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OHIO USURY LAWS AND THE REAL ESTATE MORTGAGE LENDING MARKET — A SAVINGS ASSOCIATION VIEWPOINT

ROGER A. YURCHUCK* AND JAMES M. BALL**

I. HISTORIC DEVELOPMENT OF OHIO'S USURY LAWS AND SAVINGS AND LOAN EXEMPTION

ALTHOUGH THE CONCEPT of usury was unknown at common law, it is of ancient statutory origin. Irrespective of its economic utility to society, usury has become firmly entrenched as an accepted fact of economic life.¹ The concept of usury is easily understandable and lends itself to simple definition. It is, in essence, a prohibition against the taking of an amount for the use of money which is greater than that permitted by law. While the concept itself is simple to grasp, methods of implementing that concept have varied widely from jurisdiction to jurisdiction.² Moreover, within many jurisdictions, including Ohio, legislative efforts to manage this "simple concept" have resulted in the development of convoluted, complex statutory schemes which present many hidden problems for the unwary. With this in mind, it is the primary purpose of this article to trace the origins of the Ohio usury laws and to focus upon those laws as they presently impact upon the savings and loan industry's participation in the Ohio real estate mortgage lending market.

From a historical perspective, it is clear that while the theoretical

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¹ See generally S. HOMER, A HISTORY OF INTEREST RATES at 17-24 (1963); J. MURRAY, THE HISTORY OF USURY at 28 (1866); Merriman & Hanks, *Revising State Usury Statutes in Light of a Tight Money Market*, 27 MD.L.REV. 1 (1967) [hereinafter cited as Merriman & Hanks]. Shanks, *Practical Problems in the Application of Archaic Usury Statutes*, 53 VA.L.REV. 327 (1967).

² See B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION (1965); [1978] CONS. CRED. GUIDE (CCH). In the United States, the federal government has traditionally left the area of usury regulation largely to the control of state government. However, in certain limited instances, the federal government has also thrown its hat into the arena and thereby, effectively preempted state usury laws. See Federal Deposit Insurance Act, 12 U.S.C. § 1831(a) (Supp. V 1975), amending 12 U.S.C. § 1811-31 (1970) [effective October 1974 to July 1977], which preempted state usury laws for FDIC insured banking institutions in the area of business and agricultural loans; and National Bank Act, 12 U.S.C. § 85 (1970) which provides a limited preemption from state usury laws for national banks. For a discussion of federal preemption in the usury area, see generally Note, *Preemption of Arkansas Usury Law*, 31 ARK.L.REV. 325 (1977). See Cooper, *A Study of Usury Laws in the United States to Consider Their Affect on Mortgage Credit and Home Construction Starts: A Proposal for Change*, 8 AM. BUS. L.J. 165 (1970).

justifications for the existence of usury laws are widely divergent, they are based largely upon non-economic considerations.³ Primarily for that reason, the very principle of attempting to regulate interest charges, at least in commercial settings, has been sharply criticized. While such criticism is by no means a new development, it nonetheless appears that because of recent money market activities, usury critics are now becoming more vocal, if not more numerous.⁴ Yet, when the rhetoric clears, one thing emerges with unmistakable certainty — Ohio's complex and convoluted usury laws must be dealt with by creditors on a daily basis.

Even before it was granted statehood in 1803, there were laws in Ohio setting limits on the amount which could be charged for the use of money. In 1799, the first such laws enacted by the general assembly of the Northwest Territory, of which Ohio was a part, fixed the maximum permissible contract rate of interest at six per cent.⁵ During the period from 1799 to 1849, the Ohio laws in this area were amended on several occasions, but at all times the maximum contract rate of interest remained fixed at six per cent.

In 1850, the Ohio usury laws were substantially revised. As part of those revisions, the permissible contract rate of interest was raised to ten per cent. However, the Act of March 14, 1850, which was commonly known as the "10% Act,"⁶ was short-lived and in 1859, was replaced by legislation which reinstated the six per cent interest rate ceiling in Ohio.⁷ This situation continued until 1869, at which time legislative enactments for the first time set the maximum permissible contract rate of interest in Ohio at eight per cent.⁸ The 1869 legislation was also significant in that it established a statutory rate of interest which would control in the absence of a written agreement between the parties. More specifically, the 1869 statute provided that: (1) the parties to any instrument in writing could agree to any rate of interest not exceeding eight per cent per annum; (2) any judgment rendered on such a written instrument would provide for interest at the rate stated therein until paid; and (3) in all other cases,

³ See Benfield, *Money, Mortgages, and Migraine — The Usury Headache*, 19 CASE W. L. REV. 819, 831-833 (1968).

⁴ See Prather, *Economics, Morality and the Real-Estate Loan*, 8 B. C. INDUS. & COM. L. REV. 475 (1967); Note, *An Ounce of Discretion for a Pound of Flesh: A Suggested Reform for Usury Laws*, 65 YALE L.J. 105 (1955); Comment, *Ohio's Usury Laws and Their Effect Upon The Home Mortgage Market: Economic and Constitutional Inequities*, 8 AKRON L. REV. 125 (1974); Merriman & Hanks, *supra* note 1.

⁵ OHIO STAT. § 217 (I. Chase 1833).

⁶ OHIO STAT. § 481 (Swan Rev. 1854).

⁷ 1859 Ohio Laws 27.

⁸ 1869 Ohio Laws 91. See *Colston v. Hastings*, 8 Ohio N.P. 154 (1901), for a general discussion of the development of the Ohio law in this area.

a creditor was entitled to interest at the rate of six per cent per annum, and no more.⁹

One would be hard pressed to find any real similarity between the Ohio economy of 1869 and the Ohio economy of 1979. Yet, despite that fact, at least one striking similarity does exist. In 1979, as was the case in 1869 and at all times thereafter, the "general" usury law of Ohio still places a ceiling on permissible contract interest rates at eight per cent.¹⁰ Upon closer analysis, however, it becomes apparent that this "similarity" is one of form, rather than substance.

