MINUTES

SPECIAL COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS

August 16-17, 1977

Members Present

Senator Neil Arasmith, Chairman
Representative Jim Holderman, Vice-Chairman
Senator Paul Feleciano, Jr.
Senator Larry Rogers
Representative Herman Dillon
Representative Charles Laird
Representative Mike Meacham
Representative John Reimer
Representative Marjorie Thomson

Excused - Senator Crofoot
Representative Lloyd Buzzi (August 16)

Absent - Representative Lloyd Buzzi (August 17)

Staff Present

Bill Wolff, Kansas Legislative Research Department
Bill Edds, Revisor of Statues Office

Others Present

Jim Turner, Kansas Savings and Loan League
Joe C. Morris, Columbia Savings Association, Emporia
Kenneth Brasted, Mid-Kansas Federal Savings and Loan Association, Wichita
Jack Roberts, Blue Cross/Blue Shield Insurance
Paul Lewis, Kansas Bankers Association
Robert M. Moore, Kansas Association of Realtors
Charles D. Horn, Kansas Association of Realtors
Michael Hrynewich, Kansas Savings and Loan League
Gregory D. Bangs, Greater Kansas City Home Builders Association
Gerald L. Goodell, Kansas Savings and Loan League - Attorney

August 16

Morning Session

The meeting was called to order at 10:00 a.m., in Room 528 by Chairman Arasmith. Chairman Arasmith asked the Committee members to take a few minutes to review the minutes of the July meeting. The motion was made by Vice-Chairman Holderman and seconded by Representative Thomson that the minutes be approved as written. Motion carried.

Hearings began on Proposal No. 11 - Usury Rates for Savings and Loan Associations. Mr. Jim Turner, Kansas Savings and Loan League, presented written testimony to the Committee urging its support for the passage of H.B. 2530 (See Attachment A).

Senator Feleciano expressed his continuing concern about the problem of "red-lining." He said he did not want to change any law which might have the of increasing discrimination in lending for real estate purchases. He reported to the Committee that he has received numerous calls claiming that some savings and loan associations refuse to make loans on real estate valued under $30,000. Mr. Turner replied that he knew of no "red-lining" problem in Kansas. He added that while he could not speak to the individual procedures of each association, it was his impression that savings and loan associations were eager to make all the loans which could possibly be made.

In response to a question by Representative Holderman, concerning the usury rate, Mr. Turner responded that he and the Committee staff had traced the 10 percent usury rate to its origin in 1889. To a second question by Representative Holderman, Mr. Turner said that Colorado, a state with no ceiling on first mortgage interest rates, charged 10½ to 11 percent during the last tight-money period in 1973-74.

Representative Meacham inquired as to the percentage of first mortgage real estate loans which would qualify for the exemption from the usury rate as provided in H.B. 2530. Mr. Turner estimated that perhaps 95 percent of all such loans would qualify for the exemption.

Mr. Turner called the Committee's attention to certain tables contained in his prepared remarks. He noted the different rates allowed by the several states. In particular, he pointed out those states with floating and index rates and discouraged the Committee from considering such rates. He said that a floating interest rate was not viable, index rates tended to become the established market rate, and neither type would be supported by the Kansas Savings and Loan League.

Representative Loren Hohman appeared before the Committee as a conferee in support of H.B. 2530. He explained that the bill was necessary in order to keep Kansas money in Kansas during periods of high interest rates and tight-money. He further stated that the Savings and Loan Subcommittee of the House Committee on Commercial and Financial Institutions, which he chaired, had given extensive consideration to the bill. That Subcommittee concluded that the bill would help promote a healthy growth in Kansas real estate by allowing some flexibility in the law to compensate for tight-money situations. He finished his remarks by relating the Subcommittee recommendation that H.B. 2530 be favorably considered by the House Committee.

Mr. Joe C. Morris, President of the Columbia Savings and Loan Association in Emporia, Kansas, testified before the Committee on his experience at the local market level during the last period of high interest rates. In April, 1974, savings deposits began to drop off, he said, but the demand for home loans continued. Ultimately, his association accepted applications for loans only from Emporia residents seeking to purchase owner-occupied single family dwellings. Since deposits were down, the number of loans which could be made necessarily decreased. In the period January through June of 1974, his association averaged 42 loans per month. Later in the cycle, only 25 loans per month could be made.

Mr. Morris contended that higher than 10 percent interest rates would not have been detrimental to the public at that time nor during any tight-money period. To demonstrate his point, Mr. Morris noted that a new loan of $25,000 at 8 3/4 or 9 percent would be repaid at a rate of $210 per month. At a 12 percent rate, the monthly payment would increase to $263.31, a difference of $53.31. Inflation, he argued, would cost the customer more than that difference if the potential homeowner had to wait for a period of lower interest rates before buying a home. When interest rates declined from the higher levels, Mr. Morris said that mortgages could easily seek refinancing at a lower interest rate.

Meeting adjourned for lunch at 12:00 noon.

Afternoon Session

Chairman Neil Arasmith called the meeting to order at 1:45 p.m. and hearings on Proposal No. 11 continued.

Mr. Kenneth Brasted, President of Mid-Kansas Federal Savings and Loan Association, Wichita, Kansas, appeared and encouraged the Committee to support the usury rate exemption contained in H.B. 2530. He believed that passage of the bill would prevent mortgage loans from drying up completely during the next period of tight-money. The greater the number of loans made which qualify for resale to the secondary money markets, Mr. Brasted explained, the greater the number of loans which can be made to Kansas residents. Maintaining the present usury rate, he said, could work against the consumer by denying him access to the real estate market because of higher interest rates than presently allowed. On the other hand, an exemption from the usury rate for certain first real estate mortgages would allow the market place to dictate the interest rate to be charged.

Staff pointed out to the Committee a potential for discrimination in H.B. 2530. The 5 percent of the loans which would not qualify for exemptions probably would not be made in times of a constricted money market. In addition, staff indicated that North Carolina officials are currently attempting to deal with the problem caused by some finance companies which have created separate mortgage companies in order to escape the restrictions of the usury laws.

Since most of the Committee members wished to have the evening to think over the day's testimony on Proposal No. 11, the Chairman directed the attention of the Committee to Proposal No. 12 - Equal Credit Opportunity. Staff reviewed a draft Committee Report. Chairman Arasmith suggested that the last line be changed to read, "to determine if there is a need for state intervention and enforcement." Representative Reimer moved, seconded by Representative Thomson, that the draft Committee Report as amended by the Chairman's suggestions be adopted. Motion carried.

Proposal No. 13 - Group Health Insurance Contracts. Staff reviewed the draft Committee Report. Representative Meacham moved, seconded by Representative Laird, that the draft Committee Report be adopted. Motion carried. Senator Feleciano wished to be reported as voting "no" based upon conclusions drawn from certain figures used in the report which he felt were misleading.

A bill draft requested at the last meeting was reviewed by staff (See Attachment B). Representative Holderman wondered why individual contracts should be excluded from providing a mandatory offer of coverage for mental and nervous conditions, drug abuse, and alcoholism. Senator Feleciano moved, seconded by Representative Holderman, that the draft bill be amended to include individual contracts. Mr. Jack Roberts of Blue Cross and Blue Shield explained that individual contracts historically do not lend themselves to such options. Motion carried. Representative Reimer requested to be recorded as voting "no."

Staff was directed to explore the possibility that two bills might be needed to implement the Committee decision. Senator Feleciano moved, seconded by Representative Meacham, that the bill draft be approved with the understanding that individual contracts be included as agreed upon. Motion carried.

Meeting adjourned at 4:10 p.m.

August 17, 1977

The meeting was called to order by Chairman Arasmith at 9:00 a.m. Discussion resumed on Proposal No. 11 - Usury Rates for Savings and Loan Associations.

