USURY: It is the opinion of this office that the making
INTEREST: of a loan by requiring the execution of a note to the principal of which is added simple interest on the entire amount of the loan at the rate of five per cent per annum for seven years, payable over a period of 84 months in equal monthly installments and secured by a first deed of trust on real estate constitutes usury in that the total interest payable on the note evidencing the debt would exceed eight per cent per annum as limited by Sections 408.030 and 408.050, RSMo.

September 11, 1969

OPINION NO. 292

Honorable Robert H. Branom
State Representative
35th District
7701 Forsyth, Suite 574
Clayton, Missouri 63105

Dear Representative Branom:

This is in response to your request for an opinion as to the legality of five per cent add-on interest on a note secured by a first deed of trust on real estate payable in equal installments over 84 months.

We interpret the question to refer to a loan to a borrower to whom a requested amount is advanced in money and the borrower signs a note in an amount equal to the sum of the amount advanced plus interest on the advanced amount equal to seven times the interest for one year on the entire principal sum. That is, in addition to the amount advanced there is included in the face amount of the note simple interest on the amount advanced for a period of seven years. The note is then made payable in 84 equal installments with interest from maturity. For example, in a loan of $1,000.00 the annual interest on that sum would be $50.00 and since the loan is for 84 months (seven years) a sum equal to seven time the $50.00 is added onto the principal making the total face value of the note $1,350.00. This amount is payable under the terms of the note in 84 equal monthly installments commencing the month following the making of the loan and the face amount of the note bears no interest until after maturity.

Your inquiry refers to Section 408.070 V.A.M.S. and 408.080 V.A.M.S. We believe that neither of these sections are applicable

or relevant to the hypothetical situation proposed. Section 408.070, RSMo Supp. 1967, invalidates a lien on personal property where it secures a loan which is usurious. This section is not applicable to loans involving liens on real estate. Section 408.080 provides for the compounding of interest not oftener than once a year. This section also would be inapplicable because interest has been added to the principal amount of the loan and payments are being made monthly, thereby eliminating the payment of interest on interest.

Chapter 408 of the Revised Statutes of Missouri provides what may be charged as interest on loans not covered by other provisions of the law. The loan described in your questions is governed, we believe, by Sections 408.030 and 408.050, RSMo. These are the general sections prescribing permissible interest rates and the small loan provisions of Chapter 408 do not apply to the loan described because it involves a loan secured by real estate and is, therefore, specifically excluded by Section 408.100.

Section 408.030, RSMo provides as follows:

> "The parties may agree, in writing, for the payment of interest, not exceeding eight per cent per annum, on money due or to become due upon any contract."

Section 408.050, RSMo provides as follows:

> "No person shall directly or indirectly take, for the use or loan of money or other commodity, above the rates of interest specified in sections 408.020 to 408.040, for the forbearance or use of one hundred dollars, or the value thereof, for one year, and so after those rates for a greater or less sum, or for a longer or shorter time, or according to those rates or proportions, for the loan of any money or other commodity. Any person who shall violate the foregoing prohibition of this section shall be subject to be sued, for any and all sums of money paid in excess of the principal and legal rate of interest of any loan, by the borrower, or in case of borrower's death, by the administrator or executor of his estate, and shall be adjudged to pay the costs of suit, including a reasonable attorney's fee to be determined by the court."

This office is of the opinion that the loan proposed would be in violation of the maximum interest rates allowed by the above sections of the statutes and would constitute usury.

To illustrate that the loan would be in excess of eight per cent per annum, consider a proposed loan in which the borrower is to receive $1,000.00 in money. The note would be executed in the face amount of $1,350.00. The note provides for 84 equal monthly installments commencing one month after date in the sum of $16.07+. The total interest paid over the period of seven years (84 months) is $350.00.

Available amortization tables reveal that a loan of $1,000.00 at eight per cent per annum, the maximum rate, payable over a period by 84 monthly installments requires a monthly payment of $15.586 per month. Eighty-four of these payments would total $1,309.224. Thus, the five per cent add-on exceeds by $40.87- interest on the unpaid balance at the rate of eight per cent per annum.

It is believed that Sections 408.020 and 408.050 read together would prohibit the taking of interest for a loan in excess of eight per cent per annum on the unpaid balance. Section 408.050 is not entirely clear in its expression, but it must be interpreted to mean that $8.00 is the amount permitted for the use of $100.00 for one year and that the same rate is true whether the sum is more or less than $100.00 and the time longer or shorter than one year.

