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THE REVISED ARTICLE 5069-1.07(b)

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In 1975, the Texas Legislature passed article 5069-1.07(b)† (the "present article") which reads as follows:

(b) Notwithstanding any contrary provisions of the law, any person may agree to pay, and may pay pursuant to such an agreement, the same rate of interest as corporations (other than non-profit corporations) on any loan in the principal amount of $500,000 or more, which is made for the purpose of interim financing for construction on real property or financing or refinancing of improved real property, and such a loan shall not be subject to the defense of usury unless it exceeds the maximum lawful interest rate for corporations (other than non-profit corporations).

Because of certain problems with the language of this article, a group of attorneys practicing in real estate drafted and proposed to the 1979 legislature a revision of this statute. The revision (the "amended article") passed the Texas Legislature as Senate Bill 10 which reads as follows:

(b) Notwithstanding any contrary provisions of law, any person may agree to pay, and may pay pursuant to such an agreement, any rate of interest not exceeding 18 percent per annum, if such agreement is evidenced by a written bond, note, or other contract of such person providing for a loan or other extension of credit in the original principal amount of $250,000 or more, or any series of advances of money if the aggregate of all sums advanced or agreed or contemplated to be advanced pursuant to such agreement equals or exceeds $250,000 or any extension or renewal of such loan or other extension of credit (regardless of whether or not the outstanding principal balance thereof at the time of such renewal or extension is $250,000 or more); and as to any such agreement to pay or payment, the claim or defense of usury by such person or such person's heirs, personal representatives, successors, substitutes or anyone else on such person's behalf, or by any person acting as guarantor, surety, accommodation maker, or endorser for or with respect to such agreement to pay or payment, or by any person assuming the obligation of such

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† TEX. REV. CIV. STAT. ANN. art. 5069-1.07(b) (Vernon Supp. 1978-1979).
‡ Id.
payment or otherwise becoming liable therefor, or by any person owning or acquiring property subject to a lien securing such agreement to pay or such payment is prohibited. Notwithstanding anything to the contrary contained herein, this Subsection (b) shall not apply to any loan or other extension of credit secured by (i) a lien on a building, constructed or to be constructed, which both is used or intended to be used as a single one-to-four family residence and is occupied or intended to be occupied by a person obligated to pay such loan or other extension of credit or (ii) a lien on land intended to be used primarily for agricultural or ranching purposes. Nothing herein shall be construed to limit or otherwise affect the provisions or application of Article 2.09, Texas Miscellaneous Corporation Laws Act, as amended (Article 1302-1.01 et seq., Vernon's Texas Civil Statutes), with respect to loans or other extensions of credit not covered hereby.  

This Bill has been signed by the Governor and will become effective on August 27, 1979.  

The principal changes in the amended article are the expansion of the concept of a large loan from a loan of $500,000 or more to a loan of $250,000 or more and the removal of the restriction that the statute applies only to those loans made for the purpose of interim financing for construction on real property or financing or refinancing of improved real property. The only exceptions to this statute are that, without regard to amount, it does not apply to any loan or extension of credit secured by either a lien on a building, constructed or to be constructed, that is used or intended to be used as a single one-to-four family residence and is occupied or to be occupied by a person obligated to pay the loan or other extension of credit or a lien on land intended to be used primarily for agricultural or ranching purposes. 

While the present article is restricted in its application to loans above $500,000 made for the purpose of interim financing for construction on real property or financing or refinancing of improved real property, the amended article is not restricted in its application to any particular type of collateral nor to any particular purpose of the loan. The amended article is intended to cover every loan of $250,000 or more (except for those loans specifically excepted from the operation of the article) without regard to the identity of the

4. Id.
lender or the borrower, the purpose of the loan, the type of security, the existence of security or any other matter.

The inclusion in the present article of only those loans "made for the purpose of interim financing for construction on real property or financing or refinancing of improved real property" has caused numerous problems of interpretation in the real estate lending area. For example, it is common for a construction loan to include the cost of the land as well as costs of construction. Is the portion of the loan attributable to the purchase of the raw land a loan "made for the purpose of interim financing for construction on real property?" Many practitioners think that there is at least an ambiguity here that requires that two loans be made, one for the land and one for the construction costs. This involves two sets of loan papers and increased attorney's fees and other costs. Another example of a problem of interpretation arises when a loan is made secured by a lien on improved real property but the proceeds of the loan are to be used by the borrower for the purchase of other tracts of unimproved real property. Is this loan "for the purpose of financing or refinancing of improved real property?" The statute does not say "secured by improved real property;" it is required that the loan be for the purpose of financing or refinancing of improved real property. Because of this ambiguity, many practitioners have taken the position that a loan of the above description would not fall within the present article. It is felt that the amended article removes these ambiguities regarding the scope and coverage of the article.

The maximum interest rate provided for in the present article has been changed from "the same rate of interest as corporations (other than non-profit corporations)" to eighteen percent per annum. One of the primary requirements for a usury statute is certainty about what rate can be charged, and it was felt that a specific rate per

6. Although the present article has never been construed by an appellate court, commentators have pointed out the ambiguities in the statute. See Wallenstein & St. Claire, Property, Annual Survey of Texas Law, 30 Sw. L.J. 28, 45-46 n.152 (1976).