Representative Reimer asked staff how other states handled usury rates and what the experience had been for those states which removed or modified their usury statutes. Staff reported the following information from four states surveyed: Colorado had no usury law and a present interest rate of 9-9½ percent; Connecticut had a general 12 percent usury statute, but exempted bona fide real estate loans of $5,000 or more. The present interest rate is 8¼-8 3/4 percent; Michigan has a 7 percent usury statute, but has suspended the statute temporily for first lien mortgages. The present rate of interest in Michigan is 8 3/4 percent; and North Carolina has a general 8 percent usury rate, but exempts first mortgages for principal dwellings over $10,000 from that rate. The present interest rate is about 9 percent.

Representative Laird moved, seconded by Representative Reimer, that H.B. 2530 be recommended favorably to the 1978 Legislature. In discussion which followed, Senator Feleciano expressed concern for the complete removal of the usury rate for certain mortgages. He cautioned the Committee not to take hasty action on the measure, but to hear additional conferees on the subject. The Chairman replied that public notice of the hearing had been given so that interested parties could have been present and heard.

The Chairman and other members expressed some reservation about raising the usury rate for all types of transactions. Staff replied that the rate could be limited to real estate only if that was the Committee's desire.

Senator Feleciano offered a substitute motion, seconded by Senator Rogers, that a new bill be drafted amending subsections C and D to raise the usury rate for all first real estate mortgages not to exceed 11 percent. Motion carried.

The Committee directed staff to have the Committee Report reflect that information from other states with no ceilings or higher rates reflected current market rates nearly identical to those currently charged in Kansas.

Having completed its work on Proposal Nos. 11, 12, and 13, the Committee discussed its next assigned topic, Proposal No. 10 - Privacy of Financial Records. The Chairman and Vice-Chairman reported to the Committee on the substance of a recent seminar on privacy conducted as a part of the National Conference of State Legislatures meeting in Detroit. They emphasized that the privacy subject included much more than the records of financial institutions.

The Chairman asked the members to spend some time on this subject in their districts. He noted that at the time H.B. 2480 was heard in the 1977 Session, the list of problems and complaints was quite small.

Staff was directed to provide the Committee with copies of the Maryland, Minnesota, and California privacy statutes. Also, staff was requested to supply a summary of the federal privacy study report.

Chairman Arasmith told the members that the Committee would take up first the privacy of financial records, but that, thereafter, the scope of study would include other relevant areas. The next meeting will be September 13-14, 1977.

Meeting adjourned at 11:15 a.m.

Prepared by William G. Wolff

Approved by Committee on:

9-13-77
(Date)

Attachment "A"

A -17

KANSAS SAVINGS & LOAN LEAGUE

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PRESIDENT

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August 16, 1977

TO: SPECIAL COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS

FROM: JIM TURNER, KANSAS SAVINGS AND LOAN LEAGUE

RE: H.B. 2530 - MORTGAGE INTEREST CEILINGS

The Kansas Savings and Loan League appreciates the opportunity to appear before the Special Committee on Commercial and Financial Institutions to support the passage of H.B. 2530.

Also appearing with us is Mr. Joe C. Morris, President, Columbia Savings Association, Emporia, and Mr. Kenneth Brasted, President, Mid-Kansas Federal Savings and Loan Association, Wichita.

House Bill No. 2530 was introduced in the 1977 session at the request of the Kansas Savings and Loan League and would amend K.S.A. 1976 Supp. 16-207 by adding subsections (c) and (d) to Section 1 and thereby providing the following:

1. Would exempt from the 10% usury ceiling first mortgage real estate loans which are insured or guaranteed by the federal housing administration (FHA) or veterans administration (VA) (subsection (c))

2. Would exempt first mortgage real estate loans which are sold or which are eligible for sale to the federal national mortgage association (FNMA), government national mortgage association (GNMA), and the federal home loan mortgage corporation (FHLMC), or their successors. (subsection (c))

Atch. A

3. Would exempt from the 10% usury ceiling all multi-family and commercial loans to general or limited partnerships. (subsection (d))

GENERAL BACKGROUND

Usury laws have been traced back to earliest recorded history with such laws in this country having a heritage in the early usury laws of Great Britain. The 10% usury ceiling in Kansas was established prior to 1935 and did not pose a constraint upon mortgage lending in this state until seven or eight years ago.

While there are numerous pro and con usury arguments, it would appear that the basic premise was to prevent unscrupulous lenders in a non-competitive atmosphere from charging excessive interest rates. However, today there is keen competition in the mortgage lending field and this factor has kept most market interest rates below usury ceilings.

Throughout most of the period since the 1920's usury laws have been ineffective because the interest ceilings were at levels above prevailing market rates. However, with the rise in inflation, and consequently interest rates, since the mid 1960's, usury laws have had a significant impact on many credit markets. Their effects have been arbitrary and have weighed heaviest on those credit seekers generally considered most risky.

In his book Economics Today (1973), Professor Roger L. Miller contends that usury legislation often adversely affects the ones it is designed to protect. He illustrates this conclusion by citing the Washington state experience, where consumer loans from credit card companies were generally at an annual rate of 18 percent. Consumer advocates felt that this rate was too high, and that the poor people would be aided by a lower charge. In 1968, the maximum rate was lowered by referendum to 12 percent. However, at the lower rate the amount of credit demanded exceeded the amount supplied and the people with the weakest credit worthiness were the ones denied credit at 12 percent.

As market rates approach usury ceilings, venture or developmental credit, which contains a higher than average risk, becomes limited. Since such credit can only be extended by lenders at a higher rate of interest to compensate for the additional risk involved, these loans are among the first to be affected as market rates rise relative to usury ceilings. Without such venture capital economic progress and growth is hampered.

According to Maurice Goudzwaard in his article "Price Ceilings and Credit Rationing," Journal of Finance (March, 1968), "studies show that in those states permitting higher rates, lenders tend to expand credit opportunities. Lenders appear more willing to accept higher risk of losses if the rate is sufficient to compensate for bad debt, investigation, and collection expenses." The risk factor is also referenced in our testimony in that portion dealing with the Brimmer study entitled "Risk vs. Discrimination in the Expansion of Urban Mortgage Lending."

THE KANSAS SITUATION

While all of the aforementioned factors impact the interrelationship of the usury ceiling to mortgage lending in Kansas - the most significant impact in recent years has been periods of "tight money."

Tight money refers to the shortage of lendable funds during the inflationary periods when the federal government borrows heavily in the credit market thereby created upward pressure on the rate of return available on investment instruments as well as upward pressure on mortgage and consumer credit.

During these periods of time financial institutions in Kansas in general, and savings and loan associations in particular, experience either limited or negative savings flows thereby which severely reduce the availability of mortgage funds within the State.

It is during these periods of "credit crunch" that the shortage of funds has pushed the mortgage market rate to the 10% ceiling. These periods have been identified as late 1970, late 1973, and the latter half of the year in 1974.

A recent random survey of 30 of the 78 member associations of the Kansas League revealed severe lending restraints as follows:

Late 1970 - 4 associations
Late 1973 - 4 associations
Late 1974 - 16 associations

In addition, ten of the associations reported that mortgage lending the latter part of 1974 was restricted basically to those borrowers with substantial down payment, while 5 associations reported that they ceased all lending from one to three months. Also, twenty-four of the ~~third~~ thirty respondents reported that they terminated both FHA and VA lending during the 1974 period.

The net affect during the most recent tight money period was:

1. FHA and VA loans were not made because of the substantial discounts involved and conflicting legal opinions as to whether or not the combination of interest rates and discount points violated the usury ceiling,

2. Residential mortgage credit was available for the most part to those borrowers having a 20% down payment and excellent credit rating,

3. Multi-family lending was primarily restricted to corporate borrowers,

4. Loans could not be sold in the secondary market because of a negative position in competing with loans originated in other states having either a higher usury ceiling or no restrictions,

5. To improve liquidity and yield, loans were purchased from those areas having no restrictions.

These problems can be eliminated for associations in Kansas with the passage of H.B. 2530.

