



REGULATORY GUIDANCE

DIRECTOR'S UNDERSTANDING ON THE PROTECTIONS AGAINST PENALTIES OR PREMIUMS FOR PREPAYMENT FOR OBLIGATIONS SECURED BY A "RESIDENCE" AND MADE TO BUSINESS ENTITY BORROWERS

The Financial Institutions Division (FID) has been asked if the protection against "penalties or premiums for prepayment" extends to business purpose loans, secured by a "residence," and made to business entity borrowers. It is the FID's position that any obligation secured by a mortgage on a "residence" is prohibited by the Residential Home Loan Act (RHLA) from "requiring a penalty or premium for prepayment." NMSA 1978, Section 56-8-30 (2019). However, there are two significant items to note in the FID's position. First, we note that the RHLA contemplates protecting a "residence" which is a "dwelling and the underlying real property designed for occupancy by one to four families. . . ." NMSA 1978, § 56-8-24 (1980). Secondly, the RHLA's prohibition against prepayment penalties does not apply to federally chartered thrift institutions and banks. *See Stoneking v. Bank of Am., N.A.*, 2002-NMCA-042, ¶¶ 6-8, 132 N.M. 79, 43 P.3d 1089 (the federal Home Owners Loan Act, 12 U.S.C. §§ 1461 *et seq.*, and its related regulations preempt state laws concerning prepayment penalties on home loans). It is the FID's position that any obligation secured by a mortgage on a "residence" is prohibited by the RHLA from "requiring a penalty or premium for prepayment." NMSA 1978, Section 56-8-30 (2019).

The FID's determination is based on the express language of the RHLA and the rulings of the New Mexico Supreme Court's (NMSC) and the federal district court. The prohibition of penalties or premiums for prepayment of a debt is found at Section 56-8-30:

No provision in a home loan or a loan for a mobile home, the evidence of indebtedness of a home loan, a real estate contract **or an obligation secured by a real estate mortgage** or other purchase contract requiring a penalty or premium for prepayment of an installment payment or prepayment of the balance of the indebtedness is enforceable. (emphasis added).

In *Naumburg v. Pattison*, 1985-NMSC-120, ¶ 11, 103 N.M. 649, 711 P.2d 1387, the New Mexico Supreme Court (NMSC) interpreted Section 56-8-30 and determined a real estate contract's prepayment penalty was prohibited. The real estate contract was for a purchase of a log cabin located in a commercial area of Taos County and was not the borrower's primary residence.



Further, the trial court found the plaintiffs purchased the Taos Cabin “as a recreational investment property with the intent of using it only sporadically until it was resold.” *Id.* ¶ 22. However, because the log cabin was a “residence” as defined by the RHLA and the real estate contract was secured by a mortgage on the residence, the prepayment penalty was prohibited by the RHLA. *Id.* ¶ 14. In its opinion, the NMSC determined the RHLA “confers on the [borrower] the *statutory right* to prepay the balance of the contract. . . .” *Id.* (emphasis added).

Although instructive, the NMSC’s opinion in *Naumburg v. Pattison* does not specifically answer the specific question at hand, “Does the RHLA’s prohibition against prepayment penalties apply to “business entity borrowers?” Likewise, Section 56-8-30 is silent as the nature of the borrower. However, the RHLA, uses expansive terms such as sellers, borrowers, parties, and New Mexicans. See generally, NMSA 1978, §§ 58-8-22 to -30 (1980, as amended through 2009.) However, the RHLA specifically defines “person” as “any individual or other legal entity.” This expansive language makes the RHLA applicable to all legal entities including “business entity borrowers.” §58-8-22(D).

Therefore, it is the understanding of the FID that except for federally chartered financial institutions, the RHLA guarantees a right to prepay the balance of *any obligation* which is secured by a mortgage on a “residence” regardless of the nature of the borrower. The FID comes to this conclusion much like the NMSC did in *Naumburg v. Pattison*. The RHLA created a statutory right to prepay mortgage secured accounts for any individual or other legal entity and “will not presume, absent some indication to the contrary, that the Legislature intended to limit the protection of the RHLA to primary family residences.” *Id.* ¶ 11.

