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Accounts of a Mortgage Guaranty Company

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Accounts of a Mortgage Guaranty Company

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For many years mortgage guaranty companies have been lending on first mortgages and selling these mortgages to the public as investments with their guaranty of the payment of principal and interest. The latest available reports show that such companies incorporated (under the insurance law) in the state of New York had outstanding guaranteed mortgages of about two and one-half billion dollars, which indicates their import as a financial factor.

The accounting problems involved are of interest because of the large sums invested in mortgages by the public and the large contingent liability of the guaranty companies to investors for the payment of principal and interest.

This article presents a system of accounts designed to meet the accounting problems of these companies. It includes a method of calculating interest which may also be used by companies having considerable investments in bonds as well as in mortgages. Experience has proved it accurate. Moreover, it spreads the clerical work throughout the period and facilitates the preparation of reports, which can in some instances be submitted to the executives as early as the first of each month.

Partly in order that the background may be complete and partly because the business transactions of the company are reflected in the accounting records, a brief outline of the operations of a mortgage guaranty company is necessary.

Usually each lending institution has its own definite policy with regard to the type, character and location of buildings upon which it will make loans. For example, some will not consider loans on special types of buildings, such as garages, theatres, churches, etc., or those leased to one tenant only. Objection to making such loans is well founded, for in the event of a default in interest, taxes or amortization and the necessity of foreclosure proceedings to obtain title to the property, the company should not be burdened with a building useful only to some specialized business. Similarly some companies will not make building loans, for in the event of foreclosure they might be obliged not only to take over the property but also to advance additional funds for its completion.

In determining the amount to be lent, certain limitations imposed by law or by the company's own policy need to be considered. For instance in New York, loans made by mortgage guaranty companies must not exceed two-thirds of the appraised value of the property. A company may follow a more conservative policy whereby it voluntarily reduces such percentage. While many factors enter into the determination of appraised values, it might be stated that present conditions have emphasized the advisability of considering the net income available for amortization, interest and other charges.

RECEIVABLE RECORDS

Promptly upon the closing of a loan, the loan receivable, property and maturity cards are prepared from the original papers, and the loan is listed on the proper block card.

The loan receivable card (form I) is a complete record of the mortgage receivable, showing at all times the balance due on account of principal and unpaid interest. It gives the loan number, the name and address of the owner and the borrower, the property on which the loan has been made, appraised value and date of the appraisal, date of the mortgage, maturity date, amortization requirements, interest rate and dates, insurance coverage and the amount lent. The last is posted from the cash disbursements book; the other data are posted from the original papers. As is true of other forms mentioned here, the receivable card will differ in some details among various companies, but the items mentioned are essential. This card relates solely to the borrower and gives no data regarding the sale of the mortgage to the investor.

Inasmuch as a number of important original papers, such as bonds, mortgages and assignments, pass through the company's office, it has been found wise either to keep a record book in which to enter their receipt and ultimate disposition or to make such entries upon the reverse side of the loan-receivable card.

The cards are controlled by the mortgages-receivable account in the general ledger, with which they should be in balance.

Prior to the date when interest (and instalments, if any) are due, the amounts then receivable are entered on the loan-receivable cards in the amount column, and notice is sent to the borrower. As the money is received by the company, it is posted from the cash-receipts book to the "received" section of the instalment and interest columns on the card.

The loan-receivable card is filed numerically by interest dates. In order that it may be readily found, a record known as the card index is kept. This is a list of loan numbers arranged in numerical order, with six columns to the right, each column being used for two months, as, for example, January and July. When a loan is closed, the number of it is entered in the column for the months in which interest is due.

The property card gives the address of the premises upon which the loan has been made, the loan number and interest dates. It is used as a cross index enabling one when the address of the property is known, to trace the loan card which, as stated in the preceding paragraph, has been filed numerically by interest dates.

