The State of South Carolina
Department of Consumer Affairs
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Administrative Interpretation No. 1.202-8106

FIRST MORTGAGE LOAN WHOSE PURPOSE IS SOLELY TO PAY OFF A BONA FIDE INITIAL CONSTRUCTION LOAN IS EXCLUDED FROM THE CONSUMER PROTECTION CODE UNDER CERTAIN CIRCUMSTANCES.

You have asked whether a permanent loan secured by a first mortgage on real estate which is made to an individual and used entirely or primarily to pay off a previously existing bona fide construction loan to build a residence would be considered a refinancing of a first mortgage loan and therefore a consumer loan subject to the Consumer Protection Code. Whether the loan is a consumer loan subject to the Consumer Protection Code or excluded from it will be determined by the facts involved in a particular transaction.

You described a typical situation which would give rise to this question as follows. An individual obtains a bona fide construction loan for a relatively short period of time, customarily nine months to one year, during which time the residence is being built and he is required to pay interest only. The loan would be for the purpose of building a residence in which the individual and his family will live. The construction loan is secured by a first mortgage on the subject property. Although such a construction loan to an individual to build his residence meets the definition of consumer loan in Consumer Protection Code Section 37-3-104 (Cum.Supp.1980 as amended by §2 of Act No. 6 of 1981, R16,H2164) until June 30, 1985, most such loans are nonetheless excluded from the Consumer Protection Code by Section 37-1-202(11) (Cum.Supp.1980 as amended by §1B of Act No. 6 of 1981, R16,H2164). AI's No. 3.104-7908 and 3.201-7909 of May 10, 1979. Subsection (11) of Section 37-1-202 excludes a loan "made to enable the debtor to build or purchase a residence" and therefore excludes initial construction loans from the Consumer Protection Code when made by a lender whose construction loans are subject to governmental supervision or by a Federal Housing Administration approved mortgagee or by a person other than an organization who makes no more than 10 consumer loans in a year. AI No. 3.508-7910 of June 5, 1979.

Assuming the loan in your fact situation was made by a creditor whose loans qualify for exclusion under Section 37-1-202(11), your question becomes whether the permanent loan to pay off such a construction loan would also be excluded from the Consumer Protection Code. It is the opinion of this Department that a permanent loan secured by a first mortgage which is solely for the purpose of paying off an initial construction loan as described above is excluded from the Consumer Protection Code when made by a creditor whose loans qualify for exclusion under that subsection.

Although most refinancings of first mortgage loans to build or purchase a residence are consumer loans subject to the Consumer Protection Code, in our opinion certain permanent loans to pay off a construction loan were intended by the General Assembly to be excluded from the Consumer Protection Code. As you

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pointed out, we had earlier issued an administrative interpretation that a construction loan to an individual to build his own home was not a consumer loan if secured by a first lien on land. AI No. 3.104-7706 of May 13, 1977. At that time, subsection (2) of Section 37-3-104 was in effect which excluded a loan "primarily secured by a first lien which is a purchase money security interest in land." We concluded that a construction loan was intended to be included in that exception to the definition of consumer loan and therefore to be excluded from the Consumer Protection Code itself. At that time, home acquisition loans were subject to the ceiling for first mortgage real estate loans contained in the second proviso to S.C. Code Section 34-31-30 (1976). Finding first mortgage loans for home acquisition purposes such as construction loans to be excluded from the Consumer Protection Code resulted in all such loans being subject to the rate ceiling under Section 34-31-30 (then generally 9%) which we believed to be the intent of the legislature.

The law governing rates on first mortgage real estate loans was amended by Act No. 7 of 1979 effective February 8, 1979 which deleted the second proviso in Section 34-31-30 and provided that first mortgage real estate loans had no rate ceiling at all with certain exceptions. Section 1 of Act No. 6 of 1981 (R16,H2164) extended Section 1 of Act No. 7 of 1979 until June 30, 1985. The combination of extending the time period for removal of the ceiling on certain first mortgage real estate loans, removing the exception to the definition of consumer loan in Section 37-3-104 contained in subsection (2) of that section, and excluding certain first mortgage loans from the Consumer Protection Code in Section 37-1-202(11) was apparently for the purpose of allowing the market to determine the appropriate rate for most first mortgage home acquisition loans. Although the relevant provisions of the Consumer Protection Code are non-uniform, the result is in keeping with the Uniform Consumer Credit Code's intent to exclude the ordinary home mortgage from most provisions of the UCCC. See official comment 1 to 1968 UCCC §3.105 and official comment to 1974 UCCC §1.301(15).

In our opinion, a first mortgage loan to obtain permanent financing for a residence which is used solely to pay off the initial construction loan to build that residence qualifies as a "first mortgage loan made to enable the debtor to build or purchase a residence" for purposes of Section 37-1-202(11). A construction loan is often the first step in financing a consumer's purchase of his residence. The construction loan can be seen as one phase of two phases of financing with the permanent loan's being the final phase. Although the construction loan was made to enable the debtor to build a residence, the permanent loan may nonetheless be seen as a loan to purchase that same residence.

A first mortgage permanent loan used solely to pay off an initial construction loan must be distinguished from other types of refinancings of first mortgage loans. Ordinarily, a refinancing is a consumer loan subject to the Consumer Protection Code assuming it meets the elements in the definition of consumer loan in Section 37-3-104. For example, a first mortgage loan made to a consumer to pay off an existing first mortgage loan on his residence with funds added for home improvement or other personal, family or household purposes is subject to the Consumer Protection Code because it is no longer a loan "to enable the debtor to build or purchase a residence." Likewise, a first mortgage loan to pay off a construction loan is subject to the Consumer Protection Code if additional funds are loaned for other personal, family or household purposes because the loan would no longer be solely "to enable the debtor to build or purchase a residence" and thus, in our opinion, would not be the type of loan intended to be excluded.

In summary, in our opinion a first mortgage permanent loan made to enable the consumer to pay off a bona fide initial construction loan is excluded from the Consumer Protection Code if two conditions are met: (1) the creditor's loans qualify for exclusion under Section 37-1-202(11) and (2) the loan involves no funds in addition to funds necessary to pay off the construction loan plus any financed closing costs incident to the loan.

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