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Effect of Usury Laws on Home Ownership Needs

Richard S. Stoddart and Earl R. Hoover***

THE BUILDING BOOM PREDICTED for the late 1960's and early 70's is here. Or *is* it? It *was* until mid-1969. True, "war babies" will peak in the next ten years.[1] But can home financing keep pace? Can the thrift industry stimulate home ownership, what with increasing wages, increasing material costs, increasing inflation, and especially with sky-high mortgage interest rates? Frankly, do Federal and State laws impede or assist the average American in buying a home?

In this paper we examine usury laws which thwart the thrift industry, particularly savings and loan associations, from entering fully into the needed home financing picture of the 1970's. If there is virtue in owning a home, be it a normal house, mobile home, condominium or a 99-year leasehold, (and the very basis of American life suggests that there is), and if the predicted housing boom is actually to occur, substantial changes should be made in laws which frustrate home financing.

The Problem

In 1969, institutions promoting home ownership experienced the highest finance rates in their history. There is no reason to assume, necessarily, that these high interest rates will continue at those levels through the 1970's. Yet, with the trend of our economy, it is reasonable to assume that such rates will not decline substantially in the years immediately ahead; indeed, there may well be an increase.

Home financing in the 1970's must embrace some pessimism unless many misunderstandings about its risks and profits are corrected in the mind of legislators. An example is the cost today to a thrift institution of borrowing money in our region, contrasted with what it can earn, under existing Ohio law, when these funds are invested in a mortgage on a single family home.

Savings and loans have three primary ways of obtaining money to lend for home financing: (1) savings deposits, on which interest in our area in the fall of 1969 was a minimum of 4.75% per annum and a maximum of 5.25%; (2) borrowing from the Federal Home Loan Bank System, which in the fall of 1969 was a minimum of 6¾% per annum for short term funds and 7⅝% for 5 year loans; and (3) borrowing from commercial banks, which in the fall of 1969 meant a minimum rate of

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[1] Roy Wenzlick Research Corp., 37 Real Estate Trends (3) (Jan. 1968).

8.5% to the best customers. Thrift institutions acquire most of their funds from savings deposits, so a rough figure of what it costs these institutions to borrow money would fall below the figure determined by simply averaging the costs from each source. A figure of about 5.1% is probably reasonable when all sources are considered.

Ohio law now limits to 8% the contract rate of interest on loans to individuals for the normal single family home.[2] Consequently, pure mathematics will tell you what small interest-profit a thrift institution ordinarily makes on a home loan. That is obtained by computing the difference between what the institution must pay to borrow money from depositors and banks and what it earns in lending that money—i.e.—the difference between 5.1% and 8%—or 2.9%. Now let's translate that into dollars and cents in a typical loan. Thus, for a $20,000 loan, (assuming that borrowed money costs remain constant) the maximum return for the next 12 months would be 2.9% of $20,000 or $580.

The example of a loan just given, is an example of a type where the savings and loan makes a modest profit. Unfortunately, what the public does not realize is that not all existing loans are sugar and cream and that many are now carried at no profit and even at a loss. It's like trying to buy today's groceries at wages that prevailed 10 or 15 years ago.

The reason for these millstone-around-the-neck, profitless loans is that many loans are old, fixed ones made years ago when the loan rate to the borrower was low—in fact, when the rate was so low that it is now lower than the savings and loan must currently pay to retain this money that it has lent.

Thus, some old loans that are still outstanding were made for as low as 4% whereas the savings and loan is now, as we shall see, paying 5.1% to keep the money that went into such loans. No one can pay 5.1% to obtain money, then lend it out at 4% and make anything but a loss—of 1.1%. Now, translate this into dollars and cents. On such an old loan where the balance is $20,000, the institution is losing roughly $220 a year; and, on a balance of $10,000, roughly $110.

To this impedimenta, add the fact that all the things which the institution now buys—whether they be employed services, supplies, materials, buildings, maintenance, etc., have sky-rocketed in price—and you begin to see the magnitude of the problem which proves that all is not gold that seems to glitter.

It is readily apparent that as the cost of borrowed money increases, the margin of return to the lending institution *must* decrease unless the stable usury limitation (8%) is altered upward. This squeeze is unfortunate in two ways for the potential Ohio home owner because it tends to force investment money (A) out of jurisdictions like Ohio that have

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[2] Ohio Rev. Code § 1343.01.

low usury limits into those jurisdictions where the return is substantially higher because the usury limit is higher,[3] and (B) into the more profitable, not-so-hampered, commercial and land acquisition loans instead of single family residential loans.

