

# The State of South Carolina

## Department of Consumer Affairs

2221 DEVINE STREET  
P.O. BOX 5757  
COLUMBIA, S.C. 29250-5757

STEVEN W. HAMM  
ADMINISTRATOR  
AND  
CONSUMER ADVOCATE

June 15, 1982

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Administrative Interpretation No. 3.201-8201

SECOND MORTGAGE CONSTRUCTION LOAN TO CONSUMER IS CONSUMER LOAN SUBJECT TO THE PROVISIONS OF THE CONSUMER PROTECTION CODE. A SUBSEQUENT FIRST MORTGAGE LOAN MADE BY THE SAME LENDER TO THE SAME INDIVIDUAL SECURED BY A NEWLY CONSTRUCTED RESIDENCE IS EXCLUDED FROM THE CONSUMER PROTECTION CODE UNDER CERTAIN CIRCUMSTANCES.

You have asked whether an arrangement for financing home acquisition is permissible under the South Carolina Consumer Protection Code and what interest rate maximum, if any, would be applicable to the arrangement described below.

A home purchaser, having considerable equity in an existing home, seeks to construct another, larger home. The lender, a Federal Housing Administration approved mortgagee, makes a cash advance loan secured by a second mortgage on the existing residence to the purchaser of as much as 75% of the equity in that existing home, in order to allow the purchaser to acquire land, pay initial construction costs, and so on.

Such a loan would be repayable by either of two different methods: (1) a twelve month repayment period in which repayment is deferred over the first six months, and in the second six months, six payments of one months interest each are made, with all principal and outstanding interest coming due at the end of the twelve month period, or (2) a nine month single payment note, with interest. In either event it is contemplated that the borrower/purchaser will be able to sell his or her existing home within a year and then be able to extinguish the indebtedness on the second mortgage construction loan.

In most instances, the second mortgage loan would be insufficient to cover the entire expense of constructing the new home, and the lender would in many cases provide permanent financing on the new home being constructed, taking a first mortgage on it. The loan secured by the first mortgage on the newly constructed home and the loan secured by the second mortgage on the existing home would be separate transactions, with two separate sets of loan documents. Upon entering the second mortgage construction loan, the borrower/purchaser is not bound to enter the first mortgage permanent financing agreement. A default on one of the loans is not regarded as a default on the other.

The loan secured by the second mortgage on the borrower/purchaser's existing home would appear to be a consumer loan subject to the provisions of the South Carolina Consumer Protection Code. The lender is regularly engaged in the business of making loans in which the debtor is an individual seeking to use the proceeds to acquire a home, the debt is either payable in installments,

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758-8996

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or, in the case of the nine month single payment plan, a loan finance charge is made, and the principal is secured by an interest in land. See S.C. Code Ann. § 37-3-104 (1976 as amended).


Regarding the first repayment method mentioned above, the question arises as to whether the final principal payment would be a "balloon payment" under S.C. Code Ann. § 37-3-402 (1976 as amended). If so, the lender would be required to allow the debtor to refinance the balloon payment at terms no less favorable than the terms of the original loan. In Administrative Interpretation No. 2.405-7605, this Department stated that a "balloon payment" did not include a single principal payment preceded by periodic payments of interest alone in a consumer credit sale transaction. It is the opinion of this Department that the same reasoning should apply to consumer loans.

The maximum rate of finance charge on the second mortgage transactions would be 18% per year calculated according to the actuarial method, unless the creditor were a supervised lender, or a supervised financial organization [S.C. Code Ann. §§ 37-3-501 and 37-3-502 (1976 as amended)], in which case the creditor could take advantage of the higher graduated rate on loans of relatively small amounts. S.C. Code Ann. § 37-3-201 (1976 as amended). Nevertheless, as of July 1, 1982, such supervised lenders and supervised financial institutions will be permitted to charge a self-imposed rate maximum by Section 33 of the South Carolina Consumer Protection Code Revision Act, Act No. 385 of 1982.

The loan secured by the first mortgage on the newly constructed residence presents a different question. Because it would be a first mortgage loan to build or purchase a residence, the loan would be excluded from the South Carolina Consumer Protection Code if the creditor is a Federal Housing Administration approved mortgagee. S.C. Code Ann. § 37-1-202(11) and Administrative Interpretation No. 1.202-8106. If in such a transaction the loan contract provided for a fixed rate of interest, the right to prepay in full without penalty, and if the loan was for \$100,000 or less, the parties could contract for any rate of finance charge. See Act No. 7 of 1979 as amended by Act No. 6 of 1981; but see § 57 of Act No. 385 of 1982.

In conclusion, the Consumer Protection Code does not forbid a lender to make a loan for purposes of initiating construction of a home secured by a second mortgage on the borrower's existing home, even when such loan is made in connection with a separate first lien purchase money construction loan on the home being built.

Steven W. Hamm  
Administrator

By   
Philip S. Porter  
Counsel to the Administrator

PSP/sbb