The management must know the volume of mortgage loans that mature each month. This information is obtained from the maturity cards, which are made out, as stated above, when the property cards are prepared. They give the number of the loan, the maturity date and the balance due at maturity. The cards are filed according to maturity dates.

PAYABLE RECORDS

When a mortgage loan is sold, an assignment and guaranty policy are made out and delivered to the investor, together with the original bond, mortgage, appraisal, etc.

The loan-payable card (form II) is prepared from the policy. It gives the name and address of the investor and data relating to the mortgage, such as the loan number, premises, maturity date, amortizations, interest rates, when payable, and the date from which the investor receives interest. It is used by the accounting department, and is filed numerically by interest dates.

The loan-payable card gives a complete record of the account with the investor. When a loan is sold by the mortgage company, the amount is posted from the cash-receipts book to the principal column on the loan-payable card. As interest, amortizations and eventually principal payments are made to the investor, they are posted from the cash disbursements book to the interest and instalment columns on the card.

In addition to selling individual mortgages to one party, loans may be set aside and sold as mortgage certificates representing fractional parts of mortgages. Another common practice is that of pooling a group of mortgages and issuing certificates against the group, rather than against the individual mortgages. When certificates are issued, the assignment, appraisal, bond and mortgage may be delivered to a trustee and authenticated certificates may be issued. The latter may also be registered.

A certificate card is prepared for each certificate sold. This card is similar to the one used for a loan payable except that the certificate number is also shown. The instalment column would rarely be used, for a separate certificate or certificates would usually be sold for each instalment.

The loan payable and certificate cards may be used for preparing the cheques sent to investors.

Payments to investors may also be made by using remittance cards. Under this plan, two types of cards are used, one for investors holding full mortgages and another for those holding certificates.

The first type is similar to the loan-payable card and gives the information necessary to draw the cheque and to advise the investor what it is for, such as premises, amount of loan, interest, amortizations, etc. Only one mortgage is entered on each card.

The second type is a separate card for each investor owning certificates, one card being used for January and July items, another for February and August, etc. On it are listed the certificates, giving the principal sum of each and the amount of interest payable. A cheque is drawn for the total of the latter.

Interest cheques are usually mailed by the company on the last day of the month, so that they may reach the investor promptly on the first. A remittance notice is enclosed with each cheque, showing the items in detail.

Cheques may be made out either by means of stencils or typed in duplicate sets, the duplicate serving as the cash disbursement record. One cheque may be drawn for the total amount of such disbursements and deposited in a special bank account. This is drawn upon for the disbursements described above, which are made the following day. It acts in a sense as an imprest fund having no balance except outstanding cheques.

GENERAL BOOKS AND ACCOUNTS

The accounting matters discussed in this article are chiefly those relating to the various mortgage and interest accounts; the others present no unusual features. The profit-and-loss statement and balance-sheet may readily be prepared from the accounts listed below. With regard to the balance-sheet, it might be noted that the outstanding mortgages upon which the company has guaranteed the payment of principal and interest may be shown as a direct liability, offset by the contra item, "mortgages receivable" of an equal amount. It would, however, seem preferable to show this as a foot-note, as "guaranteed mortgages outstanding $........," for the company's liability is contingent and not direct.

The books of account are the cashbooks, journal, interest-calculations book and general ledger.

The following list gives the columns of a typical cash-receipts book:

Total cash and/or bank columns
Interest due and receivable
Interest received in advance
Interest on satisfactions
Extra interest
Mortgages
Guaranteed mortgages
Guaranteed certificates
Instalments due and receivable
Real-estate income
Other columns and miscellaneous

The columns which are used in the cash disbursements book are as follows:

Total cash and/or bank columns
Interest on guaranteed mortgages and certificates
Mortgages
Guaranteed mortgages
Guaranteed certificates
Real-estate expense
General expense
Other columns and miscellaneous

Vouchers should be used to support all disbursements, either for current expenses or for the purchase of mortgages. In the latter event, the voucher should give the name of the borrower, description of the property, amount of loan, interest rate, dates, etc.