History of the Thrift Industry

It all began in April 11, 1831, when Comly Rich borrowed $375.00 from the Oxford Provident Association of Frankford, Pennsylvania. It was for twelve months and Rich paid a premium of $10.00 to induce the Association to make the loan; a mortgage securing the loan and covering premises owned by Rich on Orchard Street in Frankford was recorded almost a year later on March 2, 1832.[4]

The loan to Comly Rich was the first loan by the first known savings and loan association in the United States. Thirty-seven businessmen and workers formed the association and subscribed for shares.

Apparently the association did not have enough funds to satisfy all demands of potential borrowers, so the by-laws prescribed that members were to submit bids for funds to finance the new residential construction or to purchase an existing home. Rich submitted the highest bid for the first $375.00 available and the Association made him the loan.[5]

By the turn of the century, approximately 5,000 savings and loan associations were in existence and the predecessor of the United States Savings and Loan League had been formed. The depression took its toll on savings and loans, but the Reconstruction Finance Corporation began making loans available to the industry in 1932, followed later that year by the creation of the Federal Home Loan Bank System.[6] The Home Owners Loan Act of 1933[7] authorized the creation of federal savings and loan associations:

> In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the [Federal Home Loan Bank] Board is authorized . . . to provide for the organization, incorporation, examination, operation and regulation of associations to be known as "Federal Savings and Loan Associations," and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.[8]

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[3] The usury limit as of July 1969 for each of the states of the United States is shown in Appendix A.

[4] Bodfish, History of Building and Loan in the United States, 32-74 (1931, United States Building and Loan League). Mitchell, "The House That Rich Built," 8 The Franklin News 2 (May 1931; Franklin Society for Home Building and Savings, N. Y. City).

[5] Kendall, The Savings and Loan Business, 5-19 (1962, Prentice-Hall, Inc.).

[6] 12 U.S.C.A. § 1421-1449 (1932).

[7] *Ibid.* § 1461-1468 (1933).

[8] *Id.* at § 1464.

The Federal Savings and Loan Insurance Corporation was begun in 1934.[9] Just prior to World War II savings and loan associations were enjoying a high level of confidence, and recovery from the depression years was all but complete.

After World War II, the savings and loan business experienced its greatest period of expansion. Changes in statutes governing the insurance of deposits, premiums for such insurance, and greater involvement of the Treasury Department assisted immeasurably.

About 70 percent of existing savings and loan associations operate under state charters and are subject to supervision by a separate department within the state. The other 30% operate under Federal charters under direct supervision of the Federal Home Loan Bank Board. However operated, savings and loans are subject at least to one annual audit and examination. Many are subject to both state and federal requirements.

Today savings and loan associations provide 33%[10] of all funds being loaned by mortgage lenders, and they make available 43.8% of all financing in the United States for one to four family residential homes.[11] In 1968, 91.7% of savings deposits in associations in the United States were allocated to residential mortgage loans.[12] At the end of 1968, 5,996 savings and loan associations had assets of 152.8 billion dollars.[13]

Typically a savings and loan association offers

(1) specialized service with more liberal terms in the whole range of home financing—commitments to builders, construction loans and permanent loans. Normally commercial banks are more limited in their ability to lend, particularly in the ratio of the amount of the loan to the appraised value and the length of maturity; and

(2) legally higher interest rates than commercial banks to depositors in order to generate funds for investment in residential housing.

The sensational growth of the savings and loan business can be credited not only to its specializing in the residential housing field, and the higher interest it pays on deposits, but the care of management to invest prudently. Public acceptance is proved by the striking increase in savings deposits at savings and loan associations—from about $14 billion in 1950 to over $150 billion in 1969.

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9 *Id.* § 1724-1730 (1934).

10 Savings and Loan Fact Book 1969, p. 35 (1968 U. S. Savings and Loan League).

11 *Id.* at 38.

12 *Id.* at 36.

13 *Id.* at 61.