During the past one hundred years, and primarily within the past fifteen years, the effective usury laws in Ohio have been dramatically altered. In fact, in Ohio today, there are few instances in which commercial lenders are subjected to the general eight per cent interest rate limitation. This situation results from the fact that the Ohio legislature, in an apparent attempt to establish compatibility between Ohio law and economic reality, has, over the years, engaged in a systematic practice of carving out specific exceptions to and exemptions from the general usury law. This legislative pattern has developed to such an extent that, in Ohio today, it is the exception, rather than the general rule, which controls most usury questions.¹¹

⁹ 1869 Ohio Laws 91. In general, this statutory scheme continues in effect in Ohio today. See OHIO REV. CODE ANN. §§ 1343.01-03 (Page Supp. 1978).

¹⁰ OHIO REV. CODE ANN. § 1343.01 (A) (Page Supp. 1978).

¹¹ At present, some of the major exceptions to the general eight per cent interest rate limitation which have been carved out by the Ohio legislature are as follows: (1) where a transaction, evidenced by a written instrument, involves a principal indebtedness in excess of \$100,000, there is no interest rate limitation, [OHIO REV. CODE ANN. § 1343.01 (B)(1) (Page Supp. 1978)]; (2) in certain instances, payments to a broker or dealer registered under the Securities Exchange Act of 1934 are exempted from the eight per cent interest limitation, [OHIO REV. CODE ANN. § 1343.01 (B)(2) (Page Supp. 1978)]; (3) where an instrument, payable upon demand or in one installment, is not secured by household or consumer goods, there is no interest rate limitation [OHIO REV. CODE ANN. § 1343.01 (B)(5) (Page Supp. 1978)]; (4) a retail installment seller may contract for and receive finance charges in excess of eight per cent [OHIO REV. CODE ANN. § 1317.06 (Page Supp. 1978)]; (5) pursuant to revolving budget agreements, a seller may contract for and receive finance charges and service charges in excess of eight per cent [OHIO REV. CODE ANN. § 1317.11 (Page 1962)]; (6) a party licensed under the Ohio Small Loans Act may contract for and receive charges in excess of eight per cent [OHIO REV. CODE ANN. § 1321.13 (Page Supp. 1978)]; (7) an "insurance premium finance company," licensed under Ohio law, may contract for and receive finance charges in excess of eight per cent [OHIO REV. CODE ANN. § 1321.79 (Page Supp. 1978)]; (8) pursuant to a revolving credit agreement, a bank may contract for and receive finance charges in excess of eight per cent [OHIO REV. CODE ANN. § 1107.27 (Page 1968)]; (9) a party licensed under the Ohio Second Mortgage Loan Act may contract for and receive charges in excess of eight per cent [OHIO REV. CODE ANN. § 1321.57 (Page Supp. 1978)]; and (10) where the debtor in question is a domestic or foreign corporation, the Ohio usury laws are not applicable to the transaction [OHIO REV. CODE ANN. § 1701.68 (Page Supp. 1978)]. Certain recent exemptions, relating to real estate mortgage lending in Ohio, will be discussed at length later in this article. See notes 29 and 37 *infra*.

From a historical standpoint, one of the more significant exceptions to the general usury law in Ohio relates to the operation of savings and loan associations. Indeed, at all times from and after their legal inception in Ohio, such associations have continuously held an express statutory exemption from the general usury laws.

The first Ohio statutes providing for the organization and operation of building and loan associations were passed in 1867. By statutory enactment, these Ohio associations were created for the express purpose of "raising moneys to be loaned among members for the use in buying lots for houses or in building."¹² Since the enactment of these first statutes, they have been amended and revised in many areas. However, at the present time, the primary purpose of the associations remains unchanged — to provide a continuing source of funds for residential mortgage financing.

At the time of their formation in Ohio, savings and loan associations were organized for the limited purpose of making loans to association members, each of whom contributed funds for the common benefit of the institution. Accordingly, during the early stages of development of these institutions, all borrowers were shareholders of the association and, as such, shared in the profits generated by the association's lending activities.¹³ Because of this somewhat unique borrower-shareholder arrangement, the original Ohio statutes permitted these institutions to collect loan charges which exceeded the general maximum contract rate of interest, and, concomitantly, granted to such institutions an express exemption from the usury laws.¹⁴

During the early years of their existence in Ohio, the amount of the "additional" loan charges which could be imposed by a building and loan association was, by statute, required to be determined by competitive bidding among the members.¹⁵ However, in 1886, the competitive bidding

¹² 1867 Ohio Laws 18.

¹³ See generally *Eversmann v. Schmitt*, 53 Ohio St. 174, 41 N.E. 139 (1895), a case often cited for its discussion of the mutuality which existed between the original building and loan associations and their borrower-members.

¹⁴ 1867 Ohio Laws 18. As originally enacted in 1867, the Ohio building and loan usury exemption provided as follows:

. . . such corporations shall be authorized and empowered to levy, assess and collect from its members such sums of money by rates of stated dues, fines, interest on loans advanced, and premiums bid by members for the right of precedence in taking loans as the corporation by its by-laws shall adopt; . . . provided, that the dues, fines, and premiums so paid by members of such corporations, although paid in addition to the legal rate of interest on loans taken by them shall not be construed to make the loans so taken usurious. . . . (Emphasis added)

¹⁵ The statutory provisions requiring that the amount of "additional" loan charges be established by competitive bidding, were not only part of the original 1867 legislation [see note 14 *supra*], but were also incorporated into subsequent statutory enactments in 1868

requirement was deleted from the statute by an amendment which effectively permitted each association to establish, on its own, the amount of the charges which it would impose in connection with its lending activities.¹⁶

During the period from 1867 to 1891 the Ohio statute governing permissible savings and loan association loan charges was amended on five occasions.¹⁷ Not surprisingly, during that period, a considerable body of case law developed in Ohio concerning the appropriate interpretations of the various statutes. Initially, the cases in this area involved questions relating to the proper methodology which under the various statutes, building and loan associations were required to follow in order to collect loan charges in excess of the eight per cent contract usury rate.¹⁸ In 1899, however, the very nature of the building and loan usury exemption was, for the first time, challenged on constitutional grounds. During the next five years, litigation involving the constitutionality of the Ohio building and loan usury exemption produced conflicting results among the Ohio Circuit Courts.¹⁹ However, in 1905, the Ohio Supreme Court laid that question to rest by affirming the constitutionality of the building and loan

and 1880. See 1868 Ohio Laws 137, 173; 1880 Ohio Laws 208. In addition, under the 1880 legislation, the privilege of bidding for loans was extended to "depositors" as well as association members.

