



Handbooks: Thrift Activities  
Subject: Asset Quality, Lending

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## Classifying Commercial and Other Loans Under the Home Owners' Loan Act

**Summary:** Savings associations have significant flexibility in allocating their investments for purpose of determining compliance with the Home Owners' Loan Act (HOLA). The purpose of this bulletin is to remind savings associations of the flexibility that they have when making loans that are limited by the HOLA, such as commercial and consumer loans. This bulletin also discusses how such classifications affect other OTS regulatory classifications and requirements.

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#### Classifying Commercial and Other Loans Under the Home Owners' Loan Act.

**Background.** The HOLA provides federal savings associations with the authority to make various types of loans and investments and sets limits on those authorities. For example, federal savings associations may invest up to 20 percent of their assets in commercial loans, 400 percent of their capital in nonresidential real estate loans, 10 percent of their assets in leases secured by personal property, and 35 percent of their assets in consumer loans.<sup>1</sup> We have had several questions from institutions and examiners on exactly how flexible OTS will be in enforcing these statutory investment limitations. While there can be no debate on OTS's responsibility to enforce HOLA's investment limitations, we believe that, in passing various amendments to HOLA over the years, Congress has demonstrated its intent to provide thrifts with the flexibility to structure their portfolios in a way that will allow them to best serve their communities.

**HOLA Classifications.** OTS regulation 12 CFR 560.31 states that, "If a loan or other investment as authorized under more than one section of the HOLA, as amended, or this part, the federal savings association may designate under which section the loan or investment has been made. Such a loan or investment may be apportioned among appropriate categories, and may be moved, in whole or in part, from one category to another." This rule highlights the flexibility that savings associations have in satisfying the HOLA investment limitations.

It should be noted that each authority under HOLA is separate and distinct. Therefore, investments of the same type that are made under one HOLA authority do not have to be aggregated with such investments made under other HOLA authorities.

<sup>1</sup> See 12 CFR 560.30, "General lending and investment powers of federal savings associations," for a more complete listing.

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It is management's responsibility to appropriately classify loans to determine that the savings association's loans and investments are within HOLA's limitations. Examiners will then determine if the classification is appropriate given the regulatory and statutory requirements for such classification.

**Commercial lending.** Federal savings associations are authorized to invest up to 20 percent of their assets in commercial loans, provided that amounts in excess of 10 percent of total assets may be used only for small business loans. Savings associations may also invest up to 400 percent of their total capital in non-residential real estate loans, which, by definition, include commercial real estate loans. When a savings association makes a loan secured by commercial real estate, it may classify that loan as a commercial loan, as authorized under HOLA 5(c)(2)(A), or as a nonresidential real estate loan authorized under HOLA (5)(c)(B). The statutory requirement under the authority for a commercial loan is that the loan, whether secured or unsecured, be "for commercial, corporate, business, or agricultural purposes." Under the second authority, the only requirement is that the loan be "secured by a lien on nonresidential property." If a savings association makes a loan secured by commercial real estate, either of the statutory requirements would be met, so the institution could select under which authority it made the loan. Conversely, if a commercial loan is made without real estate collateral, it can only be classified as a commercial loan, unless it also meets the requirements of another HOLA category.

**Leases.** Under 12 CFR 560.41, federal savings associations are authorized to engage in leasing activities. The rule permits leasing two separate leasing activities, financing leases and general leases. Financing leases are the functional equivalent of loans and are authorized under a federal savings association's respective lending authorities under HOLA. For example, a federal savings association may make commercial and consumer leases, as it would make consumer and commercial loans. Such leases must be aggregated with the institution's commercial and consumer loans for purposes of determining compliance with HOLA's lending limits. General leases are allowed under a separate HOLA authority. A federal savings association may invest up to 10 percent of its assets in tangible personal property for purposes of rental or sale, including leasing. Leases made under this authority do not have to be the functional equivalent of loans and, since they are authorized under a separate authority, do not have to be aggregated with the institution's loans for purposes of HOLA's investment limits. For example, when an institution makes commercial leases on tangible commercial property, such leases do not have to be aggregated with its commercial loans. Similarly, when an institution makes consumer leases, under its general leasing authority, such leases do not have to be aggregated with its consumer loans. Since the only restriction for general leases is that they must be leases on personal property (in contrast to real property), an institution may structure a lease with similar terms as a full payout lease, and yet, still classify it as a general lease, which would not have to be aggregated with other similar loans.

**Loans to facilitate consumer lending.** Savings associations may also classify certain "commercial type" loans as consumer loans for purposes of HOLA's investment limitations if such loans are reasonably incidental to providing credit for personal family or household purposes. OTS has determined that floor-planning loans are reasonably incidental to providing credit for consumer loans when an institution grants floor plan loans to dealers to facilitate their consumer lending activities. Such floor plan loans may be classified as consumer loans for purposes of determining compliance with HOLA. Other commercial type loans may also be classified as consumer loans. For example, if a merchant obtains the line of credit from a savings association secured by the merchant's installment loans to its customers, the line of credit could be classified as a consumer loan for purposes of the HOLA investment limitations.

**Loans secured by real estate.** Questions have also been asked regarding whether an institution could classify a loan as a real estate loan if it were only partially secured by real estate. The answer to that depends on the level of security of the loan. 12 CFR 560.3 defines a real estate loan for purposes of HOLA investment classifications.

Therefore, to classify a loan as a real estate loan under the HOLA, the loan would have to meet that definition. Home equity loans may also be classified as real estate loans or consumer loans for HOLA purposes; however, such loans are real estate loans for purposes of meeting the requirements of 12 CFR 560.100-101, the Real Estate Lending Standards rule and appended interagency real estate lending guidelines.

**Underwriting.** Allowing a loan to be classified under various categories for purposes of the HOLA limitations does not reduce the institution's responsibility to underwrite the loan in a safe and sound manner and ensure proper portfolio diversification. The institution must also determine the borrower's ability and willingness to repay the loan, and consider the need for additional credit support such as collateral (with appraisals where required by 12 CFR 564).

**Questions and answers.** The following questions and answers address several related issues that arise when loans and investments may be assigned different categories for purposes of the HOLA investment limitations.

**Question:** When an institution classifies a loan for purposes of HOLA, must the classification carry through to other regulatory classifications?

**Answer:** No. Each regulation has its own requirements as to which loans are covered and what the consequences are. For example, if a savings association classifies a small business loan secured by real estate as a commercial real estate loan for HOLA investment limitation purposes, that would not preclude the institution from classifying it as a small business loan for QTL purposes, provided it meets both definitional requirements. Furthermore, accounting standards, Thrift Financial Report categorization, and expected underwriting standards do not necessarily have to be the determining factors for HOLA classification purposes.

**Question:** If a loan is secured by commercial real estate, but the institution elects to treat it as a commercial loan for purposes of the HOLA, does the loan have to have an appraisal?

**Answer:** Appraisals are governed by 12 CFR 564. Loans secured by real estate must have an appraisal or valuation, depending on the size of a loan and whether or not an exception under 564.3 applies. If an evaluation is required in lieu of an appraisal, the institution may use tax assessments or other valuations to support the property valuation.

**Question:** If a commercial loan is only 50 percent secured by real estate and it is categorized 50 percent as a nonresidential real estate loan and the other 50 percent as a secured commercial loan for purposes of HOLA's limitations, could the loan be split into a real estate secured part and non-real estate secured part for purposes of the Real Estate Lending Standards rule, 12 CFR 560.100-101?

**Answer:** Yes.



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