The Impact of Usury Laws

As earlier noted, during these high interest rates on deposits, a low usury ceiling hampers the ability of a lending institution to earn sufficient profit on residential loans to induce capital to remain within jurisdictions, like Ohio, where the lower usury ceilings prevail. No attempt will be made here to discuss the effect of usury laws of different jurisdictions.[14] Rather a probing will be made of current laws, reported cases, regulations and opinions which affect making of residential loans by savings and loan associations in Ohio.

(1) *Federal Law*

Section 5 of the Federal Home Loan Bank Act[15] provides a limit on the rate of interest which may be received by any savings and loan association which is a member of the Federal Home Loan Bank System:

> No institution shall be admitted to or retained in membership or granted the privilege of non-member borrowers if the combined total of the amounts paid to it for interest, commission, bonus, discount, premium and other similar charges, less a proper deduction for all dividends, refunds, and cash credits of all kinds, creates an actual net cost to the home owner in excess of the maximum legal rate of interest or, in case there is a lawful contract rate of interest applicable to such transactions, in excess of such rate (regardless of any exemption from usury laws) or, in case there is no legal rate of interest or lawful contract rate of interest applicable to such transactions, in excess of 8 per centum per annum in the State where such property is located. This Section applies only to home mortgage loans made after the enactment of this Act.

Applied to Ohio, the statute renders a state or federal association ineligible for membership, or subject to termination of membership, in a Federal Home Loan Bank if an individual home borrower pays interest, commission, bonus, discount, premium, or other *similar* charges which in total exceed 8% on loans of under $100,000.00.[16]

The statute is *not* a usury statute, and it is doubtful that it could be successfully invoked as a defense against usury.[17] At most it provides the requirements for admission to the Federal Home Loan Bank System and a penalty of removal from membership if an association violates its provisions. The statute does not prohibit an association from charging any interest rate or combination of fees that it desires.

Section 5 is a strange statute. On its face it appears to dictate a Congressional policy that state and federal associations, if they wish to be

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[14] See Appendix A for a listing of the usury limitations in each of the states of the United States.

[15] F.H.L.B. Act § 5, 12 U.S.C.A. § 1425 (1932).

[16] Ohio Rev. Code § 1343.01 (eff. Oct. 22, 1969).

[17] Prather, "Savings Association Mortgages and the Usury Laws," Legal Bulletin, United States Savings and Loan League, 151-3 (July 1960).

participants in a Federal Home Loan Bank, must not receive total fees and interest in excess of the usury limit of the jurisdiction where the property is located. However, the inclusion of the language "... (regardless of any exemption from usury laws) . . ." flies in the face of such policy. At least 15 states have some type of special statutory exemption from usury for state and federal associations, based upon their unique position in the thrift and home ownership areas or because they are rooted in cooperative efforts to encourage such virtues.[18]

Section 5, by reason of its last sentence, applies *only* to home mortgage loans, and not multi-family dwellings. In an Opinion dated March 12, 1969,[19] the General Counsel of the Federal Home Loan Bank Board stated:

> It is my opinion that where a Federal Home Loan Bank member currently makes a loan, such loan is not subject to section 5 aforesaid if the loan is not made upon the security of real estate upon which is located, or which comprises or includes, at least one "home" as defined in section 521.6-1 of the Regulations for the Federal Home Loan Bank System, even though the loan is made upon the security of real estate upon which is located, or which comprises or includes, one or more "other dwelling units" as the term "other dwelling unit" is defined in section 521.6-2 of said regulations.[20]

The two sections of the Federal Home Loan Bank System cited in the Opinion provide:

§ 521.6-1 *Home*

"The term 'home' means a structure designed for residential use for one family." [21]

§ 521.6-2 *Other Dwelling Unit*

"The term 'other dwelling unit' means a single combination of rooms suitable for a family, in a structure designed primarily for residential use that is not a home as defined in Section 521.6-1." [22]

Thus, loans for land acquisition and development, participation loans, and loans on multi-family buildings and commercial buildings are not covered by the prohibition.

(2) *Ohio Law*

(a) *Extension to Federal Savings and Loan Associations.* State-chartered savings and loan association provisions are extended to federal savings and loan associations:

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18 *Id.* at 146-7.

19 Federal Home Loan Bank Board Opinion, Public Index No. 1272 (1969).

20 *Id.* at 1.

21 12 C.F.R. 521.6-1.

22 *Ibid.* 521.6-2.