8. See Tex. Const. art. XVI, § 11. "The Legislature shall have authority to . . . fix maximum rates of interest; provided however, in the absence of legislation fixing maximum rates of interest all contracts for a greater rate of interest than ten per centum (10%) shall be deemed usurious . . . ." Id. Any statute that purports to regulate interest but fails to define interest or fix a maximum rate of interest is unconstitutional. See Gonzales County Sav. & Loan Ass'n v. Freeman, 534 S.W.2d 903, 908 (Tex. 1976).
annum was preferable to cross-referencing the rate corporations may pay. A second advantage to the use of the specific rate is the removal of the phrase "(other than non-profit corporations)" from two places in the present article. These references have caused considerable uncertainty since the proviso in the corporate exemption statute reads "nothing contained herein shall prevent any charitable or religious corporation from asserting the claim or interposing the defense of usury in any action or proceeding." In the years after article 1302-2.09 was passed in 1967, it was assumed by many practitioners that this reference to charitable or religious corporations did not include all non-profit corporations, with the result that a non-profit corporation that was not a charitable or religious corporation could pay interest at a rate of up to one and one-half percent per month on loans of $5000 or more. The use of the parenthetical phrase "other than non-profit corporations" in the present article raised the question whether the original assumption was correct with the result that many practitioners are now hesitant to give an opinion that a non-profit corporation which is not a charitable or religious corporation can pay more than ten percent per year under article 1302-2.09. It is hoped that the removal of these references in the amended article will eliminate this problem. Whatever the situation with respect to non-profit corporations under article 1302-2.09, the all-inclusive definition of "person" as used in the amended article and defined in article 5069-1.01(e) makes it clear that all non-profit corporations, including charitable and religious corporations, are entitled to use the amended article.

Several questions that arise in normal real estate financing practice which are not answered by the present article are answered by the amended article.

(a) The present article does not cover the situation in which a series of advances, rather than a lump sum disbursement, equals or

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9. See Tex. Rev. Civ. Stat. Ann. art. 1302-2.09 (Vernon Supp. 1963-1978). Although the corporate rate has been set at one and one-half percent per month, at least one court has stated that the rate is equivalent to eighteen percent per annum. See Micrea, Inc. v. Eureka Life Ins. Co. of America, 534 S.W. 2d 348, 353 (Tex. Civ. App.—Fort Worth 1976, writ ref'd n.r.e.) (dictum).


exceeds the applicable loan limit. The amended article now makes it clear that it covers a series of advances if the aggregate of all sums advanced or agreed or contemplated to be advanced pursuant to the agreement equals or exceeds $250,000.

(b) The present article does not apply when the original loan is extended or renewed. This problem is particularly acute when the original loan has been paid down below the cutoff line for a “large loan.” The amended article now provides that if the original loan equals or exceeds $250,000, any extension or renewal of the loan, regardless of whether or not the outstanding principal balance thereof at the time of renewal or extension is $250,000 or more, comes within the purview of the statute.

(c) The present article does not make it clear who is prohibited from the claim or defense of usury if the exemption applies. The amended article provides that the claim or defense of usury is prohibited not only to the borrower but anyone who otherwise sues on the loan; for example, the borrower's heirs, personal representatives, successors, substitutes or anyone else on the borrower's behalf, or any person acting as a guarantor, surety, accommodation maker or endorser for or with respect to the agreement to pay or payment of the loan, or any person assuming the obligation of such payment or otherwise becoming liable therefor or any person owning or acquiring property subject to a lien securing such agreement to pay or such payment. The amended article is intended to provide a transactional exemption so that if the transaction itself is exempt from the general usury laws, no person suing on that transaction would have the right to the claim or defense of usury.

The amended article contains two exceptions. The first exception is that the amended article does not apply to any loan or extension of credit secured by a lien on a building that is used or intended to be used as a single one-to-four family residence and is occupied or to be occupied by the person obligated to pay such loan or other extension of credit. It is important to note that, in order for the exception to apply, the building must be both used or intended to be used as a single one-to-four family residence and occupied or to be occupied by the person obligated to pay such loan or other extension of credit. By this language, it is intended to restrict the exception to one who is actually going to use the building as a one-to-four family residence so that developers of residential housing will have the benefit of the amended article.
The second exception is that the amended article does not apply to any loan or extension of credit secured by a lien on land intended to be used primarily for agricultural or ranching purposes. The words "intended to be used" were employed to make it clear that the proper consideration is how the owner of the subject property intends to use the property in the future, not how the property was used prior to the making of the loan. The word "primarily" was used to make it clear that an incidental use of the subject property for agricultural or ranching purposes will not suffice; the property must be used primarily for those purposes.

The last sentence in the amended article referring to article 1302-2.09 is intended generally to cover problems of overlapping between article 1302-2.09 and the amended article and is intended specifically to provide that if a corporation borrows money in an amount between $5,000 (the lower limit in article 1302-2.09) and $250,000 (the lower limit in the amended article), the provisions of article 1302-2.09 would control.

The amended article should provide greater certainty in the lending community. It is intended to make funds available for large loans outside of the home mortgage area, without the necessity for incorporation and regardless of the purpose of the loan. Although new ambiguities may arise, the amendment should eliminate the questions and restrictions that have arisen under the present article. Hopefully the new statute will help insure the availability of funds in the area of large loans, and will bring some certainty into the complex field of interest rates and usury law.