USURY RATES - SURROUNDING STATES

Enclosed as part of this testimony is the aforementioned "Brimmer Study" which contains a listing of usury ceilings, by states, as of January, 1977. Comparing these ceilings to 1960 we find the following:

	1960	1977
KANSAS	10%	10%
COLORADO	NC	NC
MISSOURI	8%	10%
NEBRASKA	9%	11%
OKLAHOMA	10%	10%

It is obvious that we are in an adverse competitive situation with Colorado which has no ceiling. It is interesting to note that Colorado did not suffer a shortage of mortgage funds during the previously mentioned tight money periods as they were able to originate and sell mortgages, not only to surrounding states, but also nationwide, thereby maintaining a flow of funds into their state.

This situation in Nebraska has been improved with the recent increase in ceiling while Missouri has improved their situation slightly but could be faced with a reoccuring dilemna in the future.

For the committee's review we have enclosed an article from the August 17, 1974, issue of Business Week entitled "When usury laws backfire against borrowers" which points up the severity of the usury restraint problem in Missouri under their previous ceiling. The same problems will undoubtedly again occur in Kansas, Missouri, and Oklahoma during the next period of "tight money."

SECONDARY MARKET

During the 1960's the secondary market developed as a vehicle for improving the flow of mortgage funds into areas of high demand. Basically it involves lending institutions in areas of limited mortgage demand, and having a surplus of savings, purchasing loans originated by lenders in "high demand" areas.

During periods of competitive market rates lending institutions in Kansas buy and sell mortgage among themselves.

However, during "tight money" periods loans are purchased outside the state in an effort to improve portfolio yield to offset ever increasing operational costs.

This need to improve yield has resulted from:

1. Increased cost of funds with savings rates ranging from 5.25% (passbook) to 7.75% (certificates) and some large certificates at a large bid rate thereby pushing the average cost of funds to approximately 7.3%,

2. Increased federal taxation as a result of a nearly 20% reduction in the allowable bad debt deduction in the past 8 years. This has resulted in savings and loan associations paying a nationwide rate of federal taxes nearly 8 basis points higher than commercial banks while credit unions pay no federal or state income taxes.

3. Elimination of "federal taxes paid" as a deduction by the state of Kansas several years ago which increase state taxation nearly 100%

4. Increased operating and personnel costs as a result of inflationary impact of increased minimum wage, unemployment compensation, and mandatory retirement programs,

5. Substantial portfolios of existing mortgage loans yielding 5% to 7%

6. Substantially increased costs to maintain compliance with the real estate settlement procedures act (RESPA), home mortgage disclosure act (HMDA), equal credit opportunity act (ECOA), and a host of other federal mandates supposedly designed to protect the consumer.

In addition, the Federal Home Loan Mortgage Corporation (FHLMC) was created in 1970 as a source of additional liquidity and to increase the exchange of mortgages in the secondary market. This has worked quite well for Kansas associations <u>except</u> during "tight money" periods when the Mortgage Corporation tends to purchase loans from states which do not have usury restrictions.

Enclosed you will find a letter from Mr. William R. Thomas, Jr., Senior Vice President of The Mortgage Corporation, which points out the operation of FHLMC as well as the adverse impact of usury restrictions. We urge your review of this letter.

ENCLOSURES

We would point out the following enclosures for review by the committee:

A. "The Brimmer Study" - Previously mentioned, we have enclosed section 8 of the 98 page report dealing with usury rates. The study contains comparisons of usury ceilings and an analysis of the adverse impact of usury ceilings on urban areas and low-income borrowers. The study also points out the limitation of usury ceilings on the development of a graduated mortgage instrument - a development which we feel this committee should take into consideration.

B. *Business Week* article regarding adverse impact of the usury ceiling in Missouri

C. Letter from William Thomas of the Federal Home Loan Mortgage Corporation

D. An article from *Savings and Loan News* (May, 1977) which points out the increased cost of housing is not a result of interest rates

E. A listing of "member comments" regarding the usury ceiling in Kansas, taken from our recent survey, that while biased are equally revealing.

CONCLUSIONS

We would conclude by urging that this committee recommend H.B. 2530 for passage. If enacted it would result in:

1. The continued availability of FHA and VA loans during tight money periods by eliminating the concern over legal interpretations of the possible violation of the usury statute,

2. The availability of mortgage money to all borrowers, i.e., first time as well as low income, and not just to those possessing a substantial down payment,

3. The increased saleability of Kansas mortgages in the secondary market thereby increasing the flow of funds into the state,

4. The decreased need to "close down" or severely restrict lending at various times,

5. The availability of funds to multi-family developers other than corporate borrowers.

The most significant impact would be to improve the economic position of State by eliminating one of the major "capitol short" problems which results in a "drain" of money out of Kansas and the reduced construction, employment, and residential sales that result from the same.

Accordingly, we remain hopefully that the committee will favorably recommend H.B. 2530.

James R. Turner
President

SECTION VIII

USURY LAWS, INTEREST RATES, AND RISK DIFFERENTIALS

Introduction

It seems wise to recognize that any program to encourage a greater volume of lending in urban areas must allow for above-average interest rates to compensate the suppliers of funds for all -- or at least a part -- of the extra risks which they face. However, it is also clear that the prevailing statutory interest rate ceilings imposed by most states will severely limit the size of the rate differential which can be introduced. Exactly how large the differential should be cannot be stated with precision. Yet, on the basis of the evidence presented in earlier sections of this study, a margin of 2.0 to 3.0 percentage points may be required. If so, little room exists under most state usury laws to accomplish this goal.

Over the last two years, financial markets have retreated from the severely tight conditions of 1974, and lenders are currently awash with liquidity. Nevertheless, interest rates remain high by pre-1969 standards. In the market for residential mortgages, the decline in rates which set in during the 1975 recession has been restrained. As a result, in many states interest rates no longer press against their legal ceilings, but the distance in between cannot quite be described as comfortable.

The high interest rates of the 1970's induced legislatures in a number of states to raise their statutory ceilings. However, such legislative changes tend to lag the advance of rates in the open market, and they cannot be relied upon to keep usury rate structures in touch with the realities of supply-demand forces in the mortgage market. Even today a few states have usury ceilings which, as legacies from a bygone era, are woefully below the going rate for mortgages in their region. New York State's 8.5 per cent ceiling is a leading example.

Thus, any plan for extending mortgage credit to borrowers -- hither to ineligible for such loans due to factors of risk -- must consider whether state usury laws would permit the upward adjustment from current mortgage rates required to induce lenders to assume the additional risk involved. Undoubtedly, in return for extending credit to a set of borrowers economically less qualified than their traditional customers, lenders would expect compensation sufficient to cover the expected losses and collection costs associated with this pool of loans. With national loan rates for first mortgages currently averaging in excess of 8.75 per cent and with usury ceilings in most states close to 10 per cent, the room for adequate compensation would appear to fall short of the risk involved.

So that these national averages do not mask greater scope for risk compensation than appears on the surface, an examination of usury ceilings and prevailing mortgage rates was made on a state-by-state and regional basis. The questions answered were: what is the current pattern of usury ceilings? How do these ceilings relate to prevailing rates on mortgages in major metropolitan areas? Are the spreads between ceilings and current mortgage rates sufficient to permit the compensation required to sustain a meaningful extension of mortgage credit to borrowers with below-average incomes?