There is a scarcity of cases defining the exact application of the sections of the statutes as pertains to installment loans. The subject is discussed in a Comment, by Gilbert B. Stephenson, in Volume 26, Missouri Law Review, Page 217, l.c. 228, as follows:

> "Installment loans are typically those which are borrowed in a lump sum but are repaid by periodic installments over a stated length of time. Because of the complexities in figuring the amounts of interest that can be legally charged on a loan the principal of which is decreased by each installment paid, the installment loan transaction is often a source of illegal profits for the lenders. The device most often used by the lenders in gaining their illegal profits is that of charging maximum legal interest on the whole sum loaned until the last installment is to be paid. This interest is simply added to the principal debt and paid in proportion to the installment. For example, in Hanson v. Acceptance Fin. Co., the principal

> debt was $1663.20, to be repaid in 18 monthly installments. The debt allegedly was to draw eight per cent interest but the lender included the sum of $226.80 interest to be paid proportionately to the installments. This sum of interest was in excess of the amount which could have been charged had the transaction not been an installment loan. Thus, the borrower was paying interest at approximately twice the lawful rate. When such a provision is called to the attention of the court it is declared usurious."

In Annotation, "Taking or charging interest in advance as usury", 57 A.L.R.2d 630, l.c. 666, it is stated:

> "Where interest on installment repayment loans has been charged in advance by adding to the principal the amount of interest computed thereon for the entire term of the loan, and making the installments in such amount as to repay the entire sum thus derived, it has been usurious. This method of taking interest in advance has the same usurious result as the deduction of interest from the principal delivered, becauge it ignores the fact that the principal does not remain outstanding for the duration of the loan in the amount on which the interest was computed."

It is likewise stated in Corpus Juris Secundum that such a loan would constitute usury, 91 C.J.S., Usury, Section 29B, Page 605:

> "Where the principal sum of a loan or debt is made payable in installments at specified intervals within the full period of the loan, but interest for the full period on the whole principal sum is agreed to be paid, or is taken or withheld by the lender in advance, or is included in the face amount of the note, the transaction is usurious, whether or not the rate of interest stipulated in the contract exceeds the maximum specified by law, if the sum so agreed to be paid or so deducted as interest is greater than interest at the lawful rate on the principal sum for the period for which it is actually lent. Similarly, where interest is calculated at the highest lawful rate for the full period of a loan, and the aggregate of the

> principal and the interest as so calculated is divided into a series of notes which mature at intervals within the full period, the transaction is usurious . . . . "

The Missouri courts have followed the above stated rules.

In VanDoeren vs. Pelt, 184 S.W.2d 744 (St.L.App., 1945) the Court of Appeals stated:

> "That the loan in this case was tainted with usury there can be no question. The maker of the note was borrowing $150 for fifty weeks. He did not get $150, he got $135. What was the $15 deducted for? The evidence shows $1.50 represented insurance premium, which was a proper deduction. The evidence shows $1.50 was deducted for an investigation. This was a proper charge and authorized under subdivision 3 of Section 5421, R.S. 1939, Mo. R.S.A. (loan and investment companies), if there was proof to justify the charge. Missouri Discount Corp. v. Mitchell, 216 Mo. App. 100, 261 S.W. 743. Plaintiff's witness Van Doeren could not remember the details of the transaction and could not swear what was done by the company with reference to investigation. The most he would say was his conclusion that an investigation of defendants' credit standing was made because that was the usual practice. But even if it be conceded that the charge was a proper one, $12 was deducted, which amounted to a year's interest at 8% on $150 which had been loaned for only fifty weeks, two weeks short of a year; not only so, but payments were contracted for of $3 each week throughout the term of fifty weeks. It is apparent without here making a computation that plaintiff was contracting for considerable in excess of 8% per annum interest, the legal rate."

In Hecker vs. Putney, 196 S.W.2d 442 (St.L.App., 1946) the plaintiff had borrowed and received $560.00 and had signed notes totaling $725.50 of which $700.00 was stated as principal and $25.50 the first year's interest at six per cent. Plaintiff signed twelve notes which fell due one on each month consecutively for one year. There the court held that this constituted and the evidence sustained a finding of usury and upon tender of the balace of the amount legally due the second mortgage on a real estate securing the notes was discharged and foreclosure was enjoined.

The device of adding on interest on the full principal amount of the loan although it is repaid in installments over a period of time will, in our opinion, result in usury if the total interest paid over the period of the loan exceeds eight per cent per annum on the unpaid balance. To compute the actual interest charged in the loan suggested in your question would require 84 separate computations. However, the foregoing computations demonstrate that the transaction would provide for interest in excess of the legal rate as provided by the applicable sections of the statutes and therefore would constitute usury.

CONCLUSION

It is the opinion of this office that the making of a loan by requiring the execution of a note to the principal of which is added simple interest on the entire amount of the loan at the rate of five per cent per annum for seven years, payable over a period of 84 months in equal monthly installments and secured by a first deed of trust on real estate constitutes usury in that the total interest payable on the note evidencing the debt would exceed eight per cent per annum as limited by Sections 408.030 and 408.050, RSMo.

The foregoing opinion which I hereby approve was prepared by my Special Assistant Larry L. Zahnd.

Yours very truly,

John C. Danforth

JOHN C. DANFORTH
Attorney General