4. Also excluded are highway construction contracts (but not maintenance agreements with local units of government, design or research contracts).
5. Instances where the department serves as a fiscal intermediary rather than as an employer or contracting agent. Examples are stipends, third-party agent for disbursement of grant monies to clients (not employees).
6. Routine maintenance services such as rubbish removal, snow removal, window washing, cleaning services, and exterminating services when such services cannot practicably be performed by classified employees.
7. The Department of Sivil Service reserves the right to demand completion of form CS-138 when there is any question as to nature or duration of the service.

The amount for personal services approved by the Civil Service Commission for fiscal 1969-70 exceeded $22,000,000. Obviously, this level of expenditure dictates a precise responsibility as to the proper and necessary use of these services. Toward this end, we ask for your cooperation in observing these requirements.

Any questions regarding contractual arrangements may be addressed to Ed Perkowski, Compensation Admin., Bureau of Classification (33072).

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MORTGAGES: A mortgagor may borrow additional funds from a mortgagee and this additional loan may be secured by a previously executed mortgage. The additional funds borrowed that are secured by a previously executed first mortgage constitute a first lien unless the mortgagee has notice of an intervening lien.

USURY: **A borrowing of additional funds secured by a previously executed first mortgage, if evidenced by an instrument executed after August 11, 1969, qualifies for the exception to the general usury rate.**

USURY: **In computing the rate of interest on a borrowing of additional funds, any increase in the interest rate on a previously executed note is considered to be part of the interest on the additional funds borrowed and must be fully disclosed as such to the borrower.**

Opinion No. 5085 December 16, 1976.

Russell S. Kropschot
Chief Deputy Commissioner
Financial Institutions Bureau
Department of Commerce
Law Building
Lansing, Michigan

You have requested my opinion on the following questions:

1. ". . . [M]ay a borrower seek an advance of additional funds from an assocation, such borrowing to be secured by a previously recorded mortgage, and agree in writing to pay a higher rate of interest on the

> unpaid balance of the original note, plus the new advance, without a discharge of the old obligation and recorded mortgage and the execution of a new note and mortgage documents?"
>
> 2. ". . . [M]ay a borrower seek an advance of additional funds, the amount of which may, together with the unpaid balance of a prior note, be incorporated in a new promissory note for the total obligation at a higher legally enforceable rate of interest; the new new note to be secured by a previously recorded first mortgage lien, without discharge of the prior lien and the execution of a new lien of even date?"
>
> 3. "Will the answers to either of the above questions be altered if the date of the original loan documents preceded or was subsequent to the date of the exemption now provided within the usuary statute for first mortgage loans granted by a regulated financial institutions?"

The question of whether a borrower may seek additional funds from a lender to be secured by a previously executed mortgage was answered by the Supreme Court in *Reiss* v *Old Kent Bank,* 253 Mich 557, 562-563; 235 NW 252, 254 (1931), as follows:

> "The question is whether the original parties to a mortgage may, for a consideration, extend it so as to become and remain security for obligations in addition to the one described in the mortgage when there are no intervening rights or equities and no-one has been misled. In *Perrin* v. *Kellogg,* 38 Mich. 720, it was held that, as long as third parties were not prejudiced, the mortgagor could agree that the mortgage should also secure an additional debt. It is well settled by the weight of authority that the parties to a mortgage originally intended to secure a particular debt may extend the security to the payment of a different debt or future advances as far as their respective rights are concerned. . . ."

It is also axiomatic that the parties to a mortgage may modify or amend the terms of the original mortgage or note at any time if based upon valid consideration without necessarily discharging the obligation. See 55 Am Jur 2d, Mortgages, § 92, p 252; § 141, p 283; § 359, p 416; Walsh, Treatise on Mortgages (1934), § 43, p 169. Section 1c(2) of the Michigan usury statute, 1966 PA 326, added by 1969 PA 305; MCLA 438.31c(2); MSA 19.15(1c)(2), prohibits any provision in a note, mortgage, or contract which would increase the initially agreed upon interest rate. While this provision would prohibit variable interest rates based on the "prime rate" or "maximum rate allowable by law," *Campbell* v *Gawart,* 46 Mich App 529; 208 NW2d 607 (1973), it does not prohibit the parties from subsequently mutually agreeing to increase the interest rate, provided consideration for the modification exist.

The Michigan usury statute, 1966 PA 326; MCLA 438.31 *et seq;* MSA 19.15(1) *et seq,* provides, subject to several exceptions, that the maximum rate of interest on a mortgage, note, contract, or other indebtedness may not exceed 7%. One of the exceptions to this limitation is that the parties to the contract may agree upon any rate of interest where the loan is secured by a first lien against real property, 1966 PA 326, *supra,* § 1c(2).

This exception, however, is only applicable if the lender is qualified under the act[1] and the rate of return on the loan does not exceed the criminal usury rate of 25%.[2]

In deciding whether usury exists, the entire transaction must be examined to determine whether the borrower is paying interest in excess of the lawful rate. See *Abeloff* v *Ohio Finance Co.*, 313 Mich 568; 21 NW2d 856 (1946). Since interest is, by definition, compensation paid for the use of money, any fee imposed upon the borrower, other than the reasonable and necessary charges, such as recording fees, title insurance, deed preparation and credit reports recognized in Section 1(a) of the Usury Statute, *supra,* in exchange for the lending of money must be taken into consideration in determining the rate of interest being charged. In the transaction you describe, the lender agrees to advance a sum of money at a specified interest rate provided the borrower agrees to increase the rate on a previously negotiated loan. The interest rate on the "new" loan must include not only the stated amount but also the additional money being received by the lender on the original unmatured obligation. The courts have warned that the effects of usury cannot be avoided by indirection or subterfuge.[3]

