



COMMONWEALTH of VIRGINIA

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June 1, 2007

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The Honorable L. Scott Lingamfelter
Member, House of Delegates
5420 Lomax Way
Woodbridge, Virginia 22193

Dear Delegate Lingamfelter:

I am responding to your request for an official advisory opinion in accordance with § 2.2-505 of the *Code of Virginia*.

Issue Presented

You ask whether state law regarding prepayment penalties is preempted when a federally regulated financial institution purchases a mortgage loan from a state-regulated mortgage lender.

Response

It is my opinion that when a borrower voluntarily pays down the balance of a loan with an initial principal amount exceeding \$75,000 that is secured by property owned in whole or in part by the borrower, Virginia law permits both a federally regulated financial institution, which holds the note and mortgage that were purchased for value, and a state-regulated financial institution, which was the maker of the note, to assess and charge a two percent prepayment penalty.

Background

You inquire regarding a situation where a private individual purchased real estate and obtained purchase-money financing in an amount exceeding \$600,000 from a state-regulated mortgage lender. You relate that the mortgage note contained a two percent prepayment penalty provision should the note be paid down within two years of the date of issuance.¹ You state that after the note was executed, a federally regulated financial institution purchased the note and mortgage.² It is my understanding that the

¹ I must assume that the transaction about which you inquire does not constitute an alternative mortgage transaction that would be subject to the Alternative Mortgage Transaction Parity Act of 1982. See 12 U.S.C.S. §§ 3801-3806 (LexisNexis 1997). The Parity Act permits a state-regulated financial institution to follow a federally regulated program of mortgage lending, in which case the state laws limiting the imposition of a prepayment penalty would be preempted by federal law. See generally *Nat'l Home Equity Mortgage Ass'n v. Face*, 239 F.3d 633 (4th Cir. 2001).

² Generally speaking, federally regulated financial institutions are given wide latitude by the Office of Thrift Supervision to assess prepayment penalties on mortgages. See 12 C.F.R. § 560.34 (2006). Furthermore, the Office "occupies the entire field of lending regulations for federal savings associations." 12 C.F.R. § 560.2(a) (2006). Where a federally regulated savings institution is the maker of the note, it may "extend credit as authorized under federal law ... without regard to state laws purporting to regulate their credit activities." *Id.* "[T]he types of state laws preempted by paragraph (a) ... include, without limitation, state laws purporting to impose requirements regarding ... prepayment penalties[.]" 12 C.F.R. § 560.2(b)(5) (2006).

private homeowners sold the property within two years of the execution of the mortgage instruments, paid down the mortgage, and the federally regulated financial institution assessed and collected the two percent prepayment penalty, which exceeded \$10,000.

Applicable Law and Discussion

Section 6.1-330.87 provides, in relevant part, that:

No lender shall collect or receive any prepayment penalty on loans secured by real property comprised of one to four family residential dwelling units, *if the prepayment results from the [lender's] enforcement of the right to call the loan upon the sale of the real property which secures the loan.* [Emphasis added.]

Generally, “[w]here the language of a statute is clear and unambiguous[,] rules of construction are not required.”³ It is evident from a plain reading of § 6.1-330.87 that the intent is to prohibit the collection of a prepayment penalty when the lender actually exercises the right to obligate the seller to pay the balance of the loan upon sale of the property. Thus, only such a limited circumstance would bar a lender from collecting a prepayment penalty on a residential mortgage.⁴

Real estate transactions often involve a contractual obligation of the seller to convey clear and marketable title to the buyer to consummate the transaction.⁵ Under such circumstances, the decision to pay down the loan is voluntary pursuant to the seller’s contractual agreement with the buyer. Generally, such decision does not arise from the action of the lender.

When the decision to pay down a mortgage does not arise from an action of the lender, we must examine §§ 6.1-330.81 and 6.1-330.83 to determine whether a prepayment penalty is permissible. Section 6.1-330.81(A) provides that:

Every loan contract ... secured by a first deed of trust or first mortgage on real estate, where the principal amount of the loan is less than \$75,000, shall permit the prepayment of the unpaid principal at any time and no penalty in excess of one percent of the unpaid principal balance shall be allowed.

Moreover, § 6.1-330.83 provides that “[t]he prepayment penalty in the case of a loan secured by a mortgage or deed of trust on a home which is occupied or to be occupied in whole or in part by a

³See *Ambrogi v. Koontz*, 224 Va. 381, 386, 297 S.E.2d 660, 662 (1982); 2003 Op. Va. Att’y Gen. 18, 19.

