LOAN PROVISIONS OF THE "G. I. BILL OF RIGHTS"

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DELIVERED BEFORE THE

CONFERENCE OF SUPERVISING EXAMINERS

WASHINGTON, D. C.

APRIL 23, 1946.

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INTRODUCTION

Mr. Chairman: - It is with some trepidation that I talk to you on the assigned subject in view of the fact that Chairman Harl spoke to the National Association of Supervisors of State Banks on the same subject at the New Orleans meeting and I assume that all of you were present at the meeting or have read his speech. However, since the Chairman's speech the so-called "G. I. Bill of Rights" has been materially amended and it is on these amendments and the regulations issued thereunder which I propose to talk on today.

Let me say in the beginning that my talk will be limited to the loan provisions of the G. I. Bill. Some of you may be interested in the other provisions of the bill but time will not permit a discussion of the educational, hospitalization and other benefits provided for in the Act. I do not like to make a technical talk - However, there are times when technicalities are necessary.

I assume that each of you is generally familiar with the old Law and consequently I shall not discuss it but merely point out the significant changes, which may be summed up as follows:

(1) An increase in the guarantee of real estate loans from $2000 to $4000.

(2) An extension of time in which veterans may take advantage of the guarantee or insurance from two years to ten years.

(3) An extension of the time limit on the terms of payment from 20 to 25 years on real estate and from 20 to 40 years on farm realty.

(4) A provision for the insurance of loans, in lieu of guaranty, of up to 15% of the aggregate of loans made or purchased by a lender. This allows a choice to the veteran and lender and consequently broadens the scope of credit assistance to veterans.

(5) Loans made for construction may now include the cost of the land on which the veteran intends to build.

(6) Certain delinquent indebtedness may be refinanced.

(7) Farm loan provisions allow for the improvement of grounds and buildings, the construction of new buildings, and the use of funds to purchase livestock and seed or for money needed for any farm operation.

(8) The business loan provisions now allow purchase of inventory and the use of funds for working capital.

(9) Benefits are extended to persons on terminal leave or hospitalized pending final discharge, and persons in the military or naval service of governments allied with the United States who were U. S. Citizens at the time of entering such service.

On March 1st, 1946 the Veterans Administration issued new regulations pursuant to the provisions of the amended G. I. Bill. These regulations are rather lengthy but a working knowledge of their provisions will be well worth any examiner's time. I seriously recommend that each examiner be furnished with a copy of these regulations, together with the explanatory notes prepared by the Veterans Administration. The American Banker in its issue of March 7 printed the complete text of the regulations and explanatory notes.

ELIGIBILITY AND NATURE OF GUARANTY

Probably the first question to arise is who is entitled to the benefits of the Act. Any person who served in the active military or naval service of the United States at any time on or after September 16, 1940 and prior to the termination of the present war and who has been discharged or

released therefrom under conditions other than dishonorable after active service of 90 days or more, or by reason of injury or disability incurred in line of duty is a veteran within the terms of the Act. Certain other individuals who served in the Armed Forces of governments allied with the United States in World War II and who at the time of entrance into such service were citizens of the United States, are also eligible veterans.

The term "G. I. loan" has become popular. Let us understand at the beginning that a G. I. loan is not a loan from the Government but is a loan made by a financial institution or other lender, a portion of which may be guaranteed or insured by the Veterans Administrator. The Act and the regulations provide that the sum of all guaranties and credits to the insurance accounts covering loans made to all individual veterans shall not exceed $2000 for non-real estate loans, nor $4000 for real estate loans, nor a proper portion of such maxima on loans of both types or in combination thereof. Not more than 50% of the original principal amount of any loan except loans which are fully guaranteed under Section 505(A), which provides for a 100% guaranty in the case of certain types of second mortgages, within limitations may be guaranteed and the maximum credit to the insurance account of a lender relative to any insured loan shall be 15% of the original principal amount of each loan or the amount thereof which could be guaranteed, whichever is less. By way of illustration, with reference to the proportion of loans between real estate and non-real estate loans which may be guaranteed or insured, assume that a veteran has used $1500 for a real estate guarantee and $350 for a non-real estate guarantee. In order to determine the remaining amount add the amount of the prior real-estate loan plus twice the amount of the non-real estate loan and substract this sum from $4000. In our illustration

this would be $1500 for the real estate loan plus $700 (twice the amount of the non-real estate loan) which would amount to $2200. Deduct this sum from $4000 which leaves a balance of $1800, which remains available for a realty guaranty or divide the same by two which equals $900, which is available for a non-real estate guaranty.