¹⁶ 1886 Ohio Laws 116.

¹⁷ In addition to those amendments referred to in notes 15 and 16 *supra*, the controlling statute was also amended in 1891. See 1891 Ohio Laws 469. The 1891 amendment was substantively significant only in that the language was changed to permit such institutions to collect "such dues, fines, interest and premiums on loans made, or other assessments," and in that it further provided that such "dues, fines, premiums or other assessments shall not be deemed usury." *Id.* (emphasis added).

¹⁸ See, e.g., *Forest City United Land & Bldg. Ass'n. v. Gallagher*, 25 Ohio St. 208 (1874); *Ohio v. Greenville Bldg. & Savings Ass'n.*, 29 Ohio St. 92 (1876); *Bates v. Peoples Savings & Loan Ass'n.*, 42 Ohio St. 655 (1885). In *Gallagher*, the court recognizing the right of an Ohio building and loan association to collect charges in excess of the usury rate, held that while interest and "premiums" could both be collected, interest could not be assessed on premiums as well as principal. In *Greenville*, the court, interpreting the statute of 1868, held that dues, fines and premiums paid by members and depositors upon loans, which were in excess of the legal rate of interest did not render the loans usurious. However, the court noted that under the statute in question, "It is by these means only that a corporation can demand or receive anything in addition to the legal rate of interest upon its loans." Similarly, in *Bates*, the Ohio Supreme Court concluded that since the statute then in effect required that loan premiums be determined by competitive bidding, that procedure was a necessary requirement to the imposition of charges which otherwise exceeded the lawful rate of interest.

¹⁹ The first case involving the question of constitutionality was *Mykrantz v. Globe Bldg. & Loan Ass'n.*, 19 Ohio Cir. Dec. 51 (1899). In that case, the Ashland County Circuit Court held that the building and loan usury exemption gave "special privileges to a certain class of corporations" in violation of the equal protection clause of the Ohio Bill of Rights and was, therefore, unconstitutional. Contrary decisions on the question of constitutionality were subsequently rendered by the Lucas County Circuit Court in *Speis v. Southern Ohio Loan & Trust Co.*, 4 Ohio C.C. (n.s.) 103 (1902); by the Cuyahoga County Circuit Court in *Brooklyn Bldg. & Loan Ass'n v. Des Noyers*, 4 Ohio C.C. (n.s.) 337 (1904); and by the Richland Common Pleas Court in *Carmichael v. Indemnity Savings & Loan Co.*, 15 Ohio Dec. 341 (1905).

usury exemption in the case of *Cramer v. The Southern Loan & Trust Co.*²⁰

The *Cramer* decision is effectively the Ohio Supreme Court's last pronouncement on the subject of the Ohio building and loan usury exemption. At all times since that decision, the building and loan usury exemption has remained a part of the statutory law of Ohio,²¹ and the existence of that exemption has been generally recognized. In fact, that exemption has become so firmly entrenched in Ohio that for the past twenty-five years, it has not even been the subject of reported litigation in this state.²²

Throughout the period of their existence in Ohio, savings and loan associations have occupied a dominant position in the area of home mortgage lending. However, during that period, they have by no means been the only participant in that area. Nonetheless, for over one hundred years, building and loan associations were the only participants in the home mortgage lending market who, under Ohio law, enjoyed an express exemption from the general eight per cent usury limitation.²³ Since 1970, that situation has changed dramatically.

The first inroads towards establishing relative equality in the usury setting, between Ohio building and loan associations and other real estate mortgage lenders came in 1972, when, in the case of *Northway Lanes v.*

²⁰ 72 Ohio St. 395 74 N.E. 200 (1905).

²¹ Three years after *Cramer*, the building and loan usury was enacted as § 9650 of the Ohio General Code. See 1908 Ohio Laws 529. Significantly, that statute extended the usury exemption to all loan transactions — not just those involving association members or depositors. In 1953, the building and loan exemptions was expressly adopted by the legislature as § 1151.21 of the Ohio Revised Code. That section, as enacted, provided as follows:

A building and loan association may assess and collect from members and others such dues, fines, interest and premium on loans made, or other assessments as are provided for in its constitution and by-laws. Such assessments shall not be deemed usury, although in excess of the legal rate of interest. OHIO REV. CODE ANN. § 1151.21 (Page 1968).

This section has not been amended since its enactment in 1953 and remains the law in Ohio today. The building and loan usury exemption is by no means unique to Ohio. At the present time, it appears that at least eight other states have enacted similar statutory usury exemptions. See Hyer & Kearn, *Legal Impediments to Mortgage Innovation*, 6 REAL EST. L.J. 211 (1978).

²² Since the enactment of the Ohio Revised Code in 1953, § 1151.21 has only been cited in one reported Ohio case, and in that case, the parties merely stipulated that the usury exemption granted to Ohio building and loan associations did not apply to the operations of commercial banks in this state. See *City Loan & Savings Co. v. United States*, 177 F. Supp. 843 (N.D. Ohio 1959).