The following is a typical chart of accounts:

Assets

Accrued interest receivable control *
Cash on deposit
Certificates of deposit
Furniture and fixtures
Instalments receivable
Insurance premiums advanced
Interest due and receivable
Investments
Mortgages receivable
Office building and real estate
Other real estate
Petty-cash fund
Taxes advanced

Liabilities

Accrued interest payable control *
Accrued interest receivable paid in advance
Capital
Capital surplus
Deposit account fire losses
Deposit account sales
Dividends payable
Guaranteed mortgages
Guaranteed certificates
Notes payable
Premiums received in advance
Reserve for depreciation—furniture and fixtures
Reserve for depreciation—office building
Reserve for taxes
Surplus
Suspense
Undivided profits

Income

Appraisal and inspection fees
Commissions
Dividends received
Extension fees
Interest earned on mortgages
Interest on bank balances
Interest on certificates of deposit
Interest on investments
Interest on government bonds
Extra interest
Premium income
Real-estate income

Expenses

Advertising
Commissions
Depreciation—furniture and fixtures
Depreciation—office building
Donations
Fees to committee and directors
General expense (analyze)
Interest expense on guaranteed mortgages and certificates
Interest expense on deposit account sales
Office building expense (analyze)
Postage, printing and stationery
Real-estate expense
Salaries—officers
Salaries—clerical
Taxes

It should be pointed out that all entries relating to mortgages should show the interest rate and dates (as January and July, February and August, etc.). Entries relating to mortgages and certificates sold should give both interest receivable and payable rates (as 6 at 5½%). It is also necessary to show interest dates

* These accounts are analyzed according to the months in which interest is receivable or payable. See under interest calculations.

on all entries for interest received in advance, on satisfactions and on redemptions.

INTEREST CALCULATIONS

The interest calculations book is a most important record.

The largest items of income and expense are interest income (including premiums) on mortgages receivable and interest expense on guaranteed mortgages and certificates. In order accurately to determine the profit or loss for each fiscal period, interest must be accrued as of the closing date.

To calculate the accrued interest on each mortgage and certificate would require considerable time. This task, however, may be reduced by grouping the mortgages according to interest rates and dates, and calculating the accrued interest on the principal amount of each group, allowing for loans outstanding for less than the full six months' period.

An extension of this plan of calculation by groups permits the interest income, expense and accruals to be readily determined each month. It requires slightly more work from day to day, but less at the end of the month and fiscal period, and, as previously suggested, it permits the presentation of a balance-sheet and profit-and-loss statement to the executives of the company promptly after the end of the month.

To instal this system, the mortgages receivable at the beginning of the period should first be divided into seven sections, six being according to the months in which interest becomes due semi-annually upon the first day, (as January and July, February and August, etc.) and the seventh, a miscellaneous section. This latter would include loans upon which interest is due either quarterly or upon dates other than the first of the month. Each section should then be further divided according to interest rates (6%, 5½%, etc.).

These sections are subsidiary to the mortgages receivable account in the general ledger, with which they should be in balance.

The interest-calculations book is used to determine interest income and expense. It is composed of two types of sheets, change sheets and summary sheets. The former are working sheets recording the day's changes in the principal sums; the latter show the balances of principal in each group at the end of the day. A specimen summary sheet for mortgages and certificates sold is given as form III.

Cash disbursements of the first day of the month for loans closed are posted from the cash-disbursements book to the change sheets. They are entered there as "additions" under groups according to interest rate and the month in which interest is receivable. Cash received in satisfaction of mortgages is posted from the cashbook to the change sheet each day. The amount is entered there as "deductions" from mortgages receivable under the appropriate month and rate grouping. Journal entries affecting the mortgages-receivable account are similarly posted to these sheets. The total daily additions are added to and the deductions are subtracted from the previous balances. The new balances thus obtained represent the mortgages receivable as of the close of business on the first of the month, and as such they are entered on the summary sheet of the interest-calculations book.