The Current Pattern Of Usury Ceilings

As is generally known, laws controlling the maximum fee which a lender may charge for the use of money constitute some of the oldest regulations of financial activity in the United States. These laws were designed to shield borrowers from "usurious" interest charges. Their effect, however, has been to curtail and cut off the access of certain borrowers to credit. In this way, these price control mechanisms promote an arbitrary distribution of credit -- that is, allocations unrelated to the effective supply and demand for funds. In effect, these laws tend to promote inefficient and more costly substitutions for the regulated credit. For the potential low-income home owner, a high-priced substandard rental unit would represent such a substitution. In fact, the monthly rent could well exceed the monthly payments for a loan bearing a rate of interest reflecting the added risk.

Usury laws are also arbitrary in the sense that considerable differences in ceilings exist among the states -- even among states within the same regional market. One state may have an 8 per cent ceiling and its neighbor a 12 per cent limit -- or no ceiling at all. Within a single state, different categories of borrowers may be subject to vastly different ceilings for essentially the same kind of loan. The distinction is usually made on the basis of loan size. Typically, borrowers of large amounts are deemed to require less protection and are subject to higher ceilings. In some states, ceilings are eliminated on loans above a certain size. Where the line is drawn varies widely. For instance, in Kentucky loans exceeding $15,000 are exempt while in South Carolina a loan must exceed $500,000 to escape legal ceilings. (For the remainder of this discussion, the usury ceilings cited will be those applicable to single-family housing costing over $15,000 but less that $50,000).

Current state usury ceilings range from a low of 8.0 - 8.5 per cent to a high of 21.0 per cent. (See Table VIII-1) There are 10 states, however, which have no usury ceilings on loans for single family homes in the range earlier cited. Among the 32 states with fixed usury ceilings, 18 and the District of Columbia have a ceiling of 10 per cent. Five have limits of 9.0 - 9.5 per cent; three are at 12 per cent, and 1 each of 11 and 21 per cent. Thus nearly three-fifths of the states with fixed rate ceilings set those limits at 10 per cent; one-quarter below 10 per cent, while only one-fifth have ceilings above 10 per cent.

Usury laws in nine states provide for floating ceilings. Those laws specify the maximum rate in terms of a fixed spread above the going rate on certain other liabilities. Typically the rates are expressed in terms of an index of long-term Federal government bond rates or the Federal Reserve discount rate. However, other bases used include the prime rate at certain major commercial banks and corporate bond yields. These provisions do place some automatic flexibility in the ceiling. They do not, however, assure that the resultant ceiling will accommodate rates which would be established by supply-demand forces in a competitive market. Increases in the discount rate, for example, tend to lag changes in market rates, and the lag can be wide since the Federal Reserve does not use the rate as a disincentive to member bank borrowing. On the other hand, advances in Federal government

Table VIII-1
Residential Loan Interest Rate Ceilings, By State
January-February, 1977

(Per Cent)

8.0 - 8.5		9.0 - 9.5		10.0	11.0 - 12.0		Over 12.0		None	Floating	
Alabama	8.0	Georgia	9.0	Arizona	Nebraska	11.0	Rhode Island	21.0	California	Alaska	10.25
New York	8.5	Iowa	9.0	Arkansas	Hawaii	12.0			Colorado	Delaware	9.5
West Virginia	8.0	New Jersey	9.5	Dist. of Col.	Washington	12.0			Connecticut	Illinois	9.0
		North Dakota	9.5	Florida	Wisconsin	12.0			Kentucky	Minnesota	8.5
		South Carolina	9.0	Idaho*					Maine	Montana	10.0
				Indiana*					Massachusetts	Nevada	12.0
				Kansas					Michigan	Ohio	8.25
				Louisiana					New Hampshire	Pennsylvania	9.0
				Maryland					North Carolina	Vermont	
				Mississippi					Virginia		
				Missouri							
				New Mexico							
				Oklahoma*							
				Oregon							
				South Dakota							
				Tennessee							
				Texas							
				Utah*							
				Wyoming*							

Summary

Ceiling (Per Cent)	Number of States[1/]
8.0 - 8.5	3
9.0 - 9.5	5
10.0	19
11.0 - 12.0	4
Over 12.0	1
Floating Ceiling	9
No Ceiling	10
Total	51

* Charges over 10 per cent are subject to the regulations in the Uniform Consumer Credit Code under which rates up to 18 per cent are allowed. However, certain fees (such as late charges, prepayment penalities, and appraisal fees) are not allowed. There is a tendency for institutions to follow the 10 per cent limit and maintain fee advantages. [1/] Includes the District of Columbia.

Source: (1) Commerce Clearing House, "Commercial Credit Code," and (2) Legal Department, U.S. League of Savings Associations.

bond rates may also lag increases in mortgage rates since the Treasury (like other borrowers) tends to shorten maturities as money becomes tight. Obviously, administratively set rates (such as the highly visible and politically significant prime rates) can be particularly poor benchmarks if market flexibility is intended. Therefore, the floating rate laws provide only a limited measure of upward mobility, and some usury laws explicitly provide for a cap on the floating ceiling. It should also be noted that problems can emerge with floating usury ceilings even when rates are falling -- since the base rate may fall more rapidly than national mortgage rate averages.

An approximation of the formulas for the floating ceilings (supplemented with some published data on actual ceilings) suggests that the usury limits set in most states with floating ceilings fall in the 9.0 - 10.0 per cent range -- although in some cases the rate would fall in the 8.0 - 8.5 per cent low end of the spectrum. (Table VIII-1). Thus floating usury ceilings, at present, do not privide more leeway than enjoyed by most states with fixed ceilings.

Regional Patterns In Usury Rates

As shown in Table VIII-2, the lowest usury ceilings tend to be found among the Southern states. The West and North Central regions have a greater number of states with usury ceilings at the higher end of the range. Diversity is the salient feature which characterizes ceiling structures in the Northeast where usury limits cover the expanse from 8.5 to 21 per cent for the three states with fixed ceilings. In addition, four of the nine states of this region have no usury ceiling while two have floating rate ceilings. With nearly half of the states in the region having no ceilings, one might be tempted to characterize the region as the most liberal in terms of usury laws. However, the two states with the lowest ceilings are New York (8.5 per cent) and New Jersey (9.5 per cent). These are two of the most populous states which would have a great potential demand for urban housing for persons with lower than average income.

Usury ceilings in the West are generally higher and somewhat more uniform than in other regions. None of the 13 states in the region have ceilings below 10 per cent, while six have rates of 10 per cent and two above 10 per cent. Three states have floating rates, and two no ceilings at all.

The South has more states (four) with fixed rates below 10 per cent than any other region. The 10 per cent limit is the most representative rate -- eight states and the District of Columbia have such a fixed ceiling. No states have fixed rates set about 10 per cent but three states have no ceilings, and one state has a floating ceiling.

In the North Central region, the range for fixed usury ceiling rates is from 9.5 to 12 per cent. Four states have a 10 per cent ceiling; two states have limits below 10 per cent, and two above. Three states have floating rates, and one has no ceiling.

Table VIII-2
Residential Loan Interest Rate Ceilings, By State and Region

(Per Cent)

NORTHEAST	Ceiling	SOUTH	Ceiling	NORTH CENTRAL	Ceiling	WEST	Ceiling
Maine	N	Maryland	10.0	North Dakota	9.5	Washington	12.0
New Hampshire	N	West Virginia	8.0	South Dakota	10.0	Oregon	10.0
Vermont	F	Virginia	N	Nebraska	11.0	California	N
Connecticut	N	Kentucky	N	Kansas	10.0	Alaska	F
New York	8.5	Tennessee	10.0	Minnesota	F	Hawaii	12.0
Pennsylvania	F	North Carolina	N	Iowa	9.0	Idaho	10.0
New Jersey	9.5	South Carolina	9.0	Missouri	10.0	Nevada	F
Massachusetts	N	Georgia	9.0	Wisconsin	12.0	Montana	F
Rhode Island	21.0	Florida	10.0	Illinois	F	Wyoming	10.0
		Alabama	8.0	Michigan	N	Utah	10.0
		Mississippi	10.0	Indiana	10.0	Colorado	N
		Arkansas	10.0	Ohio	F	Arizona	10.0
		Louisiana	10.0			New Mexico	10.0
		Oklahoma	10.0				
		Texas	10.0				
		Delaware	F				
		District of Columbia	10.0				
Average of Fixed Ceilings	12.9		9.5		10.2		10.5

Summary

Usury Ceilings	Northeast	South	North Central	West
Below 10 per cent	2	4	2	–
10 per cent	–	9	4	6
Above 10 per cent	1	–	2	2
Floating Ceiling	2	1	3	3
No Ceiling	4	3	1	2
Number of States	9	17	12	13

N = No Ceiling
F = Floating Ceiling
Source: Table VIII-1.

