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SYLLABUS:

1. A loan granted under Section 1151.291, Revised Code, upon an obligation secured by real estate is an illegal loan for failure to meet the statutory requirements of Section 1151.291, *supra*, where the buildings permanently erected upon the real estate are to be razed or the portion of the real estate upon which the permanent buildings are erected is to be released from the mortgage.

2. A loan granted under Section 1151.291, Revised Code, upon an obligation secured by real estate which is to be developed for building sites is an illegal loan for failure to meet the statutory requirements of Section 1151.291, *supra*, when the buildings permanently erected upon the real estate are to be razed to facilitate the development of the land or the portion of the real estate upon which the permanent buildings are erected is to be released from the mortgage.

Columbus, Ohio, June 26, 1963

Hon. John L. Maxwell
Superintendent
Building and Loan Association
State of Ohio
Columbus, Ohio

Dear Sir:

Your request for my opinion reads as follows:

“This Division is confronted with a supervisory problem involving mortgage loans which building and loan associations are making purportedly pursuant to Section 1151.291 of the Revised Code, division (B) of which provides in part, as follows: ‘The real estate pledged to secure the obligation shall be any real estate upon which one or more buildings have been permanently erected’

“It is my desire to submit to you for opinion the question as to whether or not the following two examples of such loans conform with the above-cited statutory lending limitation.

“1. A loan of \$300,000 was made on the security of approximately 620 acres of non-income producing land with an appraised value of \$700,000. Three houses and various other buildings having an aggregate appraised value of \$50,000 are on the land, but these were not included in the association’s appraisal

of the security since it is anticipated they will be razed in the course of developing the land into factory and residential building sites. The purpose of the loan was to provide funds for the reorganization of the capital structure of the various borrowers concerned and to provide funds for the promotion and engineering necessary for the proposed development of the land. The entire proceeds of the loan were disbursed on the day it was granted.

“2. A loan of \$42,000 was made on the security of 14 vacant lots appraised for \$2,600 each and one lot containing a dwelling appraised for \$18,100. All 15 lots are contiguous. Subsequent to the granting of the loan, the lot containing the dwelling was released from the mortgage upon payment by the borrower of \$16,000, thus leaving the balance of the loan secured by the 14 vacant lots. The purpose of the loan was to develop the unimproved lots into residential building sites, but the entire proceeds of the loan were disbursed when the loan was granted.”

Prior to 1934, the building and loan association law provided that a loan could be granted upon an obligation secured by a mortgage, deed of trust on real estate or a leasehold interest either directly to the association or to some other party and pledged to the association. The practices that developed from the broad loan authorization created the vulnerable position that the building and loan associations found themselves during the depression. As a result of this bitter experience, the legislature enacted limitations upon the building and loan associations designed to reduce the security risk on real estate loans. The present law is substantially the same as the post depression legislation of 1934 enacted under Section 9657, General Code; 115(2) Ohio Laws, 382.

The major safeguard provided in the law was the elimination of loans secured by vacant, partially developed real estate or developed real estate. This prohibition is not specifically stated in the law. However, a review of the legislative history and present statutes supports this conclusion. The real estate loan statutes read in pertinent part as follows:

Section 1151.29, Revised Code:

“A building and loan association may make loans to members and others on such terms as are provided by the

association upon obligations secured by real estate subject to the procedures of section 1151.292 (1151.29.2) of the Revised Code and the following limitations:

“(A) Such real estate shall be improved residential property, a combination of residential and business property, or a farm under cultivation.

“(B) Not more than thirty-five thousand dollars shall be loaned on the security of any one such property.

“(C) The amount loaned shall not exceed eighty per cent of the fair value of such real estate as determined by the appraisal.

“* * * * * * * *”

Section 1151.291, Revised Code:

“A building and loan association may make loans to members and others on such terms as are provided by the association upon obligations secured by real estate subject to the procedures of section 1151.292 (1151.29.2) of the Revised Code and the following limitations:

“(A) Loans made under this section shall not aggregate more than twenty per cent of the association’s assets.