With reference to the extent of the guaranty, the guaranty may not exceed 50% of the loan or $4000. However, this does not mean that 50% of each loan is guaranteed nor that the maximum loan may not exceed $8000. True in the case of an $8000 loan, the Veterans Administrator may guarantee $4000, which is equivalent to 50% of the loan. However, on a $16,000 loan the Veterans Administrator would guarantee an amount not in excess of $4000 which in this case would be 25% of the loan. Here let me point out that where a loan exceeds $15,000 the prior approval of the Administrator must be obtained.

One of the more important provisions to remember in this connection is that the guaranty is reduced or increased pro rata with any reduction or increase in the amount of the guaranteed indebtedness, but in no event will the amount payable on a guaranty exceed the amount of the original guaranty or the percentage of the indebtedness corresponding to that of the original guaranty.

To use the same illustration given above should a loan of $16,000 be guaranteed to the extent of $4,000 or 25% and later be reduced by payment to $12,000, the amount of the guaranty would be reduced pro rata. That is, the loan has been reduced by one-fourth and accordingly the guaranty has been reduced by one-fourth or $1000. Thus reducing the guaranty to $3000. The $3000, however, still represents the same percentage of the guaranty

as was originally in force. That is, 25% of the remaining balance.

The converse of the above is also true. Taking the same illustration, should the loan after it has been reduced to $12,000 be increased by the lender advancing funds for certain necessary repairs to the extent of say $2000 thus now making a total of $14,000 - 25% of the $14,000 or $3,500 would be guaranteed. A point to bear in mind is that should the loan increase above $16,000 the Veterans Administrator will not guarantee any amount beyond the original guaranty or $4,000, in the case used for illustrative purposes.

The provisions of the law with reference to the method of effecting the guaranty have been materially simplified. The basic instrument by which the guaranty is effected is the veteran's discharge certificate. Should the veteran not have his discharge certificate or should any question be raised as to whether or not the discharge is dishonorable the lender should exercise caution and determine that the veteran is entitled to the guaranty. An application may be made by the veteran to the Veterans Administration for a certificate of eligibility.

Care should also be exercised by lending agencies to determine whether or not the veteran has obtained a prior guaranty. Because if a veteran has obtained a prior guaranty the amount of the subsequent guaranty will be reduced to the extent that the total guarantee exceed $4,000. And, if application for several guaranties are filed with the Veterans Administrator the guaranty will be applied to the loans in the order in which they are filed with the Administrator. Procedure has been set up by which a bank may determine definitely in advance whether or not a veteran is eligible and if so the amount of the guaranty remaining. It must be remembered that

many veterans obtained guaranties under the prior provisions of the statute and will now obtain additional guaranties under the amendments which increased the real estate loan limits from $2000 to $4000. While on this subject let me point out that once a veteran has used the full amount of the guaranty he may not thereafter apply for an additional guaranty although the original loan or loans which were guaranteed may have been paid in full.

Another factor to be considered in connection with the amount of the guaranty arises where several veterans desire to pool their resources and to obtain a larger guaranty. Irrespective of the interest two or more veterans may acquire in real or personal property, a loan may be guaranteed or endorsed for eligible purposes if the veterans are joint obligors under the obligation. The amount to be guaranteed or insured may be charged equally to their respective guaranty benefits or apportioned as they designate, provided that the aggregate of their guarantee benefits to be used would not in any event exceed 50% of the loan, nor 15% of the principal of the loan if it is to be insured; nor may the loan be guaranteed or insured in excess of the guaranty benefits available to the several veterans. For instance five veterans may desire to purchase a property costing $25,000. The maximum issuable guaranty is 50% or $12,500. They may elect to charge each of their respective guarantee benefits with $2,500 each or two of the veterans may charge their guarantee benefits with $4,000 each or $8,000, and the other three veterans may charge their respective guarantee benefits with $1,500 making the total maximum guaranty to be issued $12,500.

