borrower, as a part of each month's payment, but is paid over to FHA for the purpose of creating a fund for the reimbursement of losses suffered by lenders. Only if there were a loss would this premium payment inure to the benefit of the lender, and then it would pay him no more than he would be entitled to receive if the borrower were fully to perform his obligations.

The Supreme Court of Tennessee considered the status of these mortgage insurance premiums in *Silver Homes, Inc. v. Marx & Bendorf, Inc.*, 333 S.W.2d 810 (Tenn. 1960). That court held that the premium payments were not interest within the meaning of the usury statutes of the state, saying, 1.c. 813:

" . . . This insurance premium is solely an expense incident to the necessity of furnishing the lender satisfactory security for the repayment of the money loaned for the purpose.

* * *

" . . . Though it is money which the borrower pays, it is not money received for the use of the lender. So, it is not interest within the meaning of our usury statute. . . ."

Numerous cases hold that payments by the borrower to the lender for the purchase of fire and casualty insurance, required to be maintained by the terms of the mortgage or deed of trust, are not interest payments. See Annotation 91 A.L.R.2d 1344.

The Tennessee opinion appears to be soundly reasoned. We see no essential difference between that state's usury statutes and Missouri's. The Tennessee court points out that the insurance premium payments are solely for the purpose of improving the security, and that they do not provide a return to the lender over and above the basic interest rate. They are payable to a third party for a valid consideration moving from that party. The payments are similar to other payments which the borrower may be required to make in order to make his security acceptable, such as the fire and casualty premiums above mentioned, abstracting or surveying expense, and charges for title examination or title insurance policies.

We believe that the Missouri courts would follow the Tennessee opinion in holding that mortgage insurance premium payments to FHA are not interest.

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Statutory Exemptions

We have considered the statutes authorizing banking institutions, trust companies, loan and investment companies and mortgage loan companies to make loans secured by real property which the FHA insures.

Section 362.180, RSMo 1959, provides as follows:

"Banking institutions, trust companies, insurance companies, loan and investment companies and mortgage loan companies are authorized

(1) To make such loans and advances of credit and purchases of obligations representing loans and advances of credit as are eligible for insurance pursuant to title I, section 2 of the National Housing Act, and to obtain such insurance;

(2) To make such loans secured by real property or leasehold interests as the Federal Housing Administrator insures or makes a commitment to insure pursuant to Title II of the National Housing Act and to obtain such insurance."

Section 362.195, RSMo 1959, provides in part as follows:

"No law of this state . . . prescribing or limiting interest rates upon loans or advances of credit, . . . shall apply to loans, . . . made pursuant to Sections 362.180 . . ."

This statute on its face might permit the making of FHA insured loans without regard to state usury laws.

The statutory provisions present problems. There is first a problem of determining the institutions to which the laws apply. Chapter 362, RSMo applies to "banks," Chapter 363, RSMo to "trust companies," and Chapter 368, RSMo to "loan and investment companies." Repealed Chapter 366, RSMo applied to "mortgage loan companies," and was a part of the statutes at the time Sections 362.180 and 362.195 were enacted. The question is whether Section 362.180 is limited to the specific corporations organized under Chapters 362, 363, 368, and former Chapter 366, or whether the terms "loan and investment companies" and "mortgage loan companies" should be given a broader reading so as to extend to savings and loan associations and other corporations which deal in real estate loans.

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Since each of the entities listed in Section 362.180 is described in terms of a corporation organized under a specific statutory chapter which was in effect at the time of enactment of Section 362.180, we are of the opinion that the exemption established by that and the following sections would be available only to corporations organized under Chapters 362, 363, 368 and repealed Chapter 366 of the Missouri Revised Statutes, and that the exemption cannot be construed as applying to savings and loan associations organized under Chapter 369, or to corporate lenders organized under other incorporating statutes.

This view is borne out by the fact that there was an attempt to amend Section 369.345, RSMo, by House Bill No. 73 of the Seventy-Fifth General Assembly which provided that FHA loans made by savings and loan associations would be exempt from the usury laws. Such bill died in the Senate Committee on banks and financial institutions.

Article III, Section 44 of the Missouri Constitution provides as follows:

"No law shall be valid fixing rates of interest or return for the loan or use of money, . . . for any particular group or class engaged in lending money. The rates of interest fixed by law shall be applicable generally and to all lenders without regard to the type or classification of their business."

In the case of Household Finance Corporation v. Shaffner, 203 S.W.2d 734 (Mo.en Banc 1947) the Supreme Court of Missouri in discussing Section 44, Article III of the Constitution said, l.c. 738:

"Section 44 does not prohibit the enactment of laws authorizing the formation and regulation of different types of lenders, such as banks, savings and loan association, etc. Nor does it prohibit the enactment of laws providing reasonable clasification [sic] of loans as to amount, or otherwise, with different permissible rates of interest for different types of loans, but the rates provided for any type of loans, must be available to all lenders who make such loans, without regard to the type or classification of their business. Whether the constitutional provision is wise or unwise is not our province to decide."

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Since Section 362.195 does classify lenders by exempting from the usury laws only the corporations listed in Section 362.180 it is unconstitutional and void because it violates Section 44 of Article III of the Constitution. However, FHA loans as well as other loans on real estate in which the interest charged is not more than eight percent per annum do not violate the Missouri usury laws.

Truth in Lending

We consider that usury problems are governed by state law, and that any federal requirements as to disclosure of fees or charges do not affect the determination of what is interest and what is not.

CONCLUSION

It is the opinion of this office:

(1) That a payment by a borrower to a lender in return for services actually rendered does not constitute interest within the provisions of Section 408.030, RSMo 1959.

(2) If a buyer and a seller of real estate have agreed in good faith on a price and have not created a fictitious price, then a monetary consideration moving from a seller to a lender, which the lender demands as a condition of making a loan, is not interest attributable to the buyer within the meaning of Section 408.030, RSMo. Therefore payment of points (each point being one percent of the face amount of the loan) by the seller to the lender to induce the lender to make a loan does not constitute interest.

(3) A mortgage insurance premium, collected by the lender from the borrower but paid over to FHA, is not interest.

(4) Section 362.195, RSMo, which exempts FHA loans made by certain corporations from the Missouri usury laws is unconstitutional and void because it does not apply to all lenders and is therefore violative of Section 44 of Article III of the Missouri Constitution.

(5) FHA loans as well as other loans on real estate in which the interest charged is not more than eight percent per annum do not violate the Missouri usury laws.

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The foregoing opinion, which I hereby approve, was prepared by my Special Assistant, Charles B. Blackmar.

Very truly yours,

A handwritten signature in cursive script, reading "John C. Danforth". The signature is written in black ink and is positioned above the typed name.

JOHN C. DANFORTH
Attorney General