STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

SAM KELLEY, Commissioner

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December 29, 1981 No. 81-33

Mr. Hugh K. Higgins, Jr.
President
Home Capital Funds, Inc.
P. O. Box 9963
Austin, Texas 78766

Dear Mr. Higgins:

This is to acknowledge receipt of your letter dated November 13, 1981 in which you inquire as to the position of this Office concerning the use of "buydowns" in "wraparound loans."

As you know, this Office considers "wraparound" loans to be secondary mortgages since they are inferior to preexisting outstanding first liens. As secondary mortgages, "wraparounds" are subject to the provisions of Chapter 5, Article 5069, V.T.C.S. if they meet the other criteria of that Chapter, and must be made in compliance with the provisions thereof. Therefore, any position we take concerning the use of "buydowns" in connection with "wraparounds" must be in conformity with what we perceive to be the correct reading of the requirements of that Chapter.

In your letter you mention only "buyers buydowns" but the FNMA brochure you sent also discusses "buydowns" involving a seller or another party other than the home buyer. So far as the provisions of Chapter 5 as they relate to "wraparounds" are concerned, we are of the opinion that "buydowns," whether they are made by the "buyer," "seller," or "other third party," should be treated the same.

As I understand the term "buydown," at the time of a home loan closing the buyer, or the seller, or even a third party (buyer's parents typically), makes a one-time payment which the lender places in an escrow account. For a specified period the buyer makes reduced monthly mortgage payments and monthly withdrawals are made from the escrow account to supplement the buyer's regular monthly mortgage payments. In your letter you "suggest that the buydown option is not prohibited by Texas law and that the buydown funds (which are fully utilized in payment subsidy) are not a 'prepaid finance charge'."

I am not in agreement with your suggestion that "buydown funds" are not prepaid interest, particularly in the instance where such funds are advanced by the borrower. However, because of the fact that we are here concerned only with their treatment on loans subject to Chapter 5 we do not have to decide whether in other loans (those not subject to Chapter 5) they should always be treated as prepaid finance charge.

Article 5.02(5) provides in part as follows:

> "In addition to the authorized charges provided in this Chapter no further or other charge or amount whatsoever shall be directly, or indirectly, charged, contracted for, or received." (Emphasis added.)

We always take the position that the Legislature authorized the interest and other charges they wished for the lender to receive on a Chapter 5 loan, and that the above language is the evidence of legislative intent that the lender should receive no other charges. There is of course no authorization in Chapter 5 for "buydown" funds to be received by a lender in the form of "other charges." Thus, it is our opinion that such funds should not be received as a separate charge by a lender in a "wraparound" or any other loan subject to Chapter 5.

However, if such "buydown" funds are treated as prepaid interest, we are of the opinion that they may be received by the lender in transactions involving these types of arrangements which are subject to Chapter 5. They should be treated in the manner of "points" which may have been received in a Chapter 5 transaction.

Sincerely yours,

Sam Kelley

Sam Kelley
Consumer Credit Commissioner