The transactions relating to mortgages receivable should be similarly treated all through the month. If for any day there are no changes, the balance of the preceding day should be carried down.

At the end of the month, the columns of the various groups are added and the total of each column is, in the case of a thirty-day month, divided by thirty. The amounts thus obtained are the average daily balances of mortgages receivable upon which interest has been earned. Interest earned is calculated upon such average daily balances at the rate shown by the columnar headings and is recorded by the following journal entry:

Accrued interest receivable (control) . . .		xxxx	
January and July	xx		
February and August	xx		
March and September	xx		
April and October	xx		
May and November	xx		
June and December	xx		
Miscellaneous	xx		
To interest earned on mortgages			xxxx
To record the interest earned on mortgages for the month.			

In the case of a twenty-eight or twenty-nine day month, the totals for the last day should again be entered either twice or once more to make a month of thirty days. On a thirty-one day month the changes of the thirty-first day should be entered as of the thirtieth, thus continuing the same thirty-day month basis. Some companies neither collect nor pay interest on loans closed or sold upon the thirty-first day of the month. In that event such principal amounts should be entered on the change sheets and the balances on the summary sheets should be adjusted after the interest has been calculated, thus keeping the principal sums in agreement with the general ledger accounts. The specimen summary sheet presented (form III), for mortgages and certificates sold, has been prepared upon that basis.

The mortgages and certificates sold should be similarly divided into seven sections according to interest dates (including miscellaneous) and, in order to determine premium income, also subdivided according to the interest rates receivable and payable, as January and July, 6 at 5½%, 5½ at 5½%, 5½ at 5%, etc. The first rate denotes the interest receivable; the second the interest payable. As with the mortgages receivable, all entries affecting mortgages and certificates sold should be posted to the change sheets and each day's closing balances to the monthly summary.

The monthly and miscellaneous sections are subsidiary to the guaranteed mortgages and certificates accounts, with which they should be in agreement.

The average daily balances for the month are determined and the interest expense calculated for each section in the same manner as for the mortgages receivable. Interest expense is recorded by the following journal entry:

Interest expense on guaranteed mortgages and certificates		xxxx	
To accrued interest payable (control)			xxxx
January and July	xx		
February and August	xx		
March and September	xx		
April and October	xx		
May and November	xx		
June and December	xx		
Miscellaneous	xx		
To record the interest expense for the month on mortgages and certificates sold.			

Corrections and the so-called extra day's interest, for the thirty-first day of the month, should be entered in the adjustment columns with an adequate explanation of the entry.

A trial balance should be taken of each section of the receivable, payable and certificate cards twice a year, as of the interest dates, in order to prove that the principal sums are in agreement with the interest-calculations book.

The company usually retains a premium of one-half of one per cent. per annum of the interest on the principal sum as it is collected. The earned premiums are calculated by taking one-eleventh of the interest expense on loans sold at five and one-half per cent. and one-tenth on those sold at five per cent., excluding however, the interest expense on loans upon which there are no premiums.

In New York the franchise tax of a corporation organized under the insurance law is one per cent. of the premium income. If organized under the banking law, the tax is four and one-half per cent. of net income or a minimum tax of one mill on each dollar of capital stock issued.

It is not necessary for a company under the supervision of the banking department to determine premium income. Therefore, when preparing interest records for such a company, the mortgages and certificates sold need not be subdivided to show both interest receivable and payable rates, as 6 at 5½% and 5½ at 5½%; one group for the 5½% payables is sufficient.

A journal entry should be made on the first of each month charging interest due and receivable and crediting accrued-interest-receivable accounts with the interest receivable on, for example, January (and July) mortgages, as shown by the loan-receivable cards. This amount should balance the accrued interest in the January and July section of the accrued interest receivable account.

Similarly, the cheques drawn in payment of interest due to investors on January first should be for the amount which the accrued interest-payable account actually shows to be due and payable on that date.