“(B) The real estate pledged to secure the obligation shall be any real estate upon which one or more buildings have been permanently erected, or other real estate which produces sufficient income to maintain the property and retire the loan in accordance with its terms.

“(C) The amount loaned shall not be more than seventy per cent of the fair value of such real estate as determined by the appraisal.

“(D) Loans for financing improvements on such real estate may be made for a term of not more than eighteen months with no provision for amortization of principal but shall require the periodic payment of interest.

“* * * * * * * *”

Section 1151.292, Revised Code:

“A building and loan association shall observe the following procedures in making real estate loans:

“(A) The association may make loans upon obligations secured by a mortgage or deed of trust on real estate, which mortgage or deed of trust shall be made directly to the association. * * *

“* * * * * * * *”

(D) In respect to *any loan* made upon the security of real estate, if it is agreed or contemplated that improvements will be made on such real estate and become a part of such security, such real estate is 'improved' within the meaning of this chapter and the value of such improvements shall be included in the appraisal value of such real estate; but during the period of construction, the amount advanced by the association in respect to such loan shall not be more than the actual cost of the *buildings* to such time of advancement.

“* * *

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(Emphasis added)

Section 1151.29, subparagraph (A), *supra*, with the exception of a farm under cultivation, requires that loans be upon improved residential or a combination residential and business real estate. This section is supplemented by Section 1151.292, subparagraph (D), *supra*, which defines improved real estate in terms of improvements relating to the construction of buildings. Section 1151.292 subparagraph (B), *supra*, makes no limitation upon the type or use of real estate, but specifically requires that one or more buildings have been permanently erected upon the real estate or that it is income producing. Under the 1934 legislation, the requirement for a loan as presently provided for by Section 1151.291, *supra*, was limited solely to real estate upon which one or more permanent buildings had been erected. It was further provided that the value of the building had to equal one half of the total value of the real estate and the amount of the loan could not exceed fifty per cent of the total appraised value. In 1951, 124 Ohio Laws 92, the legislature deleted the value requirements of the building or buildings and included income producing real estate. This amendment greatly broadened the loaning authority of an association, but did not alter the original intent of the legislature that the security for a loan must not rest solely on land value but must also be tied to permanently erected buildings, or, as later provided, to land production.

Section 1151.292, subparagraph (D), *supra*, which is applicable to Sections 1151.29 and 1151.291, *supra*, provides that if improvements are contemplated they shall be included in the appraisal of the real estate, but at no time may the proceeds advanced exceed the cost of the building as it is being constructed. This section clearly rules out the loan on vacant real estate and is

consistent with Section 1151.291, subparagraph (B), *supra*, which requires that a building or buildings "have been permanently erected" before a loan can qualify and proceeds be advanced. Real estate to qualify under Section 1151.291, *supra*, therefore, must be real estate upon which there have been erected permanent building, or there is being erected a permanent building or real estate which is income producing.

Not until 1961 did the legislature provide under Section 1151.298, Revised Code, 129 Ohio Laws, 127, that a building and loan association may grant a loan secured by undeveloped or partially developed real estate. The proceeds of this type loan must be used only for the purpose to acquire or develop the real estate, Opinion No. 3113, Opinions of the Attorney General for 1962, issued June 29, 1962. Section 1151.298, *supra*, reads in part as follows:

"A building and loan association may make loans to members and others upon obligations secured by real estate for the acquisition of undeveloped or partially developed land and the development thereof for primarily residential use subject to the procedures of Section 1151.292 (1151.29.2) of the Revised Code except division (D) thereof, and subject to the following limitations and procedures:

"* * *

* * *

* * *"

It has been ruled that a loan on developed real estate may not be made under this section, Opinion No. 2996, Opinions of the Attorney General for 1962, issued May 15, 1962.