> Federal savings and loan associations, the home office of which is located within this state, shall possess all the rights, powers, privileges, benefits, immunities, and exemptions existing on or provided after September 21, 1961, by the laws of this state for associations organized under Chapter 1151 of the Revised Code and for the members and savings account holders thereof unless federal laws or regulations provide otherwise. This provision is additional and supplemental to any provision which, by specific reference, is applicable to federal savings and loan associations and members thereof.[23]

This provision is based upon the Model Savings Association Act promulgated in 1957 by the United States Savings and Loan League.[24]

(b) *Exemption from Usury Statutes*

Ohio is one of the jurisdictions which grants to savings and loan associations a special exemption from usury statutes:

> 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 bylaws. Such assessments shall not be deemed usury, although in excess of the legal rate of interest.[25]

This exemption, extended to federal associations under the provisions of Section 1151.361, clearly provides a specific condition before exemption from the usury statute is applicable—the constitution *and* bylaws of the association *must* provide for the assessment and collection of the items specified in the statute. In extending the provision to ". . . members and *others* . . . ," the power exists to assess and collect such specified items from borrowers or third parties who have no interest in the loan transaction. The scope is broad—it includes interest itself, as well as dues, fines, premiums or other assessments specifically enumerated in the constitution and bylaws of the association.

Taken by itself, the statute permits savings and loan associations to receive interest and other fees in any amount so long as the association has so provided in its constitution and bylaws. The basis for upholding the constitutionality of this statute and the position which differentiates a savings and loan association from other organizations, is the unique

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23 Ohio Rev. Code § 1151.361.

24 The relevant section of the Model Savings Association Act, § 44, provides: "Federal savings and loan associations, incorporated pursuant to the Home Owners' Loan Act of 1933, as now or hereafter amended, are not foreign corporations. Unless federal laws or regulations provide otherwise, federal savings and loan associations and the members thereof shall possess all of the rights, powers, privileges, benefits, immunities and exemptions that are now provided or that may be hereafter provided by the laws of this State for associations organized under the laws of this State and for the members and savings account holders thereof. This provision is additional and supplemental to any provision which, by specific reference, is applicable to federal savings and loan associations and the members thereof."

25 Ohio Rev. Code § 1151.21.

place that such associations hold in financing home ownership. The leading Ohio case upholding constitutionality concludes:

> The organization of building and loan associations being authorized under a general law, we find the limitations upon their powers and the grant of their authority in few and simple rules. The major part of the government of their internal affairs is placed within the hands of the associations themselves, and the mutual rights of the borrowing and non-borrowing stockholders are to be worked out according to their own regulations, of course being supervised by limitations set by the statute. The law creating these associations can confer upon them such reasonable and ample powers for their successful operation, as the general assembly may deem necessary, within the purposes and scope of their organization, and in doing this the legislature may classify the subjects upon which the powers are conferred and yet keep within constitutional limits.[26]

Ohio specifically provides another exemption from the usury statutes in prohibiting corporate borrowers from invoking usury as a defense.[27]

During the recent session of the Ohio legislature, the usury statute was amended to provide a further exemption. The new law, effective October 22, 1969, provides:

> 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.[28]

Thus in Ohio, as we enter the 1970's, the usury limit on mortgage loans remains at 8% per annum with the exception of loans (a) to corporate borrowers, (b) to borrowers where such original principal indebtedness exceeds $100,000.00, and (c) by state and federal savings and loan associations if such associations have complied with Section 1151.21.

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26 Cramer v. Southern Ohio Loan & T. Co., 72 Ohio St. 395, 74 N.E. 200, 69 L.R.A. 415 (1905).

27 Ohio Rev. Code § 1701.68 reads as follows: "No domestic or foreign corporation, or anyone on its behalf, shall interpose the defense or make the claim of usury in any proceeding upon or with reference to any obligation of such corporation; nor shall any corporate note, bond, or other evidence of indebtedness, mortgage, pledge, or deed of trust, be set aside, impaired, or adjudged invalid by reason of anything contained in laws prohibiting usury or regulating interest rates."

28 Ohio Rev. Code § 1343.01; the prior law, repealed as of October 22, 1969, reads as follows: "The parties to a bond, bill, promissory note, or other instrument of writing for the forbearance of 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."