⁴It is my understanding that the Bureau of Financial Institutions affords a similar interpretation to § 6.1-330.87. This information was provided by the Office of the General Counsel to the State Corporation Commission, who represents the Bureau of Financial Institutions. Courts give great weight to the construction and interpretation of statutes by the agency charged with such responsibility. See *County of Henrico v. Mgmt. Recruiters of Richmond, Inc.*, 221 Va. 1004, 1010, 277 S.E.2d 163, 166-67 (1981); *Dep’t of Taxation v. Progressive Cmty. Club*, 215 Va. 732, 739, 213 S.E.2d 759, 763 (1975); *Commonwealth v. Appalachian Elec. Power Co.*, 193 Va. 37, 45, 68 S.E.2d 122, 127 (1951); 2005 Op. Va. Att’y Gen. 117, 121 n.16 and opinions cited therein.

⁵“Clear title” means “[a] title free from any encumbrances, burdens, or other limitations.” BLACK’S LAW DICTIONARY 1522 (8th ed. 2004). “Marketable title” means “[a] title that a reasonable buyer would accept because it appears to lack any defect and to cover the entire property that the seller has purported to sell.” *Id.* at 1523.

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borrower^{6]} shall not be in excess of two percent of the amount of such prepayment.” When read together, §§ 6.1-330.81 and 6.1-330.83 indicate that a prepayment penalty of two percent on a home mortgage generally is permissible unless the original note was for an amount less than \$75,000.

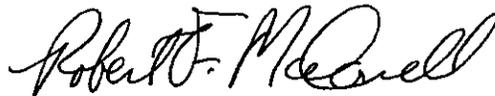
Since the transaction about which you inquire was for more than \$75,000, a two percent prepayment penalty is permissible under Virginia law. However, I must assume that the borrower voluntarily paid down the note principal pursuant to a real estate sales contract with a third party.⁷ In such a situation, there is no federal preemption issue.⁸ The state-regulated mortgage lender that originated the transaction could charge the prepayment penalty under state law, and the federally regulated institution that purchased the note and mortgage could charge the otherwise valid prepayment penalty as a bona fide purchaser for value.⁹

Conclusion

Accordingly, it is my opinion that when a borrower voluntarily pays down the balance of a loan with an initial principal amount exceeding \$75,000 that is secured by property owned in whole or in part by the borrower, Virginia law permits both a federally regulated financial institution, which holds the note and mortgage that were purchased for value, and a state-regulated financial institution, which was the maker of the note, to assess and charge a two percent prepayment penalty.

Thank you for letting me be of service to you.

Sincerely,



Robert F. McDonnell

2:1367; 1:941/07-014

⁶For purposes of this opinion, I will assume that the borrower about whom you inquire occupied at least a portion of the property secured by the mortgage.

⁷Should the lender exercise the right to call the loan upon the sale of the property, § 6.1-330.87 would apply, and a state-regulated lender would be barred from collecting a prepayment penalty. A federal institution, as a bona fide purchaser for value, could enforce a loan provision that was otherwise illegal between the original borrower and lender unless such provision was void by statute. *See Garrison v. First Fed. Sav. & Loan Ass'n*, 241 Va. 335, 340-41, 402 S.E.2d 25, 28 (1991); *see also Lynchburg Nat'l Bank v. Scott Bros.*, 91 Va. 652, 22 S.E. 487 (1895) (discussing loan provisions made illegal by statute versus those declared void at outset by statute). In the event the loan provision was void at the outset by statute, the more lenient federal regulations governing federally regulated financial institutions would not save the provision. *See Garrison*, 241 Va. at 344-45, 22 S.E.2d at 30-31. In that case, the federally regulated financial institution would merely be an assignee, not the maker of the note. *See id.*; *see also supra* note 2 (discussing federal regulation of prepayment penalties).

⁸Based on the facts you present, the federally regulated financial institution merely is an assignee and not the maker of the note. *See Garrison*, 241 Va. at 344-45, 22 S.E.2d at 30-31. If the federally regulated institution were the maker of the note, it could assess and charge a prepayment penalty, even in excess of the two percent limit proscribed by state law, whether or not it was enforcing a right to call the loan since state law would be preempted by the more lenient federal regulation. *Compare* 12 C.F.R. § 560.34 *with* VA. CODE ANN. §§ 6.1-330.83, 6.1-330.87 (1999).

⁹Generally, a bona fide purchaser for value of a note can enforce the terms of the note that it purchased unless those terms expressly are void. *See Lynchburg Nat'l Bank*, 91 Va. at 654-55, 22 S.E. at 488.