STATE OF TEXA

OFFICE OF CONSUMER CREDIT COMMISSIONEI

SAM KELLEY, Commissioner

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January 25, 1983 83-1

Mr. Robert K. Fowler
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Dear Mr. Fowler:

This is in response to your two letters concerning a provision in a first mortgage loan on a residential homestead. I will quote a portion of your first letter:

> "This firm represents a borrower who recently closed a purchase money residential homestead loan which contains what is sometimes called a "lockout" feature. This loan, which was closed in March of 1982 at a note rate of 16.50%, provided that the principal of the loan may not be paid in whole or in part except in connection with the conveyance of the property covered by the Deed of Trust to an unrelated third party purchaser in a transaction wherein the note holder has taken one of the following actions: (i) refused to consent to said conveyance after receipt of a written request from the borrower together with the required credit information on the purchaser; or (ii) conditioned consent upon an increase in the rate of interest payable pursuant to the note; or (iii) imposed a transfer fee in excess of $500.00. The effect of this provision is to prohibit the early prepayment of this loan and the subsequent refinancing at a lower rate with a new lender.
>
> "Article 1.07(f) has the effect of prohibiting prepayment penalties or charges on loans on residential homesteads of borrowers if the loans were made after May 8, 1981 at the rate of interest in excess of 12.00%. In your opinion is the "lockout" provision, which prohibits prepayment except under certain conditions, a prepayment "penalty" as contemplated in Article 1.07(f)?"

In the quote from your letter you state that "...the note may not be paid in whole or in part..." I am assuming the word "paid" should have been "prepaid."

In our Letter Interpretation No. 82-22 dated September 22, 1982 we expressed our view that the last sentence of Article 5069 - 1.07(f), V.T.C.S. prohibits prepayment penalties or charges from being collected on residential homestead loans if the rate of interest on the loan is greater than the rate prescribed in Article 5069 - 1.07(d), which rate is 12% per annum. The above mentioned last sentence of Article 1.07(f) was of course enacted in 1981 as a part of H.B. 1228, and was patterned after the prepayment penalty provision in Article 1.07(d)(4) which had been previously enacted in 1979, except that the 1981 version is limited to loans on homesteads. I think it is fair to state with regard to both enactments that the Legislature intended that if a person obtained a loan at an interest rate higher than a certain amount and later, because of lower interest rates in general or some other reason, found it possible to pay off the first loan, that the person should be allowed to do so without incurring a prepayment penalty.

The note provision you describe as a "lockout" feature is not the ordinary type of prepayment charge or penalty which might be assessed. In fact, it is not a monetary type of penalty or charge which would be "collected", and the word "collected" is used in the last sentence of Article 1.07(f). Rather than imposing a monetary type of prepayment penalty or charge, the "lockout" provision, it seems to me, as a practical matter just prohibits prepayment.

Since it is clear that Article 1.07(f) prohibits the collection of prepayment penalties or charges on certain types of loans, it would be inconsistent with that concept to state that Article 1.07(f) does not prohibit a provision which has the effect of precluding prepayment. It is our view, therefore, that Article 1.07(f) prohibits the inclusion in a loan covered thereby the type of "lockout" provision quoted herein from your letter.

You also ask our view as to the current applicability, if any, of Article 1.07(d)(4), the 1979 version of the prepayment penalty prohibition. As you know, Article 1.07(d)(4) has not been repealed even though the rates authorized therein could not be applicable to any loan made on or after September 1, 1981. Article 1.07(d)(4) states as follows:

> "No prepayment charge or penalty may be collected on any loan transaction of the class defined in Subsection (d)(1) bearing a rate of interest in excess of that authorized by Article 1.04, Title 79, Revised Civil Statutes of Texas, 1925, except where such collection is required by an agency created by federal law."

The type of loan described in Subsection (d)(1) is a loan secured by a lien on real property on which is located one or more single family dwellings or dwelling units for not more than four families. This provision is not limited to homestead loans. Also, it is applicable only if the intereest rate charged on the loan is in excess of that authorized by Article 1.04. That maximum rate, when Article 1.07(d)(4) was enacted, was 10% per annum but was increased by H.B. 1228 in 1981. I am of the opinion that Article 1.07(d)(4) still has validity since it has not been repealed and that it applies to those loans it describes which are not covered by Article 1.07(f), the later enactment. Therefore Article 1.07(d)(4) is applicable to non-homestead loans which it describes and which bear a rate of interest in excess of that authorized by the current Article 1.04.

Since that maximum rate will vary from time to time because of the "floating" maximum ceilings, the applicability of Article 1.07(d)(4) to a contract will be determined by the facts applicable to that particular contract.

Sincerely,

Sam Kelley

Sam Kelley
Consumer Credit Commissioner

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