An automatic check on the accuracy of the accruals is thus obtained by dividing the accrued interest, both receivable and payable, according to months. In addition, errors are localized, and the total amount of the interest cheques drawn to investors is verified before they are mailed.

MORTGAGE ANALYSIS BOOK

For sales and statistical purposes, as well as for general office use, a mortgage analysis book should be kept, dividing the mortgages-receivable account in the general ledger into the following groups:

Mortgages on hand (unsold)
Guaranteed mortgages (sold)
Certificates on hand (unsold)
Guaranteed certificates (sold)
Extensions
Other loans

This book may be used for various purposes, and it should be prepared with thought of the needs of the company under consideration. For example, it may be used by the sales department as a reference giving the mortgages and certificates available for sale. It may also be used for statistical purposes in determining the total mortgages that have been sold and redeemed during the company's existence.

A statement should be prepared either daily or weekly showing the cash position of the company, its commitments, mortgages and certificates sold and unsold, etc. The latter information is obtained from the mortgage analysis book. The total commitments are taken from the loan application records.

IN GENERAL

In order to prevent an undue concentration of risk in any locality, a company, before making a loan, may also consider the amount which it already has outstanding in the block or neighborhood for which the new application has been made. To obtain this information a "block card" file is kept, with a separate card for each street or block. On the appropriate cards are shown all outstanding mortgages for the territory, and reference should be made to these cards when considering applications for new loans.

A mortgage guaranty company should take adequate precautions that the properties upon which it has lent its funds are sufficiently insured and that all taxes are paid. Therefore, it is customary to require that the company hold the insurance policies and that any loss shall be payable to the mortgagee or guarantor as its interest may appear. It is also often required that the policy be stamped "paid," in order to eliminate cancellations and the receipt of unauthorized policies.

Should the borrower fail to cover the property with adequate insurance, the company places the insurance for its own protection either with an independent broker or with an insurance agency which it controls. In any event, the premiums are charged to the borrower.

Since real-estate taxes and assessments are liens having priority over mortgages, the borrower should be required periodically to submit his receipt in evidence of the payment of these items. This may be handled either through the accounting department or through a separate department.

If principal or amortizations, interest, taxes, etc. are not paid by the borrower, a company may foreclose in order to protect its investment. These proceedings may be instituted either directly or through a subsidiary company. However, they offer no accounting difficulties.

The system described has been in effective use for companies having outstanding guaranteed mortgages of over thirty million dollars. For companies of this size there is little advantage in the use of mechanical accounting equipment. For larger companies the adoption of machine accounting would be beneficial, but it would not change the general scope of the accounting methods.

LOAN RECEIVABLE CARD (FORM I)

January July

Owner Jones Real Estate Co., Inc. No. 22,579

1098 Seeley Avenue, New York City

Bond of Jones Real Estate Co., Inc.

Premises 1527 Rutherford Place, New York City

Sec. 6 Bl. 1753 Lot 53

Dated July 29, 1930 Interest from July 29, 1930

Due $600.00 Jan. and July 1, 1931, 1932, 1933, 1934, Jan. 1, 1935 and balance July 29, 1935

Mtge. rate 6%

Payable Jan. and July 1 Appraisal A.B.C. 7/2/30 $100,000 (30,000)

Insurance 60 M

			Instalment			Interest		
		Principal	Amount	Received		Amount	Received	
Date				Amount	Date		Amount	Date
1930	CD							
July 29	127	60,000.00						
1931								
Jan. 1			600.00	600.00	1/2/31	1,520.00	1,520.00	1/2/31
July 1			600.00	600.00	7/9/31	1,782.00	1,782.00	7/9/31

LOAN PAYABLE CARD (FORM II)

January July

Assigned to John Smith No. 22,579

17 Seton Street, New York City

Premises 1527 Rutherford Place, New York City

Due $600.00 Jan. and July 1, 1931, 1932, 1933, 1934, Jan. 1, 1935 and balance July 29, 1935