For all practical purposes the addition of the exemption on loans of over $100,000.00 gives no additional exemption to a savings and loan association provided that the association had availed itself of Section 1151.21 prior to the passage of the recent amendment. For associations which had not done so, the amendment provides an important new dimension. Many potential borrowers who are buying or building multi-family housing desire that title be held, not in a corporation, but in the name of an individual or a partnership or limited partnership in order to take advantage of depreciation allowances available under Federal income tax laws. These loans would normally exceed $100,000 in principal amount, and would have been subject to the 8% limitation provided in Section 1343.01 *prior* to its amendment. Certainly the amendment should facilitate mortgage lending on such projects, not only by savings and loan associations, but also by commercial banks.

(3) *Section 5 of the Federal Home Loan Bank Act Applied to Usury Exemptions Under Ohio Law.*

The practical effect of Section 5 of the Federal Home Loan Bank Act[29] is to deny to state and federal savings and loan associations in Ohio the exemption granted in Section 1151.21 when financing the construction or purchase of homes by individuals. Loans to corporate borrowers or those exceeding $100,000 could still be made, but few, if any residential loans fall into those two categories.

Savings and loan associations are generally required to invest approximately 80% of investable funds in first-mortgage home loans; thus the greatest percentage of loans made by Ohio associations fall within the discussion above. When money costs increase, savings and loan associations must seek higher interest rates and additional fees for mortgage loans in order to insure the specified return to savings depositors or to the Federal Home Loan Bank or commercial banks, wherever borrowing is obtained. If the usury laws of Ohio do not permit the charging of sufficient rates or fees to insure the necessary return, it is likely that a savings and loan association will seek and buy loans in jurisdictions outside Ohio where usury limits are less restrictive and the necessary rate of interest and fees can be received without violating Section 5 of the Federal Home Loan Bank Act. In so doing, of course, funds which otherwise would have been available for Ohio home loans, are diminished. States like Ohio with restrictive usury limitations, instead of protecting their public from higher rates on mortgage loans, are finding that such restrictive provisions merely drive money out of the state and into other investments, and make it much less likely that mortgage loan funds will be available in any substantial quantity in their jurisdictions.

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[29] *Supra* n. 16.

(4) *The Effect of Charging "Points"*

Most lending institutions, particularly in periods of tight money, insist upon charging so-called "points" (or perhaps an "origination fee," "loan fee" or similar term) for making money available to the borrower. In Ohio, state and federal savings and loan associations have no problem in making such a charge *if* they have complied with Section 1151.21. But, in order to comply with Section 5 of the Federal Home Loan Bank Act (which excludes the statutory exemption of Section 1151.21), will "points" be considered part of the interest charged on the loan so as to make it usurious and thus a violation of the 8% limitation? The question has been answered by the Federal Home Loan Bank Board's General Counsel in the negative, at least with respect to FHA and VA loans. In an opinion letter dated November 27, 1968, he responded to the question of whether the interest restrictions of said Section 5 apply to the "points" required by lenders with respect to FHA and VA loans when the "points" are paid by the *seller* of the real estate:

> In part, § 5 states that "if the combined total of amounts paid to (the institution) for interest, commissions, bonus, discount, premium, and other similar charges . . . creates an 'actual net cost to the home owner' . . ." in excess of the applicable rates the offending institution shall not be admitted or retained in membership. The phrase "actual net cost to the home owner" would seem to determine the matter; since the "points" are paid by the seller, they are not part of the total price paid by the new home owner. The argument suggested by you and others is that this cost is often ultimately paid by the vendee.
>
> Although a seller may demand and receive a higher price for real estate to be sold to an FHA or VA mortgage applicant, it is the opinion of this Office that "points" when paid by the seller in order to secure an FHA or VA loan for the buyer need not be included in the calculations set forth in § 5. Any other interpretation of § 5 would, in our judgment, create hopelessly complicated administrative problems for both the Board and member institutions.[30]

Of course, the logical extension of such opinion is that savings and loan associations could charge points to a seller on a conventional loan which, if charged to the buyer-borrower, would constitute a violation of Section 5 once the Ohio exemption is excluded. If the test of "actual net cost to the homeowner" means limited to his transaction with the savings and loan association, it would appear logical to extend the opinion to conventional home loan transactions.

Adding to the dilemma of how savings and loan associations should handle the conventional home loan where points are being charged is a 1964 Ohio lower court decision, *Bankers Guarantee Title and Trust Co.*

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30 Federal Home Loan Bank Board Public Index No. 1025, Letter dated November 27, 1968 from Alan Jay Moscov, General Counsel of the Federal Home Loan Bank Board to George L. Whitfield, Esq., Warner, Norcross & Judd, Grand Rapids, Michigan.

v. Fisher,[31] in which a commercial bank charged points to the seller in a real estate loan, which, when added to the interest rate, made the loan exceed the statutory 8% limitation.

