

**OPINION
79-175**

May 31, 1979 (OPINION)

The Honorable Jens J. Tennefos
State Senator, District 46
714 19th Avenue South
Fargo, ND 58102

Dear Senator Tennefos:

This is in response to your letter dated April 3, 1979, wherein you request our opinion regarding the maximum rate of interest allowed to be charged by North Dakota savings and loan associations. In your letter you state:

The savings and loan associations in this state are limited by Section 7-02-04 of the North Dakota Century Code to charging a maximum of 12 percent interest on any loans made by them in this state. Because of rising interest rates nationally, the local savings institutions are becoming increasingly concerned about this limitation.

I understand that at the present time most savings and loans are charging about 10.5 percent interest on standard home loans and that the interest on commercial construction loans may be somewhat higher, but still under the 12 percent limit.

The savings and loans still face an immediate problem however, because in addition to the standard interest charges most savings institutions also charge a fee or "points" for granting and processing the loan. This fee is equal to a certain percentage (usually between one and two percent) of the principal amount of the loan. In some cases the amount paid by the borrower in the first year of the loan for the combination of "points" constitute interest under the usury statute applicable to them and, if so, whether the amounts paid for "points" are allocated over the entire term of the loan for purposes of determining whether the 12 percent limit has been exceeded or whether these amounts paid are all charged to the first year of the loan for that purpose.

I believe that this is an important and significant issue of statewide significance. Consequently, I earnestly solicit your opinion as to whether a savings and loan association which, for example, makes a loan bearing 10.5 percent interest and charges 2 "points" in connection with making that loan has exceeded the 12 percent maximum interest limit provided in Section 7-02-04.

I understand that in most states for purposes of applying the usury statutes, the "points" are treated as interest but are prorated over the term, and then consequently the charging of points does not add significantly to the interest rate for purposes of those states' usury statutes. I am attaching to this letter a legal memorandum outlining the problem in more detail and citing some of the significant cases.

The first question raised by your letter is whether or not "points" charged by state savings and loan associations in connection with the making of a loan are interest as that term is used by the North Dakota statute specifying the interest rate which can be charged by savings and loan associations on real estate mortgages. "Points", as used in this context, have been defined as an amount, whether it be in the form of a bonus, premium, origination fee, or service charge, which is collected at the inception of a loan, and is in addition to the constant stated long-term interest rate. *B. F. Saul, Co. v. West End Park North, Inc.*, 246 A. 2d. 591 at p. 595 (Md. App. 1968).

Chapter 7-02 of the North Dakota Century Code sets forth the powers and duties of savings and loan associations. Section 7-02-04 provides:

<7-02-04. INTEREST, DUES, ASSESSMENTS LIMITED - USURY. - Interest collected by such associations in no event shall exceed twelve percent per annum on the amount of the loan. Interest not exceeding one percent per month also may be charged on delinquent payments or installments from the time such delinquent payments or installments are due. No association shall charge or collect from any shareholder, member, or borrower any fines, premiums, or penalties of any kind whatsoever except as herein provided for delinquent payments or installments. Such dues, interest, or advancements collected from members or others, within the limits of this section, shall not be deemed usury although in excess of the legal rate of interest. (Emphasis added)

This section was held to be determinative of the permissible rate of interest which may be charged by savings and loan associations by the North Dakota Supreme Court in *Cloone v. Minot Building and Loan Association*, 282 N.W. 441 (1938). We can find no other state statutory or case authority directly addressing the issue of whether "points" are interest.

Other jurisdictions, in determining what is and is not to be included as interest, have generally concluded that reasonable charges for actual services, if the services are incidental to the loan, are not included as interest. Examples are charges for an appraisal, title opinion and credit check. See *Cambridge Development Co. v. U.S. Financial*, 90 Cal. Reporter 333 (1970), *Paley v. Barton Savings and Loan Association*, 196 A. 2d. 682 (N.J. 1964). Other jurisdictions have also concluded that "points", on the other hand, are part of the yield to the lender and represent no actual cost. Therefore, these jurisdictions have concluded that "points" are interest because they insure to the benefit of the lender, are part of the yield to the lender, and represent no actual incurred cost. *B.F. Saul, supra*; *Grady v. Price*, 383 P. 2d. 173 (Ariz. 1963); and *State, ex rel., v. Yonkers Brothers, Inc.*, 210 N.W.2d. 550 (Iowa, 1973). See also 45 Am. Jr. ed, *Interest and Usury*, Section 204.