²³ It was, in fact, this "privileged classification" which was the basis of the constitutional claim considered by the Ohio Supreme Court in *Cramer*. However, for reasons which will be discussed at length later in this article, it is clear that, from a usury standpoint, relative equality has now been established among all parties engaged in the Ohio mortgage lending market. Thus, for reasons entirely different than those espoused by the Ohio Supreme Court in *Cramer*, the constitutionality of the Ohio building and loan usury exemption remains clear,

Hackley Union Nat. Bank & Trust Co.,²⁴ the Sixth Circuit Court of Appeals held that national banks located in Ohio were entitled to the benefits of the Ohio building and loan usury exemption. In *Northway*, a borrower sued a national bank for usury, claiming that the bank had imposed loan charges in excess of those permitted under Michigan banking laws. In that case, the court found that the national bank had, in fact, collected loan charges which a Michigan state bank could not have legally collected. However, the court also found that Michigan law would have permitted a savings and loan association to collect such charges. Based upon those facts, the *Northway* court held that the national bank was entitled to collect the charges in question since, under the applicable provisions of the National Banking Act,²⁵ national banks are entitled to charge the highest rates permitted by anyone, not just state banks, under state law. In other words, in *Northway*, the Sixth Circuit held that, from a usury standpoint, national banks are granted the "most favorable lender status" afforded by state law.²⁶

Thus, by 1972, it was clear that in Ohio, national banks, as well as state and federally chartered savings and loan associations,²⁷ were entitled to the benefits of the usury exemption set forth in Section 1151.21 of the Ohio Revised Code. This was the setting when, in 1975, the Ohio legislature enacted major amendments to the Ohio usury laws which directly affected mortgage lending activities in this state.

II. RECENT STATUTORY DEVELOPMENTS

Prior to November 4, 1975, all Ohio real estate first mortgage lenders,²⁸ other than building and loan associations and national banks, were subject

²⁴ 464 F.2d 855 (6th Cir. 1972).

²⁵ 12 U.S.C.A. § 85 (Cum. Supp. 1978). This section authorized national banking associations to charge interest "at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate one per cent in excess of the discount rate on ninety day commercial paper in effect at the Federal Reserve bank in the district in which such bank is located," whichever is greater.

²⁶ The *Northway* decision remains controlling in the Sixth Circuit, including Ohio. Moreover, that decision has since been followed in the Seventh and Eighth Circuits; *See Fisher v. First National Bank of Omaha*, 548 F.2d 255 (8th Cir. 1977); *Fisher v. First National Bank of Chicago*, 538 F.2d 1284 (7th Cir. 1976), and was tacitly approved by the United States Supreme Court in its recent decision of *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*; *Minnesota v. First of Omaha Service Corp.* 47 U.S.L.W. 4071 (1978). For an interesting discussion of the *Northway* decision, *see Comment, National And State Bank Interest Rates Under the National Bank Act: Preference or Parity*, 58 IOWA L. REV. 1250 (1972).

²⁷ Pursuant to statute in Ohio, federal savings and loan association with home offices located in Ohio are granted all rights, powers, privileges, benefits, immunities and exemptions granted to state chartered institutions. *See OHIO REV. CODE ANN. § 1151.361 (Page 1968)*.

²⁸ Since November of 1965, licensed second mortgage lenders in Ohio have been statutorily authorized to collect loan charges in excess of eight per cent per annum. *See OHIO REV. CODE ANN. § 1321.57 (Page Supp. 1978)*.

to the general eight per cent contract usury limitation. However, at that time, amendments to the Ohio general usury statute altered that situation in several respects.²⁹ First, the 1975 amendments changed the general ceiling rate of interest on real estate mortgage loans in Ohio from a fixed rate of eight per cent to a fluctuating one tied to the discount rate on commercial paper in effect at the Federal Reserve Bank of Cleveland.³⁰ Second, the amendments totally exempted from the Ohio usury laws all real estate mortgage loans which are "approved, insured, guaranteed or purchased by the federal government or any agency or instrumentality thereof."³¹

²⁹ Prior to November 4, 1975, this general usury law of Ohio, 1974 Ohio Laws 1166, read as follows:

The parties to a bond, bill, promissory note, or other instrument of writing for the forbearance or payment of money at any future time, may stipulate therein for the payment of interest upon the amount thereof at any rate not exceeding eight per cent per annum payable annually, except that any party may agree to pay any rate of interest in excess of the maximum rate provided in this section when the original amount of the principal indebtedness stipulated in the bond, bill, promissory note, or other instrument of writing exceeds one hundred thousand dollars. In addition, any party may agree to pay any rate of interest in excess of the maximum rate provided in this section if the payment is to a broker or dealer registered under the "Securities Exchange Act of 1934", 48 Stat. 881, 15 U.S.C. 78A, as amended, "for carrying a debit balance in an account for a customer if such debit balance is payable on demand and secured by stocks, bonds or other securities."

However, effective on that date, § 1343.01 (Page Supp. 1978) was amended to read, in pertinent part, as follows:

(A) The parties to a bond, bill, promissory note, or other instrument of writing for the forbearance or payment of money at any future time, may stipulate therein for the payment of interest upon the amount thereof at any rate not exceeding eight per cent per annum payable annually, except as authorized in division (B) of this section.

(B) Any party may agree to pay a rate of interest in excess of the maximum rate provided in division (A) of this section when:

(3) The instrument evidences a loan secured by a mortgage or deed of trust on real estate where the loan has been approved, insured, guaranteed, purchased, or for which an offer or commitment to insure, guarantee, or purchase has been received, in whole or in part, by the federal government or any agency of instrumentality thereof, the federal national mortgage association, the federal home loan mortgage corporation, or the farmers home administration, all of which is authorized pursuant to the "National Housing Act," 12 U.S.C. 1701; the "Serviceman's Readjustment Act," 38 U.S.C. 1801; the "Federal Home Loan Bank Act," 12 U.S.C. 1421; and the "Rural Housing Act," 42 U.S.C. 1471, amendments thereto, reenactments thereof, enactments parallel thereto, or in substitution therefor, or regulations issued thereunder; or by the state or any agency or instrumentality thereof authorized pursuant to Chapter 122 of the Revised Code, or regulations issued thereunder;

(4) The instrument evidences a loan secured by a mortgage, deed of trust or land installment contract on real estate which does not otherwise qualify for exemption for the provisions of this section, except that such rate of interest shall not exceed three per cent in excess of the discount rate on ninety day commercial paper in effect at the federal reserve bank in the fourth federal reserve district at the time the mortgage, deed of trust or land installment contract is executed. . . .