Section 1151.298, *supra*, defines the term development as follows:

"* * *

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* * *

"For the purposes of this section, 'development' includes the survey and platting of such land, the laying out and improvement of streets, the installation of water lines and mains, sewers, sidewalks, curbs, and facilities for the disposal of sewage, and the installation of such other improvement as may be necessary or advisable to prepare such land for primarily residential use."

The building and loan law therefore defines developed real estate as land which has been, or is being prepared for building sites and improved real estate as land upon which there has been or is

being erected a permanent building. Only improved real estate as herein defined qualifies under Section 1151.291, *supra*.

Loan No. 1 as referred to in your letter, describes a loan secured by real estate upon which there were three buildings subsequently razed in preparation of the land for industrial and residential sites. At the inception of this loan, the real estate qualified under Section 1151.291, *supra*, but it would be a total disregard of legislative intent to conclude that the legislature was only concerned with the nature of the real estate at the time the loan is consummated and not thereafter. The razing of the buildings reduced the real estate to vacant land on which there was not contemplated the construction of a building but rather the development of building sites. The razing of the buildings and the absence of proposed construction of permanent buildings clearly renders this loan illegal under Section 1151.291, *supra*. It is immaterial that the value of the real estate may far exceed the amount of the loan it secures. If the real estate fails to meet *all* of the requirements of Section 1151.291, *supra*, the loan is illegal.

Loan No. 2 fails for the same reasons as given under loan No. 1. It may be asked in this instance why the loan was not granted under Section 1151.298, *supra*. The question is readily answered upon reviewing the stricter limitations and requirements under Section 1151.298, *supra*. Some important differences from Section 1151.291, *supra*, are as follows: the lower aggregate loan percentage limitation; the amount of the loan to total appraised value of the real estate; the term of the loan and manner of repayment; the requirement of certified credit ratings and certified cost statements, and the manner of disbursing the loan proceeds. It, therefore, would be advantageous to both the association and the borrower to handle this loan under Section 1151.291, *supra*.

The subsequent release of the lot with the permanent dwelling makes the setup of this loan appear to be only a means to circumvent the requirements of Section 1151.298, *supra*, and qualify under Section 1151.291, *supra*. As stated above, no loan qualifies under this Section when the real estate securing the loan is to become vacant pursuant to it being developed for any kind of building sites. Therefore, loan No. 2 is also an illegal loan under Section 1151.291, *supra*.

I also bring your attention to the fact that the amount of loan No. 2 exceeds seventy per cent of the total value of the real estate as stated in your letter. Consequently, the appraisal must have included the value increment to be realized by the proposed development, but no proceeds of the loan were withheld. This would have been a violation even if the loan had qualified. However, this brings me to a further application of the conclusion I have made regarding Section 1151.291, *supra*. I have defined the term improvements as used in Sections 1151.291 and 1151.292, *supra*, as meaning the construction of a permanent building which of course would also include the improvement of existing permanent buildings. Development as defined by Chapter 1151, Revised Code, does not fall within the term improvements as used in Section 1151.292, subparagraph (D), *supra*. Therefore, in the event the lot with the dwelling had been retained and the real estate qualified as security, the appraisal of the real estate could not include the value of the future development.

Therefore, it is my opinion and you are advised:

1. A loan granted under Section 1151.291, Revised Code, upon an obligation secured by real estate is an illegal loan for failure to meet the statutory requirements of Section 1151.291, *supra*, where the buildings permanently erected upon the real estate are to be razed or the portion of the real estate upon which the permanent buildings are erected is to be released from the mortgage.

2. A loan granted under Section 1151.291, Revised Code, upon an obligation secured by real estate which is to be developed for building sites is an illegal loan for failure to meet the statutory requirements of Section 1151.291, *supra*, when the buildings permanently erected upon the real estate are to be razed to facilitate the development of the land or the portion of the real estate upon which the permanent buildings are erected is to be released from the mortgage.

Respectfully,

WILLIAM B. SAXBE

Attorney General