In summary, the lowest fixed ceilings (8.0 - 8.5 per cent) are found in the Northeast and South. The west and North Central regions have more states on floating systems -- six as compared with three states in the Northeast and South. In contrast, the Northeast and South have more states which have no ceilings -- seven compared with three in the North Central and West. Although there is noticeable variation among regions, 10 per cent is still the most characteristic ceiling in all regions -- except the Northeast.

Spreads Between Mortgage Rates and Usury Ceilings

A number of factors have combined to maintain fairly high rates of interest on mortgage loans. These include inflation, uncertainty about the future, and lenders' desire to maintain wide spreads on new loans in order to offset the low-yielding loans put on their books in earlier years. In earlier periods, usury ceilings (although particularly harmful in times of tight money) were practically unnoticeable in times of relative monetary ease. This situation no longer holds. Since the credit stringency of 1966, each successive cycle of monetary restraint has left mortgage rates fluctuating around a higher average level. For example, during the tight money period of 1969-70, the national average for contract rates on conventional mortgages peaked in the vicinity of 8.35 per cent. In the latest period of credit restraint, these rates attained a high of approximately 9.10 per cent in early 1975 for newly built homes. They declined only about 30 basis points in the following year and a half.

These national averages, however, mask much regional variation -- reflecting supply-demand conditions, state usury laws, and other factors. Looking at the usury laws of the metropolitan areas (as a subset of the national data earlier discussed) gives a slightly different pattern for regional usury ceilings. As indicated in Table VIII-3, lowest ceilings exist among the metropolitan areas of the Northeast -- in spite of this area having more states with no legal ceilings. Next to the lowest is the North Central region closely followed by the South -- where ceilings in most of the selected metropolitan areas were at 10 per cent. Highest ceilings were still found in the West -- where two of the metropolitan areas were in states with 12 per cent ceilings and two in states with no limits.

Average mortgage rates for the metropolitan areas were consistent with the regional patterns for usury ceilings. In August, 1976, the average rate on single family conventional mortgages for newly built homes (by region for selected metropolitan areas) was 8.59 per cent in the Northeast; 8.64 per cent in the North Central; 8.69 per cent in the South, and 8.91 per cent in the West.

The variation within a single region is also considerable. Contract rates on conventional mortgages actually exceeded 10.25 per cent in some metropolitan areas during the peak rates of 1975 and exceeded 9.25 per cent in August, 1976 in some areas. Thus, usury ceilings in some states are more of a real and present threat than is suggested by the spread between the national average contract rate of 8.79 per cent for new homes and 8.94 per cent for previously occupied homes -- and the typical state usury ceiling of 10 per cent.

Table VIII-3
Terms on Conventional Home Mortgages 1/,
For Selected Metropolitan Areas and
Residential Loan Interest Rate Ceilings, By State and Region

(Per Cent)

	Interest Rates For:				
	Newly Built Homes	Previously Occupied Homes	State Usury Ceiling	Differential: Ceiling vs. New Homes	Differential: Ceiling vs. Previously Occupied
Northeast					
Boston	8.67	8.72	None	*	*
New York	8.55	8.57	8.5	(.05)	(.07)
Northeastern New Jersey			9.5	.95	.95
Philadelphia	8.54	8.93	9.0	.46	.07
South					
Atlanta	8.73	8.74	9.0	.27	.26
Baltimore	8.48	9.01	10.0	1.52	.99
Dallas	9.00	9.19	10.0	1.00	.81
Houston	8.81	9.05	10.0	1.19	.95
Miami	8.44	8.55	10.0	1.56	1.45
Washington, D.C.	8.68	8.78	10.0	1.32	1.22
Maryland			10.0	1.32	1.22
Virginia			None	*	*
North Central					
Chicago	8.72	8.67	9.0	.28	.33
Northwest Indiana			10.0	1.28	1.33
Cleveland	8.70	8.70	*	(.20)	(.20)
Detroit	8.84	8.98	None	*	*
Minneapolis-St.Paul	8.23	8.76	8.5	.27	(.26)
St. Louis	8.70	8.95	10.0	1.30	1.05
West					
Denver	8.73	9.09	12.0	3.27	2.91
Los Angeles-Long Beach	9.03	9.27	None	*	*
San Francisco-Oakland	9.06	9.28	None	*	*
Seattle-Everett	8.83	9.34	12.0	3.17	2.66

1/ August, 1976.
* not applicable.
Source: Federal Home Loan Bank Board.

An examination of these spread relationships for selected metropolitan areas shows that only in five of the 22 urban areas (Boston, Detroit, Virginia, Los Angeles, and San Francisco) located in states without ceilings is there clear indication that lenders could charge rates sufficient to compensate for the risks involved in opening up homeownership to lower-income borrowers previously disqualified. (Table VIII-4) For the remaining 17 areas, the feasibility of such a program seems limited. The spread between the usury ceilings and mortgage rates is less than 100 basis points in seven of the 22 urban areas for new homes and in 10 areas for previously occupied homes. In eight areas for new homes and in five for existing structures, the spread separating usury ceilings from mortgage rates is between 100-160 basis points.

Assuming that 300 basis points is the extra margin required to compensate lenders for risk and added collection costs, only the five areas without usury ceilings could charge the going market rate plus a risk adjustment premium for loans on both new and previously occupied homes. Mortgage rates in the Denver and Seattle areas are sufficiently low with respect to their 12 per cent ceilings to permit the 300 basis point adjustment for new homes -- but not for existing units. Even so, the spread between usury ceilings and rates on new homes only narrowly exceeds 300 basis points, so that ordinary advances in rates which may occur from month-to-month could dry up the program.

If the 300 basis point requirement could be shaved to 200 (i.e., if some subsidy element were added) -- with 15 areas having a spread of less than 160 basis points -- the program would not be significantly expanded. The difference would be such that lending institutions in only Denver and Seattle could participate in the program for both newly build and existing homes on a more secure basis. In those areas there would be a large enough margin to absorb increase in market rates, plus an add-on for risk without hitting usury ceilings.

In summary, the situation in 15 major metropolitan areas -- where the spread between usury ceilings and mortgage rates is less than 160 basis points (during a period of considerable ease in the flow of funds available for mortgage loans) -- says much about the feasibility of developing a viable program of extending mortgage loans to borrowers with below-average incomes in which the private lender absorbs all risk. On this basis, given the prevailing usury ceilings, prospects for lender participation appear remote.

Clearly, a greater effort is required to induce states to eliminate usury laws. Good reasons already exist for this action. The need to expand lending in high risk urban areas -- which can only occur if more headroom is made available -- further strengthens the case.