³⁰ OHIO REV. CODE ANN. § 1343.01 (B)(4) (Page Supp. 1978), quoted at length in note 29 *supra*.

³¹ OHIO REV. CODE ANN. § 1343.01 (B)(5) (Page Supp. 1978), quoted at length in note 29 *supra*.

The Ohio legislature's decision to establish a fluctuating, rather than fixed rate ceiling for real estate mortgage loans clearly evidenced its growing awareness of economic reality.³² Moreover, the enactment of a total "federal exemption" further evidenced the legislature's awareness of the developing importance of the federally related secondary mortgage market. Thus, in terms of the general real estate mortgage market in Ohio, the economic significance of the 1975 amendments to Ohio Revised Code, Section 1343.01 is readily apparent. However, from the standpoint of the Ohio building and loan community, those amendments were of little direct import.³³ In fact, when viewed in that context, the only real significance of those amendments was that they, for the first time, granted to other real estate mortgage lenders, both regulated and nonregulated,³⁴ virtual parity with savings and loan associations in the usury area.³⁵ Yet, despite this new found parity, since 1975 savings and loan associations have continued to be the dominant participant in the Ohio home mortgage lending market.³⁶

³² Indeed, many states with fixed usury rate ceilings of 10% or less are, at the present time, experiencing a marked decline in the availability of home mortgage loan funds. *See Usury Ceilings Will Impose Economic Loss in 1979*, Vol. C No. 2 Savings & Loan News 32 (February, 1979).

³³ Under Ohio laws of statutory construction, it is clear that the 1975 amendments to the general usury statute did not affect the status of existing, specific exemptions from or exceptions to the general usury law, such as those held by building and loan associations and second mortgage lenders. *See* OHIO REV. CODE ANN. § 1.51 (Page 1978). *See generally*, *State ex. rel. Myers v. Chiaramonte*, 46 Ohio St. 2d. 230, 348 N.E.2d 323 (1976).

³⁴ The usury exemption set forth in OHIO REV. CODE ANN. § 1343.01 (B)(4) (Page Supp. 1978) applies to all mortgage lenders in Ohio. In that regard, it could be strongly argued on public grounds that the justification for imposing strict usury limitations is less compelling where the lender in question is already subject to close governmental regulation. However, in enacting Revised Code § 1343.01 (B)(4), the Ohio legislature did not see fit to draw a distinction between regulated lenders, such as state banks and insurance companies, and essentially unregulated lenders, such as mortgage bankers.

³⁵ For example, during the period from January, 1978 to November, 1978 the discount rate on ninety day commercial paper in effect at the Federal Reserve Bank of Cleveland ranged from a low of 6.50% (in January) to a high of 9.50% (in November). Accordingly, as a result of the fluctuating rate ceiling established by Revised Code § 1343.01 (B)(4), during that period, all Ohio real estate mortgage lenders were legally authorized to loan funds at interest rates ranging from 9.50% to 12.50%.

³⁶ The following statistics, supplied by the Ohio League of Savings Associations, clearly reflect the continued dominance of the savings and loan industry in the Ohio residential mortgage market.

OHIO RESIDENTIAL MORTGAGE LOAN HOLDINGS
(in million dollar units)

	S&L Associations	Commercial Banks	Life Insurance Companies
1970	10,229,500	2,639,000	2,952,000
1971	11,738,500	2,870,000	2,900,000
1972	13,648,600	3,252,000	2,920,000
1973	15,111,400	3,734,000	2,962,000
1974	16,356,900	4,079,000	2,985,000
1975	17,999,300	4,123,000	2,996,000
1976	20,671,700	4,382,000	3,017,000
1977	24,268,000	5,054,000	(numbers not yet available)

In conjunction with the 1975 amendments to Ohio Revised Code, Section 1343.01, the Ohio legislature also passed additional, related legislation which, for the first time, established limitations on the amount of "discount points" which a residential mortgage lender could receive in connection with any residential mortgage loan.³⁷ Unlike the amendments to Section 1343.01, the new discount point limitations had a direct and potentially significant impact upon the residential mortgage lending activities of all Ohio lenders, including savings and loan associations.

Initially, from the standpoint of the Ohio savings and loan industry, it seems clear that the discount point limitations are directly in conflict with the general provisions of Ohio law which grant to such associations the right to collect "such dues, fines, interest and premiums on loans made or other assessments as are provided for in their constitution and by-laws."³⁸ However, despite the conflict, it seems equally clear that, under Ohio laws of statutory construction, the discount point limitations prevail and are now controlling in savings and loan association residential mortgage transactions. This is true for two basic reasons. First, while the building and loan usury exemption grants to such associations a general right to impose whatever loan charges and assessments are authorized by their constitution and by-laws, the discount point legislation is more specific, in that it relates to a limited, special type of charge, namely, discount

³⁷ OHIO REV. CODE ANN. § 1343.011 (Page Supp. 1978), provides, in pertinent part, as follows:

(A) As used in this section:

(1) "Discount points" means any charges, whether or not actually denominated as "discount points" which are paid by the seller or the buyer of residential real property to a residential mortgage lender or which are deducted and retained by a residential mortgage lender from the proceeds of the residential mortgage. Discount points do not include the costs associated with settlement services as defined in the "Real Estate Settlement Procedures Act of 1974", 88 Stat. 1724, 12 U.S.C. 2601, amendments thereto, reenactments thereof, enactments parallel thereto, or in substitution therefor, or regulations issued thereunder.

(2) "Residential mortgage" means an obligation to pay a sum of money evidenced by a note secured by a lien upon real property located within this state containing two or fewer residential units or on which two or fewer residential units are to be constructed and shall include such an obligation on a residential condominium or cooperative unit.

(3) "Residential mortgage lender" means any person, bank, building and loan association, or savings and loan association which lends money or extends or grants credit and obtains a residential mortgage to assure payment of the debt. The term shall also include the holder at any time of a residential mortgage obligation.

(B) Except residential mortgage loans described in division (B) (3) of section 1343.01 of the Revised Code, no residential mortgage lender shall receive either directly or indirectly from a seller or buyer of real estate any discount points in excess of two per cent of the original principal amount of the residential mortgage.

