



STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

SAM KELLEY, Commissioner

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December 11, 1981 No. 81-31

Mr. John H. Harris
Associate Counsel
Mortgage & Trust, Inc.
P. O. Box 2885
Houston, Texas 77001

Dear Mr. Harris:

This is to acknowledge receipt of your letter of July 28, 1981 in which you pose three questions concerning variable rate contracts as authorized by Article 1.04(f), V.T.C.S.

Your questions are as follows:

- "1. Many permanent commercial loans (secured by mortgage on real property) now being made are evidenced by a promissory note with a fixed interest rate and payments, but the note provides for the lender to receive a specified percentage of future rental increases derived from the property (if any), or for a percentage of the equity on sale (if any), as contingent additional interest. Is the above described loan a variable rate loan as described in 5069-1.04(c) or 1.04(f)?"
- "2. Many permanent commercial loans (secured by mortgage on real property) now being made are evidenced by a promissory note with a fixed rate of interest and payments, but the note provides for an optional rate review(s) prior to loan maturity (15 year term with rate review options in the 5th and 10th years). The rate review is exercisable solely at the lenders discretion, and is not tied to any index or other formula which would lead to a mathematically determinable rate. Should the option not be exercised, the rate and payment amount will remain unchanged. Is the above described loan a variable rate loan under 5069-1.04(c)?"
- "3. Many construction loans bear interest at a rate equal to the 'prime rate' from time to time in effect. Is the above described loan a variable rate loan under 5069-1.04(f)?"

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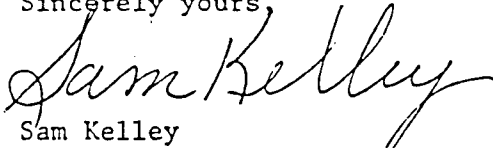
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I do not consider the examples given in your first and second questions to be variable rate loans as contemplated by Articles 1.04(c) and/or (f), Article 5069, V.T.C.S. In our view, in those two examples the parties have not contracted for a rate or amount determinable by an index, formula, or provision of law as provided for in 1.04(f). In the first example, the loan bears a specified fixed rate of interest with the contingency of additional consideration.

Although the court cases which have considered these types of transactions seem to be somewhat inconclusive, I would assume that the contingency of additional consideration, assuming it had some value, would have to be considered interest. See Gulf Atlantic Life Ins. Co. v. Price, 566 S.W.2d 381 (Ct.Civ.App. 1978, ref. n.r.e.) and Cochran v. American Savings & Loan, 568 S.W.2d 672 (Ct.Civ.App. 1978).

I agree with you that the term "prime rate" without further definition or elaboration does not meet the requirements of Art. 1.04(f) so as to qualify as an index, formula, or provision of law by or under which the numerical rate can from time to time be determined. However, the term "prime rate" can be further described so as to constitute a portion of a variable rate index or formula used to compute the rate on a variable rate contract. For example, "the prime rate" as established by a particular bank not to exceed a particular ceiling from time to time in effect could be used as a formula in a variable rate contract from which the rate on the contract could from time to time be determined.

Sincerely yours,


Sam Kelley
Commissioner