Table VIII-4
Distribution of Metropolitan Areas
on the Basis of the Spread of Usury Ceilings
Over Interest Rates on Home Mortgages
(Differentials Expressed in Basis Points)

0 and Under - 99		100 - 199		200 - 299		300 - Over	
New	Existing	New	Existing	New	Existing	New	Existing
New York	New York	Baltimore	Miami	None	Denver	Boston	Boston
New Jersey	New Jersey	Dallas	District of Columbia	None	Seattle	Virginia	Virginia
Philadelphia	Philadelphia	Houston	Maryland			Detroit	Detroit
Atlanta	Atlanta	Miami	Indiana			Denver	Los Angeles
Chicago	Baltimore	District of Columbia	St. Louis			Los Angeles	San Francisco
Cleveland	Dallas	Maryland				San Francisco	
Minnesota	Houston	Indiana				Seattle	
	Chicago	St. Louis					
	Cleveland						
	Minnesota						

Source: Table VIII-3.

BUSINESS WEEK

Aug. 17, 1974

B

FINANCE

When usury laws backfire against borrowers

A low usury ceiling makes it more profitable for S&Ls to lend out-of-state

"In talking to lenders in other states," says Jack Sheahan, president of the Mortgage Bankers Assn. of Greater St. Louis, "they just laugh and say, 'We hope you guys never change because we can come up to your state and take the money right out.' "

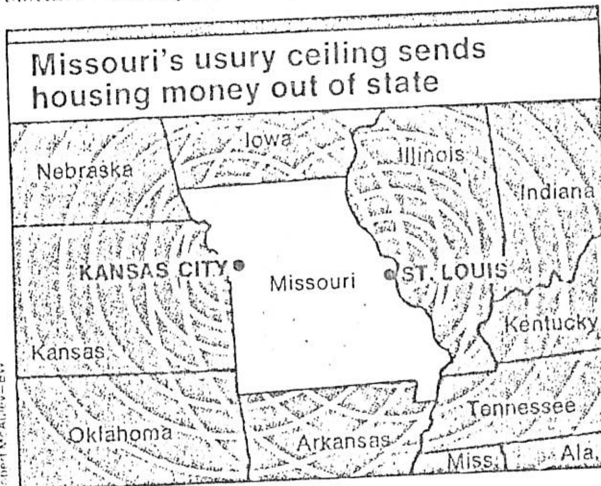
Barred by a 93-year-old statute from charging more than 8% on home mortgage loans—now the lowest usury rate ceiling in the nation—Missouri's savings and loan associations find little profit in lending inside the state. Sheahan reckons that the state's S&Ls have paid out some $600-million during the past 15 months to buy higher-yielding home loans from institutions in other states. Meanwhile S&Ls in other states—especially neighboring Kansas and Illinois—are doing a brisk business in lending to home buyers in Missouri. Mostly, though, the flow of mortgage money is out of the state, and hopes of stemming it soon by changing the law appear remote.

"It's a regular milk route," Sheahan complains. The state's thrift-minded population, much of it of German origin, has always kept Missouri's S&Ls well stocked with deposits. Until mortgage rates began going through the roof, nearly all of that money was lent to homebuyers within the state. Now, says Sheahan, lenders from such states as South Carolina and Georgia, where home mortgage money is hard to come by, "are flying here all the time," to sell their mortgages to Missouri thrift institutions at 9¼% to 9¾%.

Reluctant bankers. Even with the lending being done by out-of-state institutions, it is very difficult to get a home mortgage in Missouri these days. Some of the state's big corporations, threatening to take their business elsewhere, have pressured their local commercial banks into providing mortgage money for employees who are transferred into Missouri. But the banks, reluctant to take on long-term, fixed-rate obligations, are making as few of these loans as possible.

Since April, 10 other states with low usury ceilings have liberalized their interest laws in the face of skyrocketing mortgage rates. Vermont, which had the nation's lowest usury ceiling at 8%, raised it to 8¾% and exempted units from the new regulation. Three other states with 8% ceilings—Maryland, Mississippi, and Illinois—have all raised their permissible rates to the 9½% to 10% range. A fourth, North Carolina, simply abolished its 8% ceiling on first home mortgages on a trial basis until July 1, 1975. Kentucky, with an 8½% ceiling, freed home mortgage money by exempting loans above $15,000, while Minnesota, New York, and Oregon also put through more liberal exemptions.

Bills to raise Missouri's ceiling to 10% were introduced in last spring's session of the state legislature, on the heels of recommendations from a special study group spearheaded by economist Murray Weidenbaum, former Assistant Treasury Secretary.



Missouri's usury ceiling sends housing money out of state

Although the measure passed the Senate by a large majority, it died in the state's lower house when Democratic majority leaders demanded that Governor Christopher S. Bond, a Republican, endorse the change. Bond refused, apparently fearing consumer backlash, although there had been little organized opposition to hiking the ceiling.

Continued drought. Regathering their forces, S&Ls and homebuilders, along with sympathetic legislators, now are demanding that Bond call a special session to change the law. So far, Bond has refused to budge.

In the interim, Missouri banks and S&Ls are trying to get around the rate ceiling by charging anywhere from 5 to 15 points on the few mortgage loans that they do make. One point equals 1% of the amount of the loan—$200 on a $20,000 mortgage, meaning that 15 points would come to $3,000. But while the mortgage is repaid over a long pe[illegible] paid at the time of the loan, some by the buyer, some by the seller.

Despite the added fees, the mortgage drought continues. According to figures from the Federal Home Loan Bank of Des Moines, new loans by Missouri S&Ls, which make upwards of 80% of all the state's home loans, plummeted by 37% from $296.5-million in the April-May, 1973, period, to $186.6-million during April-May, 1974. In contrast, during the same period, new loan volume fell off only 6% in Minnesota, Iowa, and North and South Dakota, all of which are in the same Federal Home Loan Bank district as Missouri.

The skid in lending in the state has persisted through all of 1974 to date. Total home mortgage loans made and purchased in Missouri were down by less than 1% in 1973, from $1.6-billion in 1972 to $1.59-billion. In the first six months of 1974, though, the decline was 25% to $640.5-million from the year before.

The combination of the point system and Missouri's low usury ceiling is causing weird distortions in normal financing patterns in the state's two big cities, both of which straddle state lines. Robert E. Simon, president of the Plaza Savings Assn. in Kansas City, Mo., reports that his S&L quit making mortgages in the state after the effort to change the law failed, and now is making mortgages only in Kansas, where the ceiling is 10%. At the same time, borrowers in the city are crossing over to Kansas to sign papers with thrift institutions for home loans of 9% or more.

Germania Federal Savings & Loan of Alton, Ill., charges 9¾% interest and three points but says it is doing brisk business in home loans in St. Louis, just across the Missouri River. Even though they might be lucky enough to get a loan in Missouri, "most borrowers would rather pay a higher interest rate and fewer points," says Germania's President W. G. Osborn.

"It would be much more economical and simpler for Missouri institutions to lend in Missouri, and Kansas institutions in Kansas," Weidenbaum argues. "We are literally forcing people to do it the hard way. Getting around the usury law results in higher costs, which certainly don't benefit consumers." ■

The Mortgage Corporation

WILLIAM R. THOMAS JR.
Sr. Vice President
Dallas

August 12, 1977

Mr. James R. Turner
President
Kansas Savings and Loan League
612 Capitol Federal Building
Topeka, Kansas 66603

Dear Jim:

As you know The Mortgage Corporation was created by Congress in 1970 and mandated to develop a viable secondary market for conventional mortgages. Since that time we've committed to purchase over $17 billion of residential mortgages nationwide. During that same seven year period the national primary mortgage market has experienced significant swings in interest rates resulting in a "feast or famine" effect on mortgages in many areas. It's been an interesting and educational time for all facets of housing finance, primary and secondary.

Your specific question regarding the impact of usury ceilings on mortgage lending and the flow of mortgage funds is one that has stimulated a great deal of interest and study within the industry, as well as with us at The Mortgage Corporation.

