STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

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SAM KELLEY, Commissioner

December 10, 1982 82-28

Mr. Robert K. Fowler
Brown & Fowler
P. O. Box 56712
Houston, Texas 77256

Dear Mr. Fowler:

This is to acknowledge receipt of your letter dated October 15, 1982 concerning a type of loan proposed to be made pursuant to Chapter 5, Article 5069, V.T.C.S. The quoted portion of your letter set out directly below describes the type of transaction in question.

> "My client holds a Regulated Loan License pursuant to Chapter 3. My client proposes to offer home improvement and purchase money simple interest secondary mortgage loans which involve the payment of points. Your Interpretative Letter No. 81-9 authorized the charging of such points. As you are aware points are a device utilized by lenders to increase the yields on their loans. The fact that lenders choose to charge points and offer a seemingly lower interest rate as opposed to charging no points and offering a higher interest is a result of market factors and would not seem to be germane to the answers to the questions put forth below so long as the lender acknowledges such points will be considered interest and the loans are simple interest loans. As a practical matter, however, the points are charged because the lender may book those points as current income rather than wait until the higher interest is paid over a longer period of time.
>
> "My client has determined to offer the service to borrowers of lending those points at consummation rather than requiring additional cash outlays at that time by the borrower. This will be accomplished by the lender's advancing at consummation an amount equal to the principal amount which the borrower seeks to borrow plus the points. For example, if the borrower applies for a loan for $40,000 which requires four points, the lender will advance $41,600. $40,000 will be paid to the borrower or on his behalf, and the $1,600 in points will be paid back to the lender which he may book as current income. The borrower, in

> turn, will execute a note for $41,600. The borrower obligates himself to repay the entire $41,600 on a simple interest basis over the life of the loan. For example, a loan of $41,600 at 15% per annum over 240 months is repayable in monthly installments of $547.78."

You ask our opinion as to whether such a transaction may be made pursuant to Chapter 5 and if so, what is the proper method for computation of the true interest rate on the transaction for interest rate celing purposes.

I am of the opinion that the type of transaction described above may be made pursuant to Chapter 5. Although it may be a matter of terminology rather than substance I would not designate the described $1,600 as "points." My concept of points is that they are prepaid interest paid in advance by the borrower or some other party. In your described transaction because the "points" are in effect borrowed by the borrower they do not seem to me to be prepaid in the traditional sense. The borrower signs a note for $41,600 but in reality receives the use of only $40,000 in that the $1,600 charge is in the nature of "discount interest" rather than "points." It is our view that the proposed simple interest transaction could be structured in that manner and be in conformity with Chapter 5 and Article 1.04 of Article 5069.

In the proposed transaction the borrower is obligated to repay $41,600 at an interest rate of 15% per annum over a 20 year period. That would result in 240 monthly payments of $547.78 each, or a total amount repaid of $131,467.20. Since the borrower had use of only $40,000, that figure would be subtracted from the $131,467.20 to determine how much interest had been paid, which amount of interest in this example would be $91,467.20. The true yield on the contract would be determined by applying this total amount of interest to the $40,000 actually received and repaid over a 20 year period. Thus the interest rate on the proposed contract would be 15.71%.

Sincerely,

Sam Kelley

Sam Kelley
Consumer Credit Commissioner

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