³⁸ OHIO REV. CODE ANN. § 1151.21 (Page 1968), quoted at length in note 21 *supra*.

points. For this reason alone, the discount point provision takes precedence.³⁹ Second, in enacting the discount point legislation, the Ohio General Assembly clearly expressed its intention to include building and loan associations within the scope of that provision.⁴⁰ Thus, the prevalence of the discount point limitation over the general building and loan usury exemption cannot be seriously questioned.⁴¹

Since savings and loan associations are now subject to the discount point limitations, it is imperative for such institutions to acquire a thorough understanding of the operative provisions of that legislation. Unfortunately, that is no simple task. Many of the provisions of Revised Code Section 1343.011, the discount points legislation, are ill defined and highly ambiguous.⁴² Moreover, although that statute has been in effect in Ohio for over three years, it has not been interpreted in any reported Ohio cases. For these reasons, the true impact of the discount point legislation remains largely unknown at this time. In fact, about the only thing that is clear, is that from a compliance standpoint, Revised Code Section 1343.011 presents potentially serious problems to all parties making residential mortgage loans secured by Ohio real estate.⁴³ Fundamentally, those

³⁹ Under the Ohio law of statutory construction, where a general statutory provision conflicts with a special one, the special provision prevails as an exception to the general statutory provision, unless the general provision is the later adopted and the manifest intent is that the general provision prevail. See OHIO REV. CODE ANN. § 1.51 (Page 1978).

⁴⁰ The discount point limitations are expressly made applicable to all "residential mortgage lenders," a term which, by statutory definition, includes building and loan associations. See OHIO REV. CODE ANN. § 1343.011 (A)(3) (Page Supp. 1978), quoted at length in note 36 *supra*.

⁴¹ This situation contrasts well with the 1975 amendments to OHIO REV. CODE ANN. § 1343.01 (Page Supp. 1978). Specifically, unlike the discount point legislation, those 1975 amendments were general legislation relating to the overall usury picture in Ohio. Moreover, unlike the discount point legislation, the 1975 amendments to § 1343.01 did not manifest an intent to "prevail" over the existing special exemption granted to building and loan associations. Accordingly, while it is clear that the discount point legislation "prevails," over the building and loan usury exemption, it is equally clear that the 1975 amendments to § 1343.01 do not. See note 33, *supra*.

⁴² It should initially be noted that, in enacting the discount point legislation, the General Assembly did not in any way define the intended working relationship between that statute [§ 1343.011] and the general usury state [§ 1343.01]. In other words, it is unclear whether the legislature intended for "discount points" to be treated as something other than interest, or whether it simply intended for "discount points" to be treated as a sub-species of interest. The first characterization would permit all residential mortgage lenders to collect authorized discount points in addition to the maximum contract rate of interest established by § 1343.01. However, under the second point characterization, such a practice would render a transaction usurious. Thus, while it is clear that, under either characterization, a building and loan association, because of its express usury exemption, would always be entitled to collect the maximum amount of discount points authorized by § 1343.011, the same would not be true for all other residential mortgage lenders.

⁴³ The statutory discount point limitations are only applicable to transactions involving "residential mortgages" on real property located in Ohio. See OHIO REV. CODE ANN. § 1343.011 (A)(2) (Page Supp. 1978) quoted at length in note 37 *supra*.

problems are as follows: first, trying to determine precisely what a discount point is; second, trying to determine the total amount of discount points which may lawfully be collected; third, trying to determine the potential exposure for violation of the discount point limitations.

The problem of determining what specific charges will constitute "discount points," is a serious one which results directly from the legislature's failure to give that term a coherent meaning.⁴⁴

The statutory definition of discount points has a two tiered structure. The first tier, or basic definition, effectively includes within the meaning of discount points "any charges . . . which are paid . . . to a residential mortgage lender." The second tier, or exclusionary clause, excludes from that basic definition "costs associated with settlement services as defined in the 'Real Estate Settlement Procedures Act of 1974.'"⁴⁵ Thus, under a literal interpretation of the present statute, one is inescapably led to the following conclusion: *any* charge received by a residential mortgage lender which is not, in fact, associated with a settlement service, is a discount point. The Ohio legislature could not have intended such a result.

It is obvious that, by enacting the discount point limitation, the legislature did not intend to place a two per cent interest rate ceiling on residential mortgage loans. Yet, the existing statute could be so interpreted, since by definition, the terms "discount points" includes not only "up front" charges which are not associated with settlement services, but also, any other charges, including contract interest, which the lender receives throughout the life of the loan. Accordingly, in attempting to determine what a discount point is, one must look to the real intent of the legislation.

From a practical standpoint, it seems abundantly clear that the discount point limitation was intended to place a cap upon the amount of "up front" charges which a residential mortgage lender could receive, thereby lessening the buyer-borrower's up front burden and allowing him to finance the transaction over the full life of the mortgage. Thus, it seems equally clear that the basic flaw in the existing definition is that it fails to define discount

⁴⁴ The term "discount points" is specifically defined in OHIO REV. CODE ANN. § 1343.011 (A)(1) (Page Supp. 1978), *supra* note 37.