Since the points were not for a specific service rendered by the bank, the court concluded that the points should be added to the basic interest rate in the first year of the loan thus making the loan usurious.

Considering the current status of Ohio law, the reasoning of the court in the *Bankers Guarantee case*[32] would not apply to savings and loan associations which had complied with the provisions of Section 1151.21. And since the points were paid by the *seller,* if the opinion of the General Counsel of the Federal Home Loan Bank Board can be construed as applying to conventional home loans, the case would not invoke the expulsion provision of Section 5.

(5) *First Conclusions*

In order to make certain that Ohio savings and loan associations, whether state or federal, will commit substantial funds to single family home mortgages in Ohio in the 1970's, some amendment should be made to federal and state laws. The simplest approach—and that which would immediately solve the problem for all jurisdictions having a specific statutory usury exemption for savings and loan associations—is for Congress to amend Section 5 of the Federal Home Loan Bank Act so as to remove the exclusion of exemptions that various jurisdictions now provide to savings and loan associations.[33] However, any change in Section 5 would not absolutely resolve the problem for savings and loans, and it certainly provides no relief for the commercial banks. Raising the Ohio usury limitation would end any concern involved with possible expulsion from the Federal Home Loan Bank system; such a change could easily be supported by commercial banks in Ohio since it would improve the total ability of Ohio lending institutions to hold funds available for the housing needs of the 1970's. If it were a sufficient increase, it would equalize the position of commercial banks and savings and loan associations, since no reliance would then be placed on the special exemption for savings and loan associations.

The recent session of the Ohio legislature did produce the new $100,000.00 exemption from usury limitations. However, at the same time, four Ohio Senators introduced a bill which would have eliminated the long-time exemption for savings and loan associations and specifically included points, origination fees and similar charges as part of the inter-

31 2 Ohio Misc. 18, 204 N.E. 2d 103 (Com. Pl. 1964).

32 *Ibid.*

33 § 413(a) of S. 2864, 91st Congress, which passed the U.S. Senate on September 23, 1969 proposes removing the exemption exclusion contained in Section 5.

est computation in Section 1343.01.[34] This bill was not acted upon by committee and thus never reached the floor of the Senate.

I.R.S. Ruling on Deductibility of "Points"

Revenue Ruling 69-188,[35] casts a new light on the deductibility of "points" which are paid by the borrower in connection with the making of a mortgage loan. The discussion is in response to a taxpayer request for advice on deducting as interest under Section 163(a) of the Internal Revenue Code[36] funds paid for a "loan processing" fee. The fee

> . . . was not paid for any specific services that the lender had performed or had agreed to perform in connection with the borrower's account under the loan contract. The loan agreement provided for separate charges for these services. For example, separate charges were made for a preliminary title report, a title report, an escrow fee, the drawing of the deed and other papers, and insurance. In determining the amount of this "loan processing fee" the lender considered the economic factors that usually dictate an acceptable rate of interest. That is, he considered the general availability of money, the character of the property offered as security, the degree of success that the borrower had enjoyed in his prior business activities, and the outcome of previous transactions between the borrower and his creditors.[37]

In deciding that the payment of this fee constituted deductible interest under Section 163(a) of the Internal Revenue Code, the I.R.S. sets down two distinct criteria: (1) the fee "was paid as compensation to the

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[34] 108th General Assembly, State of Ohio, S.B. 157 provided in part as follows: "§ 1.—That sections 1151.21 and 1343.01 of the Revised Code be amended to read as follows:

"Sec. 1151.21. A building and loan association may assess and collect from members and others, such dues, fines, interest, and premiums on loans made, or other assessments, as are provided for in its constitution and bylaws and do not result in a violation of Section 1343.01 of the Revised Code.

"§ 1343.01. 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.

"For the purposes of this Section, on any loan secured by a mortgage on real property made by a bank, building and loan association, insurance company, or mortgage banker or any agent of, or broker who regularly sells such loans to, any of such lenders, interest includes origination charges, points, or similar costs or fees discounted from or added to the amount of the loan or received by the lender, agent, or loan broker from the borrower, seller, real estate broker or salesman, or any other person connected with the obtaining of the loan or the making of the sale of the property which is to secure the loan, or acting for the benefit of the borrower or the seller of such property."