From our vantage point in the secondary mortgage market we've witnessed very profound effects on the movement of mortgage money caused by arbitrary usury limits and resulting in adverse availability of conventional mortgages. We've analyzed various areas during the interest-rate-rollercoaster of the recent past to compare those markets that have been the victims of usury ceilings with others, free of such artificial constraints and limited only by the marketplace.

I'd like to share with you the results of a study we recently made of six states, four with low usury ceilings, and two with no effective limits on savings and loan mortgage lending for the period of 1973 through 1975. The low ceiling states were New York, Maryland, Illinois, and Minnesota and the two

Dallas Regional Office
Federal Home Loan Mortgage Corporation
12700 Park Central Place, Suite 1800 Dallas, Texas 75251 Phone (214) 387-0600

with no effective limits were California and North Carolina.

The study clearly showed that in the states of New York, Illinois, and Minnesota there were times during the three years when loan originations exceeded capital inflows (net new savings received plus interest/dividends credited and repayment of loans) however, throughout the period the S/L's continued to purchase more loans than they sold. This was due to the fact that in these states the S/L's could not competitively sell their loans in the secondary market during the high interest rate periods (late 1973 and 1974). Because the S/L's could get better yields by buying loans out of state they continued to purchase loans even in deficit periods. This obviously reduced the primary lending function within their own states and the flow of funds into mortgages suffered.

In Maryland, the usury ceiling was changed from 8% to 10% in April, 1974. Our study revealed absolutely no net loan sales in 1973 or early 1974 due to the low ceiling. However, by the end of 1974 S/L's had originated enough loans at a realistic market rate to be able to sell more loans than they purchased. Thus, by raising the ceiling the primary market lenders had access to more mortgage money in the secondary market and they were able to continue their lending operations at market rates.

In North Carolina and California where usury was little or no problem S/L's were free to sell loans at market rates to raise needed funds. This resulted in frequent net sales positions in the secondary market and enabled them to provide a more reliable flow of funds into the primary mortgage market at market rates.

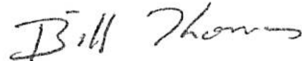
From the study we can conclude that low usury ceilings restrict the flow of funds into the primary market when rates rise above the ceiling. And, states with high or no ceilings have the greatest potential for raising needed funds in the secondary market. As a matter of fact it's during these periods of high interest rates that S/L's desperately need to be able to sell loans but frequently cannot, due to usury ceiling restrictions.

<u>All of our analysis indirectly supports the idea of freeing loans from usury restrictions if they can be sold in the secondary market</u>.

Jim, I imagine your involvement with this very critical subject has led you to many articles and dissertations about it but allow me to recommend one that is extremely well done and applicable to your own concerns about the Kansas law. The article is, "Minnesota's Usury Law: An Evaluation" published in the Ninth District Quarterly, Federal Reserve Bank of Minneapolis, Vol. II., No. 2 (April, 1975), pp. 16-25, by Arthur J. Rolnick, Stanley L. Graham, and David S. Dahl. A follow-up article by the same authors appeared in the same publication earlier this year and was entitled "Minnesota's Usury Law: A Reevaluation". Both articles are excellent and you'd enjoy them.

If you need additional information about our views or beliefs about usury ceilings vs. the secondary mortgage market just let me know.

Cordially,



William R. Thomas, Jr.

WRT:lm

D

D 'T TAKE THE BLAME FOR HIGH HOUSING COSTS

Congressional study shows mortgage rates to be an insignificant factor in the spiraling cost of homes

For a number of years, many observers have commented on the rapid increases taking place in the cost of housing and the resulting impact on consumers. Although most efforts have concluded that many Americans have been and continue to be excluded from the new housing market, data limitations have generally prohibited further comment.

This is no longer the case.

Early this year, the Congressional Budget Office published a *Budget Issue Paper,* which provides new insight into the various aspects of home ownership cost increases and their impact on different groups of home buyers. Although the remainder of this article reviews some of the highlights of these newly available data, we are not necessarily endorsing the CBO's conclusions.

We do feel, however, that in spite of the limitations of the study, as pointed out by a number of reviewers, these new data make two valid and salient points:

(1) Contrary to the common impression, home ownership costs during the 1970s have increased as a result of factors other than mortgage interest rates; and

(2) The first-time home buyer is the consumer being damaged by housing price inflation.

The home owner has been bombarded by cost increases throughout the 1970s, as shown in Table 1. (The CBO report only provides data for the period 1970-1975.)

HOME OWNERSHIP COST COMPONENTS

It is interesting to study the relative changes by home ownership cost components. Note, for example, that the biggest cost increases have been in areas not frequently mentioned by housing market observers: Maintenance costs up 117.7%, property taxes up 104.6% and insurance up 89.0%.

One frequently discussed area is heat and utilities, which were up 72.8% in cost over this period. This estimate represents a serious understatement as every consumer knows who has experienced the price increases during the past year and especially last winter.

The other cost areas frequently discussed are sales prices, which were up 67.9%, and mortgage interest rates, which were up 6.6%.

Thus, mortgage rate cost increases, as reported by the CBO, stand in sharp contrast to all the other major home ownership cost components reported. In fact, when 1976 and 1977 data are fully available, the recent declines in mortgage interest rates will reduce their contribution to the housing price spiral even further.

1. COMPONENT COSTS OF HOME OWNERSHIP

Year	Total monthly cost	Sales price	Interest rate	Insurance	Property taxes	Maintenance, repairs	Heat, utilities
1970	$217	$23,400	8.45%	$ 5.65	$31.76	$12.15	$26.74
1971	230	25,200	7.74	10.09	37.89	13.20	26.27
1972	256	27,600	7.60	6.50	47.45	15.88	31.87
1973	305	32,500	7.95	7.84	50.63	20.82	38.54
1974	370	35,900	8.92	13.12	62.80	24.00	45.35
1975	396	39,300	9.01	10.68	64.98	26.45	46.21
1970-75	82.4%	67.9%	6.6%	89.0%	104.6%	117.7%	72.8%

4. SECOND-TIME HOME BUYER COSTS

Year	Annual housing cost	Monthly housing cost	Percent change	
1970	$2,648	$221	1970-71	1.6%
1971	2,691	225	1971-72	5.0
1972	2,826	236	1972-73	6.8
1973	3,019	252	1973-74	7.2
1974	3,240	270	1974-75	4.1
1975	3,371	281	1970-75	27.3%

5. NONMOVER HOME OWNER COSTS

Year	Annual housing cost	Monthly housing cost	Percent change	
1970	$2,652	$221	1970-71	5.0%
1971	2,784	232	1971-72	5.6
1972	2,940	245	1972-73	4.7
1973	3,072	256	1973-74	2.6
1974	3,144	262	1974-75	3.4
1975	3,252	271	1970-75	22.6%

One can conclude from Table 1 that mortgage interest rates are not a major cause of the rapid increases in home ownership costs.

HOME BUYER IMPACT

The CBO study divides home owners into three groups: First-time buyers, second-time buyers and nonmovers. Table 2 shows that over the first half of the 1970s, the cost of buying an existing home for a first-time buyer has increased 63%. Table 3 shows that the cost of buying a new home for these consumers has increased 82.4% over the same period.

These cost increases sharply contrast with those facing second-time buyers (up 27.3%) and nonmovers (up 22.6%) as shown in Tables 4 and 5.

This contrast is further reinforced by Table 6, which shows that both median family income (up 39%) and the Consumer Price Index (up 38.6%) have increased more rapidly than have housing costs to second-time buyers and nonmovers.

When compared to the cost increases experienced by first-time buyers, however, the median family income and CPI indices fall far behind. One might conclude from Table 6 that first-time home buyers are being severely damaged by housing cost inflation.

POLICY IMPLICATIONS

The CBO presents a long list of policy conclusions from its study. In contrast, we conclude that:

(1) Efforts to control home ownership costs should include an examination of such component areas as maintenance costs, property taxes and insurance. These areas have been generally ignored.