I am concerned that an unsophisticated borrower may agree to increase the rate on what appears to be a favorable mortgage without being aware of its long term cost. This manuever could enable a lender to receive a rate of return on the additional advances greatly in excess of the rate stated and perhaps in excess of the criminal rate of 25%. The law requires that the lender truthfully represent and fully inform the borrower of the cost of a

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[1] Section 1c(5) of the usury statute, *supra,* provides that the first lien real estate loan exception to the usury rate is only applicable to "loans made by lenders approved as a mortgagee under the national housing act or regulated by the state, or by a federal agency, who are authorized by state or federal law to make such loans." Unqualified lenders may not charge a rate of interest in excess of 11% per annum. 1966 PA 326, *supra,* § 1c(6).

[2] The criminal usury statute, 1968 PA 259, MCLA 438.41; MSA 19.15(1), provides that:

> "A person is guilty of criminal usury when, not being authorized or permitted by law to do so, he knowingly charges, takes, or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding 25% at simple interest per annum or the equivalent rate for a longer or shorter period. Any person guilty of criminal usury may be imprisoned for a term not to exceed 5 years or fined not more than $10,000, or both."

[3] In *Wilcox* v *Moore,* 354 Mich 499, 504; 93 NW2d 288, 291 (1959), it was recognized that in protecting necessitous borrowers from usury ". . . a court must look squarely at the real nature of the transaction, thus avoiding, so far as lines within its powers, the betrayal of justice by the cloaks of words, the contrivances of form, or the paper tigers of crafty. We are interested not in form or color but in nature and substance."

loan.[4] Any practice which enables lenders to substantially increase the interest on a prior loan in consideration of a small additional advance may be misleading, deceptive, or potentially fraudulent.

The status of the mortgage is important since it is the basis of the exception to the usury interest ceiling and because state chartered banks and savings and loan associations may only make real estate loans secured by first liens. See 1964 PA 156, § 375(2); MCLA 489.775(2); MSA 23.540(375)(2); 1969 PA 319, § 194; MCLA 487.494; MSA 23.710(194). The problem of which lien takes priority becomes important when the same property is used to secure debts to other mortgagees. The rule in this respect is stated at 55 Am Jur 2d, Mortgages, § 359, p 416, as follows:

> "The general rule that the parties to a mortgage or deed of trust may by a written agreement extend the security of it to cover an additional indebtedness cannot properly be applied to the holder of an interest in the property acquired between the time of the execution of the mortgage and the time of the extension thereof to the additional obligation."

In Michigan, the priority of a mortgage can only be protected by recording the mortgage in the county in which the property is located. Thus, in order to assure that each additional advance will constitute a valid first lien, the lender must record the modification agreement to give notice to third parties that the originally executed mortgage secures an additional obligation.

A standard provision in most mortgages provides that the mortgage may secure future advances made by the lender to the mortgagor. Mortgages containing such a provision are generally referred to as "blanket" or "open-end" mortgages. The validity of such mortgages is well recognized. See *Macomb County Savings Bank* v *Kohlhoff,* 5 Mich App 531; 147 NW2d 418 (1967). I OAG, 1955, No 2229, p 435, 437 (August 22, 1955) recognized the propriety of such mortgages even though the mortgage did not recite the total amount of indebtedness to be secured. In discussing priority, it was stated:

> ". . . If a blanket mortgage is recorded, all persons are presumed to have notice of the existence of the mortgage and are afforded the means of ascertaining by inquiry the amount claimed to be due at any time."

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[4] Title I of the Consumer Credit Protection Act [Truth In Lending] 82 stat 146 (1968) *et seq,* 15 USC 1601 *et seq,* requires disclosure of the finance charge in connection with any transaction to be determined as "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit . . ." 82 Stat 148, 15 USC 1605. Similarly, § 1b of the usury statute, *supra,* requires a bank or insurance company to furnish the borrower with a statement indicating in detail the charges the borrower has paid or obligated himself to pay the lender or to any other person in connection with the loan . . ." In addition, Michigan's deceptive advertising law, 1966 PA 241, MCLA 445.801 *et seq;* MSA 19.853(1) *et seq,* prohibits the making of any public statement which is untrue, deceptive, or misleading.

In answer to your first two questions, therefore, it is my opinion that a borrower may seek additional funds from a lender and may secure the loan by a previously recorded mortgage. The loan may be made either pursuant to an open-end provision, by amending the original instrument or by substituting a new note without discharging the original mortgage. However, in order to assure that an additional advance will constitute valid first lien, the lender should amend any recorded documents to give notice to subsequent mortgages of the additional advance. Furthermore, if a second mortgage is already on record, an additional advance is treated as a third mortgage and the maximum interest rate of 7% per annum will apply.

In answer to your third question, the Michigan usury statute, *supra,* provides that any interest rate may be charged on "any note, bond, or other evidence of indebtedness, executed after August 11, 1969, the bona fide primary security for which is a first lien against real property, . . ." 1966 PA 326, *supra,* § 1c(2). Where the advance is made pursuant to a mortgage executed before August 11, 1969 with an open-end provision, and no new note or other evidence of indebtedness is provided, the interest rate may not be increased so as to exceed a maximum of 7% per annum. If the subsequent advance is evidenced by a new note, then the parties may agree upon any rate of interest, subject to the limitations heretofore discussed.

FRANK J. KELLEY,
Attorney General.