Department of Law
State of Georgia

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OFFICIAL OPINION 2003-8

To: Commissioner
Department of Banking and Finance

July 31, 2003

Re: If a loan or origination fee charged in connection with a non-real estate loan of under $3,000 is not adduced based on the time value of the money involved, if its use merely increases the lender's expectation of collecting in full the principal amount of the loan plus interest or if the fee is attributable to a service or benefit other than the extension of credit, and if the fee's factual justification is clearly documented in sufficient detail, such a fee should not be considered prepaid interest.

As Commissioner of Banking and on behalf of the Department of Banking and Finance (the "Department"), you have presented the Department of Law with the following request for an official opinion:

Please confirm that a "loan fee" or "origination fee" that reflects reasonable, documentable costs or services in connection with a non real estate loan of under $3,000 is not prepaid interest for purposes of determining civil usury under [O.C.G.A. § 7 4 2(a)(2)]. We have reviewed [1980 Op. Att'y Gen. 80-21] but would like an updated response to this question.

Official Code of Georgia Annotated § 7 4 2(a)(2) provides for a simple interest rate of 16% for loans under $3,000. We agree with [1984 Op. Att'y Gen. 84-79], which we believe says that financial institutions exempt from GILA [the Georgia Industrial Loan Act] may charge 16% on loans under $3,000, without using GILA rates and fees. The Department has taken the position that reasonable documentable costs or services in connection with a non real estate loan of under $3,000 do not constitute interest. Examples could include coupon books, cost of origination, or title search.

I understand your question to pertain only to transactions that are not subject to the Georgia Industrial Loan Act.

Georgia's general usury law provides a statutory definition of "interest":

As used in this Code section, the term "interest" means a charge for the use of money computed over the term of the contract at the rate stated in the contract or precomputed at a stated rate on the scheduled principal balance or computed in any other way or any other form. Principal includes such charges to which the parties may agree under paragraph (1) of this subsection. Amounts paid or contracted to be paid as either an origination fee or discount points, or both, on any loan secured by an interest in real estate shall not be considered interest and shall not be taken into consideration in the calculation of interest and shall not be subject to rebate as provided in paragraph (1) of subsection (b) of this Code section.

O.C.G.A. § 7 4 2(a)(3). Implicit in the phrase "the use of money" is the notion that an extension of credit is occurring. In other words, money is being loaned. If money is being loaned, then the determination must be made whether "interest" is being charged. Implicit in the phrase "computed over the term of the contract at the rate stated in the contract or precomputed at a stated rate on the scheduled principal balance or computed in any other way or

any other form" is the idea that, in order to be "interest" under the definition cited above, the arrangement must involve some form of "time value of money" calculation.[1]

Therefore, a transaction that involves an extension of credit and a charge that is based on a time value of money calculation generally will fall under the usury statute unless a statutory exception exists. A charge that is not truly based on a "time value of money" calculation will not, then, be "interest," provided that the lender is actually providing a service for which the charge is assessed and provided that the charge bears a reasonable relationship to cost of providing the service. These provisos have their origin in decisions of the appellate courts of Georgia. The Supreme Court of Georgia "has uniformly and consistently held that a lender's charge for service, when no service was in fact rendered or to be rendered the borrower, is a charge for the use of the money advanced and is therefore interest." *First Fed. Sav. & Loan Ass'n v. Norwood Realty Co.*, 212 Ga. 524, 531 (1956). *See also Williams v. First Bank & Trust Co.*, 154 Ga. App. 879 (1980) ("service charge" constituted interest where there was no evidence that the bank performed any service in return for the fee and where one of the bank officers testified that he did not know what the fee was for).[2] Thus, if a particular fee is "interest" because there is no factual justification for its imposition, it must be considered cumulatively with whatever stated interest is being charged, using the controlling "time value of money" formula to determine the actual effective rate of interest.

This analysis is not in conflict with the views expressed in 1980 Op. Att'y Gen. 80-21 ("status, as prepaid interest, of fees charged in addition to periodic interest on loans, which are stated to cover out-of-pocket expenses of the lender made in connection with the loan, will depend upon all of the circumstances"). *Id.* at 50. Relying on *First Federal Savings & Loan Ass'n*, 212 Ga. at 531, the opinion concludes that "[a]n unexplained fee should be presumed to represent prepaid interest." 1980 Op. Att'y Gen. 80-21, at 50. This presumption is still valid, although it is rebuttable by a showing by the lender of the nature of and reason for a particular fee. Opinion 80-21 articulates two general tests with respect to a fee as prepaid interest:

(1) "a fee is not prepaid interest if its use merely increases the lender's expectation of collecting in full the principal amount of the loan plus interest"; and (2) "a fee is not prepaid interest if it is attributable to a service or benefit other than the extension of credit."

Id. at 49, 50.

Therefore, it is my official opinion that if a loan or origination fee charged in connection with a non-real estate loan of under $3,000 is not adduced based on the time value of the money involved, if its use merely increases the lender's expectation of collecting in full the principal amount of the loan plus interest or if the fee is attributable to a service or benefit other than the extension of credit, and if the fee's factual justification is clearly documented in sufficient detail, such a fee should not be considered prepaid interest. As noted in 1980 Op. Att'y Gen. 80-21, at 50, however, "[e]very fee must be judged on its own particular merits, so the amount, variability, and justification should be weighed in determining whether to treat it as prepaid interest."

Prepared by:

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[1] A "time value of money" formula involving simple interest for a loan of one year or more can be stated as: Effective ratesimple = Stated (or nominal) rate ÷ Principal Amount of Loan. A "time value of money" formula for a loan involving compound interest can be stated as: FVn = PV(1+(knom ÷ m))mn, where FV = future value, n = number of years, m = number of times per year compounding occurs, PV = present value, and knom = stated (or nominal) interest rate. This formula, as well as others of a similar nature, is contemplated under a plain reading of the Code section.

[2] This situation is to be distinguished from transactions in which the lender introduces some consideration, token in nature or undesired by the borrower, for the purpose of disguising interest and circumventing usury laws. See

Tribble v. State, 89 Ga. App. 593, 596-97 (1954); 2002 Op. Att'y Gen. 02-3.