⁴⁵ Section 3(3) of the Real Estate Settlement Procedures Act of 1974 provides as follows: [T]he term "settlement services" includes any service provided in connection with a real estate settlement including, but not limited to, the following: title searches, title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or broker, and the handling of the processing, and closing or settlement. 88 Stat. 1724, 12 U.S.C. 2603.

points in terms of "up front" costs. If the statutory definition were amended in that respect, it would immediately clear up a number of problems.⁴⁶

Thus, notwithstanding the existing statutory definition, probably the most reasonable interpretation of the statute is that the legislature intended to include within the meaning "discount points" all charges collected up front by a residential mortgage lender, except those which can be accounted for in terms of "settlement services" actually rendered to the buyer or seller. However, even if such an interpretation were adopted by the Ohio courts, the failure of both the Ohio legislature and the United States Congress to adequately define "settlement services" would leave some questions unanswered. For example, would a lender's bona fide loan commitment qualify as a "settlement service"?⁴⁷ While that particular item is not included in the Real Estate Settlement Procedures Act's laundry list of "settlement services," that list is not exclusive.⁴⁸ Moreover, it seems clear that such a commitment arrangement does, in fact, constitute a service, the charge for which is distinguishable from interest.⁴⁹ Yet, despite that fact, unless such a service were held to be a "settlement services," the charge for the service would presumably be treated as a discount point. Thus, under the present statutory definition, the concept of "discount points" appears to be broader than, and not synonymous with, interest.⁵⁰ Until these definitional problems are resolved, a prudent residential mortgage lender will have little alternative but to presume that any up front charge which cannot be directly tied to one of the items specified in the Real

⁴⁶ Because of this existing definitional flaw, a court, interpreting the present statute, could conclude that any post settlement charge, such as interest, a late charge, or even an insurance escrow payment falls within the definition of "discount points." A statutory amendment, re-defining discount points in terms of "up front" charges, would alleviate this potential problem.

⁴⁷ In many instances, building and loan associations and other residential mortgage lenders will make loan commitments to developer-sellers in order to insure that permanent mortgage loan funds will be available to buyers of the developer's homes. Typically, the developer-seller will pay the lender a fee for this service and will pass the cost on to the buyer as part of the purchase price of the home.

⁴⁸ *Supra* note 45. The specific question of whether a loan commitment fee qualifies as a settlement cost under the Real Estate Settlement Procedures Act has not been answered by either regulatory or case law interpretation.

⁴⁹ Although there are no reported Ohio cases which address the issue of the property classification of loan commitment fees, courts from other jurisdictions have recognized that such fees constitute a charge for a legitimate service, the privilege of borrowing money later, and as such, do not constitute interest. See *Gonzales County Savings & Loan Ass'n v. Freeman*, 534 S.W.2d 903 (Texas 1976); *D & M Dev. Co. v. Sherwood & Roberts, Inc.*, 93 Idaho 200, 457 P.2d 439 (1969); *United Am. Life Ins. Co. v. Willey*, 21 Utah 279, 444 P.2d 755 (1968); *Pivot City Realty Co. v. State Savings & Trust Co.*, 88 Ind. App. 222, 162 N.E. 27 (1928). This view has also been consistently accepted by the commentators in the area. See e.g., Shanks, *supra* note 1; R. KRATOVIL, *MODERN MORTGAGE LAW AND PRACTICE* Ch. 14, § 14 (1972).

⁵⁰ *Supra* note 37.

Estate Settlement Procedures Act laundry list, will be considered to be a discount point.

Even if one could successfully get past the hurdle of determining precisely what charges will be considered as discount points, an additional obstacle to compliance would exist. One would still have to determine the total amount of discount points which could be lawfully collected. Here again, the operative statutory language is susceptible to different interpretations.⁵¹

A cursory reading of the statute suggests that the discount point limitation is fixed at two per cent of the original principal amount of the mortgage. Upon closer analysis, however, it becomes apparent that the statute is also susceptible to the following interpretation, a residential mortgage lender may receive from the buyer or the seller⁵² discount points in an amount up to four per cent of the original principal amount of the mortgage, with a maximum of two per cent coming from the buyer and two per cent coming from the seller.⁵³

While it is true that arguments exist to support either of the above-discussed statutory interpretations, until that issue is ultimately decided by the Ohio courts or by statutory amendment, it is evident that Ohio residential mortgage lenders, including savings and loan associations, cannot rely upon the more lenient interpretation without exposing themselves to potential liability for violation of the statutory prohibitions.

This is true despite the fact that, in enacting the discount point limitations, the Ohio legislature did not provide for any specific remedy for enforcement of its provisions. In this regard, it has long been recognized in Ohio that where a duty or prohibition imposed by statute is manifestly

⁵¹ See OHIO REV. CODE ANN. § 1343.011 (B) (Page Supp. 1978) which is quoted at length in note 37 *supra*.

⁵² Since the discount point prohibitions are expressly limited to situations in which a residential mortgage lender receives payments from a "seller or buyer of real estate," those prohibitions should not apply to refinance transactions or other loan transactions which do not involve a buyer or seller. See note 37 *supra*.

⁵³ Had the Ohio legislature actually intended to limit the aggregate amount of discount points to two per cent, § 1343.011 (B) could have been drafted without reference to the buyer and seller, as follows:

No residential mortgage lender shall receive . . . any discount points in excess of two per cent of the original principal amount of the residential mortgage.

The phrase "either directly or indirectly from a seller or buyer of real estate" adds nothing to the meaning if the intent was to limit aggregate discount points to two per cent. One must assume that by adding the reference to the buyer and seller, the Ohio legislature has a purpose in mind. That purpose, at least arguably, was two-fold: (1) to limit the amount of discount points which could be charged to either the buyer or seller; and (2) to prohibit the shifting of the burden from one party to the other—hence the use of the language "either directly or indirectly."

intended for the protection and benefit of individuals, where an individual is injured by a breach of that duty or prohibition, the common law will supply a remedy if the statute does not.⁵⁴ Thus, where a residential mortgage lender collects discount points in excess of that permitted by statute, an action would lie with the aggrieved party, either "seller or buyer," to recover from the lender the excess discount points received.⁵⁵ While a residential mortgage lender's potential exposure for violation of the discount point limitations would not be great in any one case where a pattern of violations exists, the potential liability in a class action situation could, indeed, be great.

Relative to the subject of potential liability for violation of the discount points statute, one further matter merits discussion. It is clear that the discount limitations are not applicable to FHA or VA transactions, or to any other residential mortgage loan transactions which involve the direct participation of agencies or instrumentalities of the federal government.⁵⁶ Moreover, it also appears that where a residential mortgage lender receives excess discount points in connection with a "conventional" loan transaction, it can subsequently avoid all liability for the discount point violation by simply selling the loan to a federal agency in the secondary mortgage market.⁵⁷ Whether or not this type of "ex post facto" absolution was actually intended by the legislature, it is nonetheless sanctioned by the existing statutes.