Accordingly, in response to your first question, it is our opinion that the best reasoning, consistent with the authorities cited above, leads to the conclusion that "points" are to be considered as interest, at least insofar as any determination of usury would be

concerned.

The second question raised by your inquiry concerns the manner in which "points" under such circumstances are to be computed as interest. Again, we find no North Dakota statutes or case law which are controlling. We, therefore, must turn to other jurisdictions for guidance and interpretation.

In interpreting a District of Columbia statute, similar to Section 7-02-04, the Court of Appeals in *Montgomery Federal Savings and Loan Association v. Baer*, 308 A. 2d. 768 (D.C. App. 1973), reversed the lower court ruling and held that the term "per annum" refers to the maximum rate of interest chargeable for the term of the loan, regardless of how much of that interest might be collected during the first year of the loan in the form of "points". The court went on to rule that the payment of "points" should be prorated over the entire term of the loan:

We believe that the trial court's interpretation misconstrues the statutory language and results in an erroneous application of the usury statute. That law does not read that the rate cannot exceed 8 percent annually or 8 percent for any one year, but it states it shall not exceed 8 percent 'per annum'. As the Missouri Supreme Court succinctly said in *First National Bank v. Kirby*, 175 S.W. 926, 929 (Mo., 1915), 'the words 'per annum' . . . designate rate of interest, while the word 'annually' . . . indicates the time of payment.' (Emphasis added). Thus, the phrase '8 percent per annum' in section 28-3301 relates to the rate of interest and rate only. It has no bearing on the time of payment, as to which the statute is simply silent. A review of usury cases decided in this jurisdiction, and elsewhere, convinces us that this is the correct interpretation of the statutory language.

. . . .

While it is the generally accepted rule that 'points' are considered as interest, it appears that every court in other jurisdictions which has decided the question we have before us has held that the 'points' should be prorated or apportioned over the entire term of a loan in determining if the rate of interest is usurious. Three states, Oregon, Tennessee and Virginia have statutes to the same effect. The courts of the remaining states to our knowledge either have not directly faced the proration issue, or they have no usury laws, or have exempted savings and loan associations from their usury statutes.

. . . .

We agree with the foregoing authorities that a loan placement fee should relate to the whole loan for the entire period it is outstanding and is not attributable to interest in any single year. The payment of points by the borrower although paid in full the first year is in consideration of the lender making the full loan for the entire term and the borrower does not pay such a fee for the privilege of having the use of the money for

only one year. (Pages 771, 772 and 773)

The Montgomery court cited numerous cases from other jurisdictions holding that "points" must be prorated or apportioned over the entire term of the loan in determining if the interest rate is usurious. (P. 772, footnote 17) The Montgomery court also relied upon the United States Supreme Court decision of Fowler v. Equitable Trust Company, 141 U.S. 411, (1891), holding that the determination of whether or not a loan is usurious is dependent upon the total amount of interest collected over the life of the loan.

In reliance upon the above-cited authorities, it is our opinion that "points" are to be prorated over the entire term of a loan for the purpose of determining the rate of interest.

Finally, while the case law referred to above does not rely on any one precise method of calculation to be used in computing interest rates by prorating "points" over the entire term of a loan, one step in the calculation, however, is considered by all of the courts to be essential and is also required by the federal government's disclosure law, the Truth in Lending Act and its accompanying regulations. (See 12 CFR 226) This step is that the interest, including points, must be calculated on the amount of money actually loaned (the face amount of the note minus the points deducted) and may not be calculated on only the face amount of the note. The reviewing courts have reasoned that the borrower has use of only the amount of the note minus points and is paying interest for the privilege of using only that amount.

It is hoped that the foregoing will be of assistance.

Sincerely,

ALLEN I. OLSON

Attorney General