A veteran may obtain a loan with a non-veteran. By way of illustration - Should a veteran desire to purchase real property with a non-

veteran a loan for such purpose will be eligible for guaranty or insurance but the amount of the guaranty or insurance credit that will be issued by the Administrator will be based on the proportional interest the veteran shall have or may acquire in the property.

Also in the case of a non-real estate loan the veteran may join with others in a farm or business venture and his loan may be guaranteed or insured based upon the reasonable value to the veteran of his participating share or contribution to the enterprise.

For example: A veteran may contribute $4000 to a machine shop business, two non-veterans contribute to the other tangible or intangible assets estimated at a value of $5,000. A loan to the veteran of $4000 may be guaranteed to the extent of $2000 or insured for $600. This will be true irrespective of any agreement that may exist regarding the interests of the various parties in the business.

INSURANCE OF LOANS

One of the most important provisions of the Act relates to the insurance of loans. Under this provision - in lieu of loans being guaranteed - lending institutions (if subject to supervision and examination by State and Federal authorities) may have the benefit of insurance against loss on any type of loan which is eligible for guaranty.

This insurance will be effected by setting up an account in the name of the individual lending institution by the Veterans Administration to which will be credited an amount not in excess of 15% of the principal of the loan to be insured subject to the following limitations: (1) The account so credited may not exceed $4000 in respect to a real estate loan

or $2000 in the case of non-real estate loan; (2) it cannot exceed the unused portion of the veterans guaranty benefit. The insurance against loss plan covers all types of loans, real estate as well as non-real estate. The provisions of section 508 of the law (The insurance provisions) are permissive and operate as follows:

On a $1,000 loan $150 or 15% will be credited to the lenders insurance account. On a loan of $5000, $750 will be credited; on a $13,333.33 loan, non-real estate $2000 will be credited; on a $15,000 non-real estate loan $2000 will be credited and not $2,250 for the reason that $2000 is the maximum guaranty permitted on a non-real estate loan for a veteran. The same principle applies in the utilization of the veterans guaranty benefit for real estate loans. It should be understood that there is no limit on the amount of the loan that can be insured, except that loans in excess of $15,000 must be submitted to the Veterans Administrator for prior approval. This same limitation also applies in the case of a guaranty.

Insured loans may be transferred without recourse from one insured institution to another institution which is eligible for insurance. A report of the transfer on the proper form is made to the Veterans Administration and the Veterans Administration will debit the seller's insurance account and credit the buyers insurance account in an amount equal to the original percentage credited to the insurance account in respect to the loan or loans or to the purchase price whichever is lesser. By way of illustration: Bank "A" has made or purchased in connection with an original vendor or dealer transaction a loan to veteran X for $5000. The insurance account of bank "A" is credited with $750 or 15%. The loan is paid down to $4000 at which time bank "A" sells to bank "B" for this amount. The

Administrator will charge to the account "A" and credit to account "B" $600 or 15% of the unpaid principal balance.

No transfers between insured accounts are made where the loan transactions involve a transfer with recourse or guaranty or repurchase agreement, nor is any such a transaction required to be reported to the Administrator.

Generally speaking in the event of a claim being made the amount charged against the insurance account standing in the name of the lender will be represented by net loss sustained in connection with the insured loan. This result may be arrived at, however, in several ways: (1) The lender may liquidate the loan and file claim with the Administrator for the net loss involved, provided the amount standing to his credit in his insured account is sufficient therefor. The Administrator will pay such loss and charge it to the holders account; (2) if, upon notice of default to the Administrator, the Administrator elects to take over the entire loan, upon payment to the holder of the full amount of the indebtedness upon assignment to the Administrator of the instruments representing the indebtedness, there will be charged to the holder's insurance account an amount equal to the difference between the amount paid to the holder by the Administrator and the value of the security as determined by an appraiser designated by the Administrator. This amount will not be less than the percentage of the loan originally credited to the insurance account. By way of illustration - Let us assume that there has been an original loan of $5000 and that a credit to the lender's insurance account had been made in the sum of $750 (15% of $5000) but the loan defaults when the loan balance stands at $4000 and the Administrator pays this amount to the holder upon assignment of the papers. The property, according to appraisal is valued at $3,000, conse-

quently, the amount charged against the insurance account is the difference between $4000 and $3000 or $1000.

