STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

SAM KELLEY, Commissioner

2601 NORTH LAMAR
AUSTIN, TEXAS 78705-4207

(512)479-1280
(214)263-2016
(713)461-4074

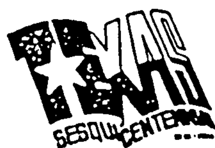
November 21, 1985   85-13

Mr. Daniel A. Winterbottom, Jr.
Brice and Mankoff
Attorneys and Counselors
1909 Woodall Rodgers Freeway
Suite 300
Dallas, Texas 75201

Dear Mr. Winterbottom:

This is to acknowledge receipt of your letter dated October 15, 1985 in which you request an interpretation by this office. I will set out the issues presented by your letter by quoting a portion thereof as follows:

> "My Savings and Loan Association clients issue commitments for 'mini-permanent' loans, i.e., commitments for loans for a term of three to five years, which will be funded upon completion of construction of commercial real estate projects. These commitments frequently contain a provision that the interest rate during the term of the loan will be a fixed rate, which fixed rate will be determined by reference to a formula, which is set forth in the commitment, and the determination made on the day the loan is funded (usually one year or eighteen months after the commitment is issued). As an example, a typical commitment might provide for a fixed rate equal to 250 basis points in excess of the published yield in percent per annum of U. S. Government Securities-Treasury Constant Maturities of three years ('Index') on the date the loan is funded, as such Index is made available by the Federal Reserve Statistical Release H-15 or comparable or similar publication. Use of this Index allows my clients to contract for a rate with the borrower which exceeds by an agreed amount my client's 'cost of funds.' On the day the loan is funded, the interest rate is computed and set forth in the note evidencing the loan as a fixed rate, e.g., twelve percent (12%) per annum.



"If Article 5069-1.04 makes the ceilings which are in effect when the commitment is issued the applicable ceilings for determining the maximum rate, it would be impossible for lenders, when interest rates are likely to increase, to issue commitments for fixed rate loans to be funded in the future, in which they include a precise formula for determining the fixed rate. The lender's risk would be that the rate determined by reference to the formula on the day the loan is funded would exceed the earlier ceilings. As the lender's pricing is based on cost of funds, funding such a commitment would create a loss for the lender.

"I would appreciate your interpretation of Article 5069-1.04 on the issue of whether a lender which issues a commitment to be funded in the future for a fixed rate loan, and in which the interest rate would be determined by reference to a formula on the date the loan is funded, may take advantage of applicable interest rate ceilings at the time the loan is funded which are higher than the ceilings which were in effect when the commitment was issued."

Response

The type of transaction to which you refer would be fixed-rate, closed-end. Thus, either the indicated (weekly) ceiling or the quarterly ceiling could be applicable (Article 5069 - 1.04(a) and (e)). Such ceilings do not go below 18% per annum (Article 5069 - 1.04(b)(1)). The indicated (weekly) ceiling is applicable to interest rates contracted for during the week of that ceiling's applicability and the same is true of the quarterly ceiling for the quarter of its applicability, the key issue in both cases being "when the interest rate is contracted for."

In the situation you describe in your letter, suppose that on January 6, 1986 the parties enter into the described agreement which is subsequently funded on July 10, 1987. The agreement is a fixed rate, closed-end contract. On January 6, 1986 the parties do not agree to a specified numerical rate of interest but rather agree that the rate on the contract will be equal to 250 basis points in excess of the published yield in percent per annum of U. S. Government Securities - Treasury Constant Maturities of three years on the date the loan is funded.

As previously mentioned, the ceilings in effect at the time a rate of interest is contracted for are those which are applicable to the contract. In your described example, it is the opinion of this office that the parties have not on January 6, 1986 contracted for a rate of interest. They have contracted for a method of determining that rate at some future date (in the hypothetical July 10, 1987), and the interest rate is of course not known at the time of the agreement (January 6, 1986). Since the parties have agreed on a method by which the interest rate will be determined at some future date, it is the opinion of this office that the ceilings in effect at that future date should be applicable to the interest charged on the contract. The ceilings in effect at the time of the agreement (January 6, 1986 in the example) would not be applicable to the interest charged on this type of agreement. As is apparent, this conclusion can have the result of working either for or against either the borrower or the lender, but it seems a fair result. Since the parties have agreed to an undetermined rate, it seems appropriate that the ceilings in effect at the time the rate is determined should be applicable to the interest charged on the contract.

Sincerely,

Sam Kelley
Consumer Credit Commissioner