Questions and Answers on Real Estate Lending Standards (RELS) Regulation and Guidelines

1. Are pre-March 19, 1993 loans included in the calculation of the 30% and 100% limits on "loans in excess of the supervisory Loan-to-Value (LTV) ratio limits?"

   ANSWER: No. All pre-March 19, 1993 loans are grandfathered, though we still retain supervisory authority to stop inappropriate or unsafe and unsound lending practices.

2. a. What is the private mortgage insurance (PMI) requirement for home mortgage loans?

   ANSWER: The requirement is that home mortgage loans of 90% LTV ratio or greater have "appropriate" PMI or readily marketable collateral. There is no requirement to have PMI coverage that would bring the effective LTV ratio down to 80%. Of course, the risk-based capital rule gives favorable treatment to 80% or less LTV ratio home loans. If an association made a 95% loan and required PMI only down to 90%, it would not be placed in the 50% risk-weight category.

   b. Can a thrift originate 100% LTV ratio loans without PMI?

   ANSWER: A thrift can originate 100% LTV ratio home mortgage loans without PMI, though they would be included in the 100% "Loans in excess of the supervisory LTV limits" loan category. While regulators would not take exception to a moderate amount of such loans, the institution may be criticized if the loans were underwritten in a manner that would make them unsafe and unsound.

3. What is the loan category for a loan to a borrower to purchase a developed residential lot where the roads and sewers, etc., are in place, but there are no immediate plans to build a home?

   ANSWER: The loan should be treated as a land development loan. Although the purpose of the loan is not to develop the lots, the end product is the same. Note that when the agencies established 75% as the maximum supervisory LTV ratio limit for land development loans, we did not expect all of an institution's loans in this category to be 75%. Those loans with higher risk would be expected to be made at lower LTV ratios, and those with a lower level of risk, such as loans to purchase finished lots, could be made at the maximum LTV ratio.

4. Do deposits in excess of $100,000 count as "financial instruments" for "readily marketable collateral?"

   ANSWER: Yes.

5. How would the maximum supervisory LTV ratio limit be calculated for loans fully cross-collateralized by two or more properties or secured by a collateral pool of two or more properties?

   ANSWER: For cross-collateralized loans, the maximum loan that could be made within the supervisory LTV ratio limits would be based on the following formula: [(Value of each property X appropriate maximum LTV ratio) - senior liens].

6. What is the loan category of a loan to construct a single-family home, where the borrower has a take-out commitment (made by either the same lender or a different lender) for permanent financing when completed?

   ANSWER: A construction-permanent loan secured by a single-family residence to the owner-occupant will be treated as a permanent mortgage loan for purposes of categorizing the loan in the supervisory LTV ratio limits, i.e., there is no maximum supervisory LTV ratio limit, but if the LTV ratio equals or exceeds 90%, the loan should have credit enhancement in the form of PMI or readily marketable collateral.

   A construction loan by one lender with the permanent take-out by a second lender will be treated as a one- to four-family construction loan (with an 85% supervisory LTV ratio limit) until construction is complete and the loan is refinanced by the permanent lender. If the second, permanent lender is a closely held affiliate of the construction lender, then the loan can be treated as a permanent loan.

7. Are unsecured loans (with loan proceeds used to purchase real estate) subject to the rule?

   ANSWER: No, but the loan should be underwritten to much tighter standards than secured loans because the willingness and ability of the borrower to repay the loan would be the only source of repayment. In essence, such loans should be made at similar rates and terms as other unsecured loans made by the institution.

8. Are loans underwritten as “unsecured” loans where the lender takes a security interest in real estate at borrower’s request (i.e., for tax purposes) subject to the RELS rule?

   ANSWER: No, provided that the real estate collateral was truly taken as an abundance of caution and the underwriting criteria and loan terms were more indicative of an unsecured loan.

9. How should institutions categorize, for supervisory LTV ratio limit purposes, second mortgage loans that are not principal residences?

   ANSWER: Unless such residences meet the Internal Revenue Service (IRS) test of residency, the loans are considered improved property loans (85% LTV ratio limit) since they are not owner-occupied one- to four-family residences. (The definition of owner-occupied requires that the home be the borrower’s principal residence.) If the loan is made with an LTV ratio higher than 85%, it would be placed in the larger 100% of capital “bucket” (which does not have a principal residence requirement).

   Loans that meet the IRS test of residency are treated as owner occupied one- to four-family residences.