TERMS OF LOAN

A loan may be made for any legitimate purpose prescribed within the limitations of the Act. It would be difficult to describe in detail the type and character of all the eligible purposes for which a guaranteed or insured loan may be made, but a lender may consider any application for the purposes generally eligible, provided, that when full disbursement has been made it will meet the requirements of the Act and Regulations.

If part of the proceeds of a loan are to be used to refinance an obligation incurred by a veteran prior to sixty days of the filing of a loan report or an application for guaranty (as distinguished from the refinancing loan provided under Section 507), that part of the loan shall be excluded in computing and requesting an amount of guaranty or insurance. For example: A veteran owns a home upon which he has a first lien of $2000 made five years before the date of filing an application. He desires to borrow $3000 for improvements to the property. Assume that the $3,000 exceeds 40% of the present reasonable value of the property "as is". Under section 4343 of the regulations a first lien is required. To accomplish this the present lien of $2,000 must be refinanced. Therefore, the loan of $5,000 to be secured by a first lien will be guaranteed, not for 50% of $5,000 but 50% of $3,000, or $1,500. The percentage relationship of the guaranty to the new loan would be 30%.

In case the foregoing loan was to be insured, the amount of credit to a lender's insurance account would be 15% of $3,000 or $450 and not 15% of $5,000 or $750.

Exigent conditions may arise in an eligible transaction where it becomes necessary for a veteran to have temporary financing for the immediate acquisition of a home, equipment, supplies, or for other purposes. Assuming a lender is willing to make the loan for the interim financing, in such cases the loan if otherwise eligible will be guaranteed or insured if the loan report or application for guaranty is filed with the Veterans Administration within 60 days of the date the obligation was incurred.

A loan to refinance an installment land contract or a contract of sale for the purchase of realty in which the veteran has not a vested but only an equitable interest in the property may if otherwise eligible be guaranteed or insured. The reasonable value of the property will be determined at the time the application is made for the loan to refinance.

The balance owing on a deferred purchase money mortgage or contract given for the purchase of unimproved real property is eligible for refinancing in connection with an eligible loan for new construction. The amount owing on such mortgage or contract may be paid out of the proceeds of the construction loan.

A loan for the purchase of unimproved real estate with the intent to improve it at some future date is not eligible for a guaranty or insurance. A lot or unimproved realty may be purchased out of the proceeds of a construction loan, provided the purchase of such lot or unimproved realty is in connection with or part of the contract for construction. A loan for the purchase of unimproved realty in connection with farming and business operations is eligible for guaranty or insurance, provided the land is used for the purpose intended. For example, in a business loan the land may be used for a parking lot.

Section 4353 of the Regulation permits the guaranty or insurance of a loan for the purchase or construction of a combination residential and business property under the home loan provisions.

If a veteran is in need of a secondary loan, the loan will be eligible for guaranty provided the proceeds are used concurrently with and as part of the same transaction to purchase or acquire property or for the cost of constructing improvements and, provided further that the primary lien to be made, or assumed, is made, guaranteed or insured by a Federal agency and that the amount of the second lien does not exceed 20% of the purchase price or cost. This type of loan may be fully guaranteed to the extent of $4,000 for real estate loans or $2,000 for non-real estate loans if these amounts of guaranty benefit are available. The purchase price shall not exceed the reasonable value as determined by an appraiser designated by the Administrator.

Under section 507 of the Act a loan may be guaranteed or insured, the proceeds of which are to be used to refinance a delinquent indebtedness provided it is secured of record on the property used or occupied by the veteran as a home or for farm purposes. A delinquent indebtedness incurred by a veteran in the pursuit of a gainful occupation, that is, in the conduct of a business, does not have to be of record but must have been definitely incurred in the pursuit of a gainful occupation. No loan shall be made to refinance a delinquent indebtedness less than 60 days in default without a written statement from the holder of the indebtedness that the loan to be refinanced is delinquent. Loans guaranteed or insured under the provisions of the Act can not be refinanced under Section 507 of the Act. And, loans to refinance delinquent unsecured obligations incurred for personal service

or comfort are not eligible for guaranty or insurance. However, loans for the payment of delinquent taxes, special assessments, ground rents and other governmental levies are eligible for guaranty or insurance.