(2) A special effort needs to be made to help the first-time home buyer.

In light of this second point, it is encouraging to see such congressional initiatives as that proposed by Senate bill S.664, titled the "Young Families Housing Act of 1977." This bill addresses the two basic barriers to home ownership for the young family — the high monthly payment and high first-time down payment.

One objective of the bill is to lessen the impact of the rising monthly payment through a provision calling for graduated payment mortgages. Such a mortgage calls for monthly payments that would be lower in the first years of the mortgage contract but would rise gradually from year to year.

The bill would also work to lower the other major hurdle of the first-time home buyer, the initial down payment. S.664 calls for the establishment of individual housing accounts — savings accounts which could be accumulated over 120 months with a $10,000 maximum.

A family could save up to $2,500 per year and deduct these deposits from taxable income. Also, the family would not have to pay taxes on interest credited to these accounts. The funds would then have to be applied to a home purchase.

These recommendations are worthy of support since they address the real problem of housing affordability — the problem of the first-time home buyer. ■

2. EXISTING HOME COSTS FOR FIRST-TIME BUYERS

Year	Annual housing cost	Monthly housing cost	Percent change	
1970	$2,648	$221	1970-71	5.9%
1971	2,810	234	1971-72	9.4
1972	3,071	256	1972-73	11.7
1973	3,432	286	1973-74	14.3
1974	3,918	327	1974-75	10.2
1975	4,317	360	1970-75	63.0%

3. NEW HOME COSTS FOR FIRST-TIME BUYERS

Year	Annual housing cost	Monthly housing cost	Percent change	
1970	$2,604	$217	1970-71	6.0%
1971	2,761	230	1971-72	11.3
1972	3,072	256	1972-73	19.2
1973	3,662	305	1973-74	21.2
1974	4,437	370	1974-75	7.1
1975	4,751	396	1970-75	82.4%

6. INCREASES IN COSTS, INCOME, PRICES

	First-time buyers					
Years	Of existing housing	Of new housing	Repurchasers	Nonmovers	Median family income	CPI
1970-71	5.9%	6.0%	1.6%	5.0%	4.2%	4.3%
1971-72	9.4	11.3	5.0	5.6	8.1	3.3
1972-73	11.7	19.2	6.8	4.7	8.4	6.2
1973-74	14.3	21.2	7.2	2.6	6.5	11.0
1974-75	10.2	7.1	4.1	3.4	6.9	9.1
1970-75	63.0	82.4	27.3	22.8	39.0	38.6

Note: 1970-1975 percent changes are not the sums of annual percent changes, since the compounding of annual changes produces the five-year result.

Source: Congressional Budget Office, Budget Issue Paper, *January 1977.*

USURY RESTRICTIONS

MEMBER COMMENTS

"When 6% was the accepted mortgage rate the mandated usury rate was 10% while today the rate is 8 3/4% to 9 1/4% and should be raised. Inflation has caused the price of all commodities to rise and money is a commodity just like wheat and beef. The customer is the final judge as to the fairness of a loan rate."

"With the many consumer safeguards we have today, I would hope there would be no ceiling and let competition in the market place determine the rate."

"Supply and demand is still the best barometer for rates, not some artificial ceiling."

"A comparison of rates between the State of Kansas and those states that have no usury limit will reveal very little differences in rates except during periods of tight money. Then those states that have no usury limit will still be able to lend because of their ability to sell loans to those lenders in states that have usury limits."

"The effects of the 10% limit when market rates are higher is to shift money out of the mortgage market; Kansas money goes to other states where there are no artificial limits; and the consumer is hurt, particularly if low-incomed, because there is no money available to him."

"FHLMC went up to 11% in August, 1974 so that when they went above 10% we could not even originate loans to sell to them nor could you sell loans in the secondary market during 1974 because there are states like Colorado which have no usury ceiling and thus are able to keep moving with the market."

"The usury ceiling restricts the availability of funds by limiting participation in the secondary market. I've had realtors and customers observe that families would rather pay a higher rate of interest than be denied the opportunity to own their own home."

______ BILL NO. ________

By Special Committee on Commercial and Financial Institutions

Re Proposal No. 13

AN ACT relating to insurance; concerning reimbursement or indemnity for services rendered in the treatment of alcoholism, drug abuse, and nervous and mental conditions; amending K.S.A. 1977 Supp. 40-2,105, 40-1809 and 40-1909 and repealing the existing sections.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 1977 Supp. 40-2,105 is hereby amended to read as follows: 40-2,105. Every insurer, which issues any group policy of accident and sickness, medical or hospital expense insurance which provides for reimbursement or indemnity for services rendered to a person covered by such policy in a medical care facility, must make available by affirmative offer and, if requested by the contract holder, provide reimbursement or indemnity under such policy which shall be limited to not less than thirty (30) days per year when such person is confined ~~in either a licensed hospital~~ for ~~the~~ treatment of alcoholism, drug abuse or nervous or mental conditions in a medical care facility licensed under the provisions of K.S.A. 1977 Supp. 65-429 or a treatment facility for alcoholics licensed under the provisions of K.S.A. 1977 Supp. 65-4014 ~~for the treatment of alcoholism~~, a treatment facility for drug abusers licensed under the provisions of K.S.A. 1977 Supp. 65-4605, a community mental health center or clinic licensed under the provisions of K.S.A. 75-3307b or a psychiatric hospital licensed under the provisions of K.S.A. 75-3307b. Such policy shall also provide reimbursement or indemnity of a portion of the costs of treatment of such person, as provided in such policy, for alcoholism, drug abuse or nervous or mental conditions in said facilities hereinbefore enumerated

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when confinement therein is not necessary for said treatment.

Sec. 2. K.S.A. 1977 Supp. 40-1809 is hereby amended to read as follows: 40-1809. Such corporations shall be subject to the provisions of ~~K.S.A. 1977 Supp. 40-2,105 and to~~ K.S.A. 40-215, 40-216, 40-218, 40-219, 40-222, 40-224, 40-225, 40-226, 40-229, 40-230, 40-231, 40-235, 40-236, 40-237, 40-247, 40-248, 40-249, 40-250, 40-251, 40-254, 40-2a01 to 40-2a19, inclusive, and 40-2401 to 40-2421, inclusive, and amendments thereto, and K.S.A. 1977 Supp. 40-214, 40-223, 40-252, 40-2,102, 40-2,105, as amended, 40-2216 to 40-2220, inclusive, and 40-3301 to 40-3313, inclusive, except as the context otherwise requires, and shall not be subject to any other provisions of the insurance code except as expressly provided in this act.

Sec. 3. K.S.A. 1977 Supp. 40-1909 is hereby amended to read as follows: 40-1909. Such corporations shall be subject to the provisions of ~~K.S.A. 1977 Supp. 40-2,105 and to~~ K.S.A. 40-215, 40-216, 40-218, 40-219, 40-222, 40-224, 40-225, 40-226, 40-229, 40-230, 40-231, 40-235, 40-236, 40-237, 40-247, 40-248, 40-249, 40-250, 40-251, 40-254, 40-2,100, 40-2,101, 40-2a01 to 40-2a19, inclusive, and 40-2401 to 40-2421, inclusive, and amendments thereto, and K.S.A. 1977 Supp. 40-214, 40-223, 40-252, 40-2,102, 40-2,104, 40-2,105, as amended, 40-2216 to 40-2220, inclusive, and 40-3301 to 40-3313, inclusive, except as the context otherwise requires, and shall not be subject to any other provisions of the insurance code except as expressly provided in this act.

Sec. 4. K.S.A. 1977 Supp. 40-2,105, 40-1809 and 40-1909 are hereby repealed.

Sec. 5. This act shall take effect and be in force from and after its publication in the statute book.