

TO: All Personnel
FROM: Emil E. Tahvonen

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Mortgages - Variable Rate

STATE OF MICHIGAN

FRANK J. KELLEY, ATTORNEY GENERAL

MORTGAGES: Variable rate mortgages

In the absence of state legislation, lenders subject to the federal Depository Institutions Deregulation and Monetary Control Act of 1980 may issue variable rate mortgages.

Opinion No. 6000

OCT 21 1981

Norton L. Berman, Director
Department of Commerce
Law Building
Lansing, Michigan

You have requested my opinion on the question whether a lender subject to the federal Depository Institutions Deregulation and Monetary Control Act of 1980, 94 Stat 161-168 (1980), 12 USC 226 note, may issue variable or adjustable rate mortgages in Michigan.

A variable or adjustable rate mortgage is defined as a mortgage loan "made pursuant to an agreement intended to enable the lender to adjust the rate of interest from time to time...." 46 F.R. 18943 (March 27, 1981); 12 CFR 29. The interest rate adjustments are linked to changes in a predetermined index which may include any criteria which is verifiable by the borrower and beyond the lender's control, such as the national average of mortgage rates, the average cost of funds to insured lenders, or the average treasury bill rate. By using variable rate mortgages, lenders may maintain the return on their loan portfolios in a current market condition, while borrowers may experience agreed to, but uncontrollable changes (by the parties to the mortgage contract), in their monthly mortgage payment.

The ability of a lender in Michigan to increase the initially agreed upon interest rate is limited by 1966 PA 326, § 1c, as added by 1969 PA 305; MCLA 438.31c; MSA 19.15(1c), which provides, in pertinent part:

"(2) For the period ending on December 31, 1981, it is lawful for the parties to a note, bond, or other evidence of indebtedness, executed after August 11, 1969, the bona fide primary security for which is a first lien against real property, or a land lease if the tenant owns a majority interest in the improvements thereon, or the parties to a land contract, to agree in writing for the payment of any rate of interest, but the note, mortgage, contract, or other evidence of indebtedness shall not provide that the rate of interest initially effective may be increased for any reason whatsoever....

* * *

"(3) Subsection (2) shall not impair the validity of a transaction or rate of interest lawful without regard to subsection (2)."
(Emphasis added.)

Initially, it must be noted that the prohibition against variable rate mortgages only applies to a "note, mortgage, contract, or other evidence of indebtedness" subject to 1966 PA 326, § 1c(2), as amended, supra, which are loans executed after August 11, 1969 and secured by first liens against real property, or a land contract. See Campbell v Gawart, 46 Mich App 529, 531; 208 NW2d 607, 609; 60 ALR 3d, 469, 471 (1973). Thus, the prohibition does not apply to loans made pursuant to alternative authority, such as loans secured by second liens on real property under 1969 PA 319, § 194(4), as added by 1978 PA 293; MCLA 487.494(4); MSA 23.710(194)(4), or loans to corporations made pursuant to 1972 PA 284, § 275; MCLA 450.1275; MSA 21.200(275). Most significantly, the usury law clearly states that the prohibitions contained in subsection (2) may not impair the validity of a transaction which would otherwise be lawful without regard to subsection (2).

Assuming that all the loans in question are first lien residential loans, the question presented is whether a variable rate mortgage may be made pursuant to alternative authority which would be valid in the absence of 1966 PA 362, § 1c, as amended, supra. As explained in detail in OAG, 1980-1981, No 5894, p ____ (May 1, 1981), the state's usury laws relating to first lien residential real property loans have been preempted by the federal Depository Institutions Deregulation and Monetary Control Act of 1980, supra. This federal regulation applies to lenders who are either federally regulated or otherwise federally approved, although a recent amendment to the act authorizes individuals who finance the sale of unencumbered residential real property in which they live to also take advantage of the federal usury preemption. 94 Stat 1648 (October 8, 1980); 12 USC § 1735f-7 note.

Since the federal Depository Institutions Deregulation and Monetary Control Act of 1980, supra, exists as alternative legal authority permitting eligible lenders to issue loans secured by first liens on real estate at any rate of interest, 1966 PA 326, § 1c, as amended, supra, does not invalidate the transaction.

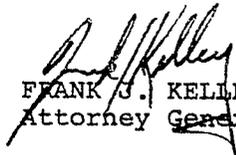
In reaching this conclusion, the following observations are in order. Variable rate mortgages are permitted in Michigan, not because of any specific federal preemption of the state's prohibition against variable rate mortgages,¹ but because the federal Depository

¹The preemptive provisions of the federal Depository Institutions Deregulation and Monetary Control Act of 1980, supra, only act to override interest rates or components of the interest rate, such as discount points or miscellaneous charges. 94 Stat 161 (1980); 12 USC § 1735f-7 note. The preemption was not intended to preempt provisions of state law designed to protect consumers. See S Rep No 96-368, 96th Cong, 2d Sess 19; 1980 US Code Cong and Admin News, Vol 2, Legis Hist, PL 96-221, at p 255.

Institutions Deregulation and Monetary Control Act of 1980, supra, stands as alternative, independent authority for the making of real estate loans, and because 1966 PA 362, § 1c, as amended, supra, expressly provides that subsection (2) thereof may not act to invalidate an otherwise lawful transaction.

The Legislature may reimpose the state's prohibition against variable rate mortgages by either overriding the applicability of the federal Depository Institutions Deregulation and Monetary Control Act of 1980, supra, pursuant to authority found at 94 Stat 167 (1980); 12 USC § 1730g note, or by enacting legislation prohibiting provisions in any mortgage which would act to increase the initially effective rate.

It is my opinion, therefore, that in the absence of state law to the contrary, qualified lenders doing business in Michigan who are subject to the federal Depository Institutions Deregulation and Monetary Control Act of 1980, supra, may issue variable rate mortgages.


FRANK J. KELLEY
Attorney General