10. How should loans under the FHA Title I program be treated?

    ANSWER: Similar to OTS’s capital rule treatment of such loans, FHA Title I program loans are not considered guaranteed loans, so if the loans are made with LTV ratios of 90% or higher without PMI, they would go in the loans in excess of the supervisory limits “bucket.”

11. Does readily marketable collateral include cash surrender value of life insurance?

ANSWER: Yes, however, the following conditions should be met: (1) the institution must hold the insurance policy and a legally binding hypothication agreement with the policy owner; (2) the institution must have a written statement from the insurance company that it will honor the hypothication agreement; and (3) the institution can only count the "net realizable" value of the policy (i.e., the cash surrender value less any required IRS or local tax withholdings).

12. Does the RELS rule cover mobile homes?

    ANSWER: The rule applies to real estate loans. Loans secured by "manufactured homes" that are affixed to real property are real estate loans and the RELS rule applies to them. For manufactured home loans, the current § 545.45 applies. Manufactured homes are different than "mobile home" loans in that they are built to the "HUD-code."

    Other "similar" personal property - mobile homes, RVs, etc. - are chattel and are not considered home loans under our rules. A loan secured by only a mobile home is a consumer loan and the RELS rule would not apply. If the loan is secured by a mobile home and a lot, the security property would be categorized as chattel and land (either raw land or a developed lot) and the lot loan would be subject to the RELS rule unless the real estate collateral was taken only as an abundance of caution.

13. How should loans guaranteed by either the federal government or state governments be treated for purposes of the Supervisory LTV ratio limit if the guarantee is less than the loan amount?

    ANSWER: All loans guaranteed by the U.S. Government or its agencies and all loans backed by the full faith and credit of a state government are excluded from the supervisory LTV ratio limit guidelines. Consequently, such guaranteed loans should not be categorized as "loans in excess of the supervisory LTV ratio limit." As with all assets, however, if an institution has significant risk exposure on a guaranteed loan, an examiner may criticize and, if appropriate, adversely classify the asset.

14. Do we include nonowner occupied one- to four-family loans in the 100% of capital exception bucket?

    ANSWER: Yes. Nonowner occupied one- to four-family loans are subject to the 85% LTV ratio for improved property loans and such loans with LTV ratio greater than 85% are placed in the 100% exception bucket.

15. Are loans in excess of the supervisory limit secured by developed lots for one- to four-family residential homes placed in the 100% of capital exception bucket?

    ANSWER: Yes. All loans related to one- to four-family residential properties go into the 100% exception bucket. For developed lots, the lots should be in a one- to four-family residential subdivision and properly zoned to be treated as one- to four-family residential properties.

16. What is the treatment of home improvement loans?

    ANSWER: Home improvement loans are treated like permanent mortgages, not construction loans.

17. If an institution has a firm take-out commitment on a construction loan, can it be treated as an excluded transaction under the fourth exclusion (loans to be sold)?

    ANSWER: No.

18. How do you determine the supervisory LTV ratio limits for multistage projects?

    ANSWER: The LTV ratio for multistage projects is ultimately limited by the LTV ratio applicable to the final stage of the loan. Institutions should establish, as part of their loan administration policies, procedures on loan disbursements. In general, prudent loan disbursement means that funding of the initial acquisition of raw land should not exceed 65% of the cost of the land and funding the development stage should not exceed 75% of the costs of development, etc.

19. For “value,” should institutions use retail value or discounted value?

    ANSWER: Thrifts should use appraised value as determined in accordance with 12 CFR Part 564. The guidelines reference our appraisal rule, which should be used for the term “value.” For projects where individual units will be sold over a multi-year period, yet funds will largely be disbursed at the beginning of that period, the appraised value should reflect the discounted net cash flows of the project, not the gross retail value of all the units.

20. For cross-collateralized loans, we calculate the maximum LTV ratio based on a weighted-average method. If the one loan in the pool is over the LTV ratio limits, what goes into the high LTV ratio “bucket?”

    ANSWER: If the weighted-average LTV ratio of the pool is over the maximum supervisory LTV ratio, the whole pool goes into the bucket. If the weighted-average LTV ratio is less than the supervisory maximum, nothing goes into the bucket, even if one loan is above the maximum supervisory LTV ratio. This is in recognition that with cross-collateralization, the institution has “excess LTV ratio cushion” in one loan to “cover” another loan’s lack of LTV ratio cushion. Conversely, if all the excess cushion is used, then the whole pool presents a higher degree of risk. This will give institutions an incentive to structure pools to exclude any loans that might cause the pool to be put in the bucket, but that is acceptable. We can review any individual loan for safety and soundness, and institutions should only be making prudent loans.