Certain definite provisions have been placed in the law with reference to the terms of the loan. The term of the loan shall in no event exceed: 5 years non-amortized, 10 years for non-real estate loans, 25 years for home or business loans on real estate and 40 years on farm loans or real estate for farming operations. However, the maturity of a loan should not exceed the economic life of the property.

The rate of interest on a guaranteed or insured real estate loan may not exceed 4% per annum. On non-real estate loans the interest rate may not be in excess of an amount equivalent to the $3.00 discount per $100 on the original face amount of a 1 year note payable in equal monthly instalments or the equivalent of a simple interest rate of 5.70 percent per annum. The discount may be deducted from the principal of the loan or in lieu thereof of a gross charge not exceeding 3% discount may be added to the principal of the loan.

Another interesting feature of the law provides for the payment to the lender by the Veterans Administrator of an amount equivalent to 4% on the amount originally guaranteed or an amount equivalent to 4% of the amount credited to the lenders insurance account to be credited upon the loan. This amount shall be treated as payment on the principal of the loan, or may at the election of the borrower be used to pay part of the interest during the first year. This payment will be received by the lender only after the loan has been closed and disbursed. Under this plan it will not be necessary to recast the amortization schedule.

Another feature of the G. I. loans requires that all loans, the maturity date of which is beyond five years from date of the loan, be amortized. The lender and the veteran may by agreement provide for the payment of proportionate amounts with each regular amortization period to care for taxes, ground rents, special assessments, fire and other hazard insurance premiums. The regulations require that a debtor shall have the right to repay at any time without premium or fee the entire loan or any part thereof, not less than the amount of one installment or $100, whichever is less.

Any real estate loan other than for repairs, alterations or improvements shall be secured by a first lien on realty, except that a loan made under the provisions of section 505(A) may be secured by a second lien. Loans for less than $1000 for alterations, repair or improvement of real property need not be secured. Loans for more than $1000 for alterations, repairs or improvements of real estate property but less than 40% of the reasonable value of the property to be improved and prior to making improvement shall be secured by either a first or second lien. Loans for more than $1000 for alterations, repairs or improvement on real property and in excess of 40 per cent of the reasonable value of the property shall be secured by a first lien. All non-real estate loans shall be secured by personalty to the extent legal and practical, except that loans for working or other capital, merchandise, good-will and other intangible assets may be made without a lien. A farm loan for crop production should ordinarily be secured by a first lien on the crop.

DEFAULTS

Provision for the extension of a loan in the case of default is

provided in the regulations. No loan may be extended beyond the maximum maturity prescribed in the Act for loans in its class. A loan guaranteed under the provisions of the original Act, may, in the case of default, be extended not beyond the maximum maturity prescribed in the amendments to the Act. For example, a loan made for twenty years, secured on real estate may be extended up to and including twenty-five years.

The holder of an extended guaranteed or insured loan is required to forward to the Regional office of the Veterans Administration, which issued the evidence of guaranty or insurance, an executed duplicate copy of the extension agreement.

The regulations set forth specific methods for reporting defaults. If the failure to any debtor to comply with the terms of a guaranteed or insured obligation persist as long as six months or as long as two months under a loan extended (under the regulations just discussed) the holder of the indebtedness must give prompt notice of such failure to the Administrator.

The Administrator may approve the holders request, if any, to postpone action to press his claim against the debtor or against the property. Such postponement, with the consent of the Administrator or any obligor. However, if the holder, failing to obtain such consent, fails to proceed within two months towards the liquidation of the security the Administrator in addition to the rights to pursue any legal or equitable remedies which may be available, may fix a date beyond which no further charges may be included in the computation of the guaranty claim or an insured claim. If the holder does not begin appropriate action within two months after the request by the Administrator, the Administrator may begin and prosecute to completion any action or proceeding in his name or in the

name of the holder, which the Administrator deems necessary to liquidate the loan or the security therefor.

In the event any failure of a debtor to discharge his obligation under a loan continues for a period of three months or for more than one month on an extended loan or a term loan, the holder may at his option, then or thereafter submit a claim for payment of the guaranty. He may also notify the Administrator of his intention to pursue his legal rights. In any case where any material prejudice to the rights of the holder or hazard to the security warrants more prompt action a claim for guaranty may be submitted prior to the three months period. In normal procedure, however, a holder shall not begin proceedings in court or give notice of sale under power of sale or otherwise take steps to terminate the debtor's rights in the security until an expiration of thirty days after delivery by registered mail to the Administrator of a notice of intention to take such action, except upon express waiver by the Administrator. However, immediate action may be taken to protect the property.