Guar. rate 5½% Mtge. rate 6%

Payable Jan. and July 1 Interest from August 17, 1930

			Instalment		Interest	
Date						
1930	Remarks	Principal	Amount	Paid	Amount	Paid
Aug. 17	C R 160	60,000.00				
1931						
Jan. 1	C D 217		600.00	1/1/31	1,228.33	1/1/31
July 1	C D 295		600.00	7/1/31	1,633.50	7/1/31

MORTGAGES AND CERTIFICATES SOLD, JANUARY AND JULY

Date	6 @ 6%	6 @ 5½%	5½ @ 5½%	5½ @ 5%
Opening balance	$329,050.00	$2,679,670.00	$96,550.00	$2,294,515.00
1931				
Jan. 1	$315,800.00	$2,596,475.00	$79,050.00	$2,247,065.00
2	315,800.00	2,604,675.00	79,050.00	2,247,065.00
3	315,800.00	2,610,675.00	79,050.00	2,249,315.00
4	315,800.00	2,610,675.00	79,050.00	2,254,415.00
5	315,800.00	2,612,475.00	79,050.00	2,253,115.00
6	315,800.00	2,612,475.00	79,050.00	2,253,115.00
7	315,800.00	2,612,475.00	79,050.00	2,258,015.00
8	320,800.00	2,617,475.00	79,050.00	2,264,015.00
9	320,800.00	2,631,975.00	79,050.00	2,264,015.00
10	320,800.00	2,635,475.00	79,050.00	2,264,015.00
11	320,800.00	2,635,475.00	79,050.00	2,267,915.00
12	320,800.00	2,637,875.00	79,050.00	2,269,215.00
13	320,800.00	2,639,875.00	79,050.00	2,291,215.00
14	320,800.00	2,655,975.00	79,050.00	2,294,165.00
15	320,800.00	2,655,975.00	74,050.00	2,315,165.00
16	320,800.00	2,655,975.00	74,050.00	2,300,165.00
17	320,800.00	2,658,475.00	74,050.00	2,300,165.00
18	320,800.00	2,658,475.00	74,050.00	2,275,515.00
19	320,800.00	2,659,975.00	74,050.00	2,278,865.00
20	300,800.00	2,656,475.00	74,050.00	2,279,965.00
21	300,800.00	2,656,475.00	74,050.00	2,279,965.00
22	286,800.00	2,651,075.00	74,050.00	2,280,465.00
23	286,800.00	2,651,075.00	74,050.00	2,280,465.00
24	286,800.00	2,678,975.00	74,050.00	2,286,965.00
25	286,800.00	2,678,975.00	74,050.00	2,286,765.00
26	286,800.00	2,685,225.00	74,050.00	2,287,215.00
27	286,800.00	2,694,725.00	74,050.00	2,289,815.00
28	286,800.00	2,688,225.00	74,050.00	2,292,015.00
29	286,800.00	2,700,725.00	74,050.00	2,294,915.00
30	286,800.00	2,704,225.00	74,050.00	2,299,465.00
	$9,243,000.00	$79,449,100.00	$2,291,500.00	$68,304,550.00
Daily average	308,100.00	2,648,303.33	76,383.33	2,276,818.33
Interest	1,540.50	12,138.06	350.09	9,486.74
Adjustments				.83
Total interest expense	$1,540.50	$12,138.06	$350.09	$9,487.57
Premiums	None	$1,103.46	None	$948.76
Closing balance, 31st	$286,800.00	2,721,725.00	$74,050.00	2,300,565.00

Monthly Summary Sheet (Form III)

Space limitations require that there shall be shown here, the following columns which in actual practice would be shown to the right of the "5½ at 5%" column.

ADJUSTMENTS

Description	6 @ 6%	6 @ 5½%	5½ @ 5½%	5½ @ 5%
Balance of 1/18 understated by $1,000 error corrected 1/24–6 days interest				83¢