C. CONCLUSION

As a result of the legislature's well intentioned but impressionistic approach to statutory drafting, the general usury/discount point picture in Ohio today is less clear than it was prior to 1975. Because of the lack of substantive legislative history surrounding the 1975 enactments, many of the existing ambiguities cannot be definitely resolved without the assistance of statutory amendments or court interpretation. Obviously,

⁵⁴ See generally *The C. & H.C. & I. Co. v. Tucker*, 48 Ohio St. 41, 26 N.E. 630 (1891); *Village of Cardington v. Adm'r of Fredericks*, 46 Ohio St. 442, 21 N.E. 766 (1889).

⁵⁵ One potential form of such action would be an action for declaratory judgment coupled with a request for mandatory injunctive relief. See OHIO REV. CODE ANN. § 2721.03 (Page Supp. 1978).

⁵⁶ See OHIO REV. CODE ANN. §§ 1343.011 (B) and 1343.01 (B)(3) (Page Supp. 1978) which are quoted at length in notes 37, 29 *supra*.

⁵⁷ OHIO REV. CODE ANN. § 1343.011 (B) (Page Supp. 1978) expressly provides that the discount point prohibitions do not apply to residential mortgage loans "described in division (B)(3) of Section 1341.01 of the Revised Code." One of the loans described in § 1343.01 (B)(3) which is quoted at length in note 29 *supra*, is a "loan secured by a mortgage or deed of trust on real estate where the loan has been . . . purchase[d] . . . by the federal government or any agency or instrumentality thereof." Obviously, a residential mortgage lender could only take advantage of this situation if the conventional loan in question met the qualifications imposed by the federal agency purchasing in the secondary mortgage market.

clarification by means of the latter alternative is a risky matter. Nonetheless, at least from the standpoint of the Ohio savings and loan industry, certain definite parameters exist at this time.

Initially, it remains clear that the Ohio savings and loan usury exemption remains in full force and effect.⁵⁸ There are, however, four limited exceptions to this general usury exemption.

First, in connection with "residential mortgage" transactions, as defined in Ohio Revised Code, Section 1343.011,⁵⁹ an association is limited to the amount of discount points which it may receive from a buyer or seller of real estate. As a result of the unsettled nature of the controlling statute, the most prudent policy at this time would be to limit "up front" charges, which cannot be directly tied to one of the specific settlement services listed in the Real Estate Settlement Procedures Act,⁶⁰ to a maximum of two per cent of the original principal amount of the mortgage loan. Second, in such residential mortgage transactions, a savings and loan association may only impose prepayment penalties during the first five years of the mortgage and, during that period, such penalty may not exceed one per cent of the original principal amount of the mortgage loan.⁶¹

Third, since November of 1973, Ohio building and loan associations have been authorized to engage in certain non-traditional lending activities, including second mortgage lending and unsecured lending. However, when participating in these non-traditional lending areas, savings and loan associations are expressly prohibited from charging interest, finance charges or penalties which exceed the amount that competing lenders would be entitled to charge for the same type of loan.⁶² Thus, in

⁵⁸ See OHIO REV. CODE ANN. § 1151.21 (Page 1968), *supra* note 21. Because of the breadth of the building and loan usury exemption, such associations need not be concerned with the often amorphous question of whether specific charges, such as late charges, actually constitute interest or something other than interest.

⁵⁹ *Supra* note 37.

⁶⁰ *Supra* note 45.

⁶¹ OHIO REV. CODE ANN. § 1343.011 (C) (Page Supp. 1978). Because of express federal preemption in this case, the Ohio prepayment penalty provisions are not applicable to federal savings and loan associations. See 12 C.F.R. § 555.15; 12 C.F.R. § 545.612(b). It is unclear whether a federal association could successfully take the same position with regard to the Ohio discount point limitations.

⁶² OHIO REV. CODE ANN. §1151.343 (B) (Page Supp. 1978), provides as follows:

An association may make any of the following loans provided that it shall not charge, collect or receive interest, finance charges and penalties in excess of the maximum rate or amount which competing lenders chartered, licensed, or authorized to do business in this state are permitted to charge by law for the same type of loan: (1) A second mortgage loan made pursuant to section 1321.51 to 1321.60 of the Revised Code; (2) A second mortgage in excess of any amount authorized by division (B) (1) of this section but not in excess of an amount that could be made under a first lien on real property under any other section of Chapter 1151 for such loans; (3) Secured or

these limited instances, the specific usury exemption contained in Ohio Revised Code, Section 1151.21 could not be relied upon by a savings and loan association.

Fourth, since the usury exemption granted to savings and loan associations does not extend to the operations of their "service corporations," it is clear that such corporations are subject to the same usury laws as other Ohio corporations.⁶³ As a result of that fact, the lending activities of such corporations should be carefully structured and closely monitored.

In summary, while recent legislation has placed certain additional constraints upon the lending practices of building and loan associations, such associations nonetheless continue to enjoy a favorable position in the overall Ohio usury scheme. However, it should be recognized that such is not necessarily the case under the usury laws of other states which, in many instances, differ dramatically from those of Ohio.⁶⁴ Accordingly, Ohio associations entering the national lending market should do so with caution.

unsecured loan to its employees and their immediate families not in excess of \$5,000; (4) Interim financing for the purpose of financing construction of modular housing units; (5) Lines of credit to a builder for the purpose of financing improvements to real property.

⁶³ As previously indicated in this article, the maximum permissible interest rate which such service corporations would be entitled to charge in any given situation would depend largely upon the specific nature of the loan transaction in question. See note 11 *supra*. However, it is clear that under Ohio law, a violation of the usury law would subject such a creditor to a forfeiture of all interest in excess of the rate allowed by law at the time the contract was made. See OHIO REV. CODE ANN. § 1343.04 (Page Supp. 1978).

⁶⁴ Unlike in Ohio, in some states, a violation of the usury laws can subject a creditor to the forfeiture of all principal and interest on the loan. For a current picture of the general status of the usury laws in all fifty states, see [1978] 1 Cons. Credit Guide (CCH).