The Administrator may, upon receiving a notice of default or a claim for a guaranty, within thirty days thereafter require the holder upon penalty of otherwise losing the guaranty or insurance to transfer and assign the loan and the security therefor to the Administrator or to another designated by him upon receipt of payment in full of the balance of the indebtedness remaining unpaid to the date of such assignment.

The regulations require that the Administrator be furnished with copies of all legal proceedings.

Where security for a guaranty or an insured loan is to be disposed of through private sale, the amount to be realized therefrom shall

be reported to the Administrator at least ten days in advance of the sale and the Administrator may thereupon either assent to such sale, or upon agreement to indemnify the holder to the extent of any increase or resultant loss consequent thereon, may establish an upset price which shall govern in adjusting the rights and the liabilities of the holder and the Administrator.

Upon receipt of notice of a public sale to liquidate any security for a guaranteed or insured loan the Administrator may appraise such security and notify the holder in advance of the sale of the amount required to be credited to the indebtedness on account of the sale thereof subject to the following alternatives: (1) If a third party acquires the security at the sale the holder shall credit against the indebtedness the net proceeds of the sale or the amount specified by the Administrator, whichever is greater; (2) if the holder acquires the security at the sale he shall credit the indebtedness, for the purpose of accounting to the Administrator, with the amount specified by the Administrator, paying over to the Administrator the excess, if any, by which such credit exceeds the sum required to satisfy the indebtedness and he may further dispose of the security in accordance with the rights he derived through the sale, or he may within fifteen days after the date of the sale advise the Administrator of his election to transfer or convey the security [or the rights therein derived through sale] to the Administrator in return for payment of the specified amount required to be credited to the indebtedness, or the amount required to satisfy the indebtedness, whichever is less; (3) upon receiving repayment in full on all payments made on the guaranty or insurance the Administrator shall deliver an appropriate release of all rights

in the property accruing by reason of the guaranty or insurance of the loan.

When a debtor proposes to transfer or convey any security or other property to a holder to avoid foreclosure, the consent of the Administrator to the terms of such proposal shall be obtained in advance of such transfer or conveyance. Prior to giving such consent the Administrator will appraise the property and fix the amount which the holder shall be required to allow for the value of such property in a subsequent accounting to the Administrator for a surplus resultant after payment of the guaranty, or in computing the net loss on an insured loan. The holder shall be entitled to elect to transfer or convey the property to the Administrator upon payment by the Administrator of the stated valuation up to the amount thereof required to satisfy in full the remaining balance of the indebtedness. Such election must be exercised within fifteen days.

In computing the amount of the guaranty the total amount payable shall in no event exceed the original guaranty. The amount payable on a claim for the guaranty shall be the percentage of the loan originally guaranteed applied to the indebtedness computed as of the date of claim and not later than (1) the date of judgment or of decree of foreclosure, or (2) in non-judicial foreclosures the date of publication of the first notice or sale or (3) in case in which the security is repossessed without a judgment or decree or foreclosure the date the holder repossesses the security or (4) if no security is available or no repossession takes place the date of the claim but not more than six months after the first uncured default.

Probably the most interesting feature and the one which has given lenders the most trouble in the past is now apparently cleared up by Section 36.4323 of the regulations which relates to subrogation and

indemnity. This section provides that the Administrator shall be subrogated to the contract and the lien or other rights of the holder to the extent of any sum paid on a guaranty or insured loss, which right shall be junior to the holders rights as against the debtor or the encumbered property until the holder shall have received the full amount payable under his contract with the debtor.

Under this provision should a loan of $8,000, which is guaranteed up to the extent of $4000, be reduced to $6,000 and then the borrower default, the holder may file claim with the Veterans Administrator for $3000 which is 50% of the remaining balance due on the loan. The Veterans Administrator will then pay the lender this amount thus leaving a net debt of $3000. The holder may then foreclose and should the property bring $4000 the debtor would be entitled to retain $3000, thus paying his debt in full. He must then refund the remaining $1000 to the Veterans Administrator.