"Section 2. That existing sections 1151.21 and 1343.01 of the Revised Code are hereby repealed. . ."

[35] I.R.B. 1969-16, 8.

[36] Internal Rev. Code of 1954 § 163(a) reads as follows: "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness."

[37] *Supra* n. 32 at 9.

lender solely for the use or forbearance of money," [38] and (2) the borrower "did not initially obtain the funds to pay this fee from the lender." [39]

Two earlier Revenue Rulings had dealt respectively with the deductibility under Section 163(a) of "points" paid in connection with FHA and VA financing,[40] and with the claim of a seller that points be paid in order that the buyer could obtain financing, were deductible.[41] In the former ruling, the I.R.S. ruled that "points" paid by the borrower to the lending institution were for *services rendered* and therefore did not constitute interest. In the latter ruling, the I.R.S. took the position that ". . . in order for a taxpayer to deduct a loan charge as interest, the charge must be his own obligation." [42]

Thus a conventional mortgage loan borrower may deduct fees or points as interest if the funds are not borrowed from the mortgage lender and if such fees or points were paid for the use or forbearance of money. Not so with FHA or VA financing. Certainly this ruling will have a significant impact on the 1969 borrowers who paid points during the tight money times; if the tests are met, the deduction as interest on 1969 Federal Income Tax returns will be considerably greater.

Overall Conclusions

The thrift industry has a tremendous challenge ahead if it is to meet the housing needs of the 70's. To be hampered by usury laws which do not achieve their avowed purpose but rather inhibit the availability of funds in times of rising costs for borrowed money may effectively preclude the industry from meeting the challenge. A mortgage loan borrower now receives ample knowledge of the precise charges which are being assessed when he is given the Disclosure Statement required by the Federal Truth in Lending Act.[43] Each charge is itemized and the separate additional fees being charged for the availability of money are clearly stated.

It is suggested that the Ohio legislature consider the impact of its low usury rate on the ability of residents to find mortgage funds available in the 70's. There is obviously a point at which savings and loans cannot lend to individual borrowers in Ohio—at any price—not because they would not desire to do so, but simply because the usury laws prohibit sufficient enough return for funds to be invested in home mortgages in this State.

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[38] *Id.* at 10.

[39] *Id.*

[40] Rev. Rul. 67-297, C.B. 1967-2, 87.

[41] I.R.B. 1968-52, 9.

[42] *Id.* at 10.

[43] Consumer Credit Protection Act, 15 U.S.C.A. Title 1 § 1601 et seq. (1968).

The new ruling of the Internal Revenue Service providing for the deductibility of "points" under certain conditions is a hopeful sign. So is the report that Section 5 of the Federal Home Loan Bank Act might be amended to overcome the deficiency now inherent in the interpretation of that statute. Who should take the leadership to insure that in Ohio there will be a maximum supply of dollars for home mortgage loans in the 70's? It is submitted that the legislature of Ohio bears the responsibility to make certain that the usury laws do not impede the thrift industry from meeting the housing challenge of the next decade.

APPENDIX A

Mortgage Interest Rate Maximums for Individuals

Alabama	8%	Montana	10%
Alaska	8%	Nebraska	9%
Arizona	8%	Nevada	12%
Arkansas	10%	New Hampshire	12%
California	10%	New Jersey	7½%
Colorado	10%	New Mexico	10%
Connecticut	12%	New York	7½%
Delaware	8%	North Carolina	6%
Florida	10%	North Dakota	7%
Georgia	8%	Ohio	8%
Hawaii	12%	Oklahoma	10%
Idaho	8%	Oregon	10%
Illinois	7%	Pennsylvania	6%
Indiana	8%	Rhode Island	12%
Iowa	7%	South Carolina	7%
Kansas	10%	South Dakota	8%
Kentucky	7%	Tennessee	6%
Louisiana	8%	Texas	10%
Maine	12%	Utah	10%
Maryland	8%	Vermont	6%
Massachusetts	12%	Virginia	8%
Michigan	7%	Washington	12%
Minnesota	8%	West Virginia	8%
Mississippi	8%	Wisconsin	12%
Missouri	8%	Wyoming	0