FEDERAL RESERVE BANK OF NEW YORK

[Circular No. **10619**
January 20, 1993]

UNIFORM REAL ESTATE LENDING STANDARDS

Effective March 19, 1993

To All State Member Banks, Bank Holding Companies, and Branches and Agencies of Foreign Banks in the Second Federal Reserve District, and Others Concerned:

Following is the text of a statement by the Board of Governors of the Federal Reserve System:

> The Federal Reserve Board has announced adoption of final amendments and guidelines to Regulation H (Membership of State Banking Institutions in the Federal Reserve System) to implement uniform real estate lending standards, as mandated by Section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).
>
> The amendments prescribe standards for extensions of credit secured by liens on real estate or made for the purpose of financing permanent improvements to real estate.
>
> The standards were developed in consultation with the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation.
>
> The uniform regulations become effective March 19, 1993.

Enclosed — for State member banks, bank holding companies, branches and agencies of foreign banks, and others who maintain sets of the Board's regulations — is an excerpt from the *Federal Register* of December 31, 1992 containing the official notice of this action by the Federal regulatory agencies, including the text of the amendments to the Board's Regulation H (12 CFR Part 208). Additional, single copies of the enclosure can be obtained at this Bank (33 Liberty Street) from the Issues Division on the first floor, or by calling our Circulars Division (Tel. No. 212-720-5215 or 5216).

Questions on this matter may be directed to Barbara A. Klein, Manager of our Domestic Banking Department (Tel. No. 212-720-8324).

E. GERALD CORRIGAN,
President.

federal register

Thursday
December 31, 1992

Part VI

Department of the Treasury

Office of the Comptroller of the Currency
12 CFR Part 34
Office of Thrift Supervision
12 CFR Parts 545 and 563
Federal Reserve System
12 CFR Part 208
Federal Deposit Insurance Corporation
12 CFR Part 365

Real Estate Lending Standards; Final Rule

[Enc. Cir. No. 10619]

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 34

[Docket No. 92-27]

FEDERAL RESERVE SYSTEM

12 CFR Part 208

[Regulation H; Docket No. R-0765]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 365

RIN 3064-AB05

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 545 and 563

[Docket No. 92-484]

RIN 1550-AA56

Real Estate Lending Standards

AGENCIES: Federal Deposit Insurance Corporation; Board of Governors of the Federal Reserve System; Office of the Comptroller of the Currency, Treasury; Office of Thrift Supervision, Treasury.

ACTION: Final rule.

SUMMARY: The Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (Board), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) (collectively, the agencies) have adopted a final uniform rule on real estate lending by insured depository institutions. The agencies are taking this action as required by section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991. The final rule prescribes real estate lending standards that require each insured depository institution to adopt and maintain comprehensive written real estate lending policies that are consistent with safe and sound banking practices. The policies must address certain lending considerations, including loan-to-value limits, loan administration procedures, portfolio diversification standards, and documentation, approval, and reporting requirements. The policies must also be appropriate to the size of the institution and the nature and scope of its operations, and must be reviewed and approved by the institution's board of directors at least annually. The policies adopted by the institution also should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies established by the agencies in conjunction with the final rule. The final rule is intended to establish real estate lending standards as required by Section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991.

EFFECTIVE DATE: March 19, 1993.

FOR FURTHER INFORMATION CONTACT: *FDIC:* Robert F. Miailovich, Associate Director, Division of Supervision, (202) 898-6918; Robert Walsh, Examination Specialist, Division of Supervision, (202) 898-6911; Garfield Gimber, Examination Specialist, Division of Supervision, (202) 898-6913; Martha L. Coulter, Counsel, Legal Division, (202) 898-7348, Federal Deposit Insurance Corporation, Washington, DC 20429.

Board: Roger T. Cole, Deputy Associate Director (202) 452-2618, Rhoger H. Pugh, Assistant Director (202) 728-5883, Todd A. Glissman, Supervisory Financial Analyst (202) 452-3953, Virginia M. Gibbs, Supervisory Financial Analyst (202) 452-2521, Alfred D. Teuscher, Supervsory Financial Analyst (202) 452-3007, Division of Banking Supervision and Regulation; or Scott G. Alvarez, Associate General Counsel (202) 452-3583, or Brian E.J. Lam, Attorney (202) 452-2067, Legal Division. Board of Governors of the Federal Reserve System, 20th Street and Constitution Ave., NW., Washington, DC 20551. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202) 452-3544.

OCC: Frank R. Carbone, National Bank Examiner, Office of the Chief National Bank Examiner, (202) 874-5170; William W. Templeton, Attorney, Bank Operations and Assets Division, (202) 874-4460; Mitchell Stengel, Financial Economist, Banking Research and Statistics, (202) 874-5240, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

OTS: John C. Price, Jr., Deputy Assistant Director for Policy, (202) 906-5745; Robert Fishman, Program Manager for Credit Risk, (202) 906-5672; William J. Magrini, Project Manager for Credit Policy, (202) 906-5744, Supervision Policy; Deborah Dakin, Assistant Chief Counsel, (202) 906-6445, Ellen J. Sazzman, Counsel (Banking and Finance), (202) 906-7133, and Valerie J. Lithotomos, Counsel (Banking and Finance), (202) 906-6439, Regulations and Legislation Division, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

A. Background

Section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA),[1] enacted December 19, 1991, requires each federal banking agency to adopt uniform regulations prescribing standards for extensions of credit secured by liens on or interests in real estate or made for the purpose of financing the construction of a building or other improvements to real estate, regardless of whether a lien has been taken on the property. In establishing these standards, the agency are to consider: (a) The risk posed to the deposit insurance funds by such extensions of credit; (b) the need for safe and sound operation of insured depository institutions; and (c) the availability of credit. These regulations are to become effective within 15 months following the enactment of FDICIA.

The legislative history of section 304 indicates that Congress wanted to curtail abusive real estate lending practices in order to reduce risk to the deposit insurance funds and enhance the safety and soundness of insured depository institutions. Congress considered placing explicit real estate lending restrictions in the form of loan-to-value (LTV ratio limitations directly into the statute. Earlier versions of the legislation included specific LTV limits. Ultimately, however, Section 304 was enacted without LTV limits, or any other specific lending standards. Instead, Congress mandated that the federal banking agencies adopt uniform regulations establishing real estate lending standards without specifying what these standards should entail.

On July 16, 1992, the agencies' joint notice of proposed rulemaking (Joint Proposal) was published in the **Federal Register**, 57 FR 31594. The Joint Proposal requested public comment for a 45-day period, which ended on August 31, 1992.

On August 17, 1992, a supplement to the Joint Proposal was published by the OCC and the OTS in the **Federal Register**, 57 FR 36911. The supplementary analysis provided, for public comment, a description of the estimated costs and benefits that were likely to accrue as a result of implementing the Joint Proposal.

B. The Joint Proposal: Two Alternatives

The Joint Proposal took the form of two alternative regulations, both of which would establish an LTV framework for real estate lending. Under the first alternative (Alternative 1), each

[1] Pub. L. No. 102-242, 105 Stat. 2236, 2354 (1991); 12 U.S.C. 1828(o); 12 U.S.C. 371(a).

insured depository institution would be required to establish prudent lending standards, including internal LTV limits, for specific categories of real estate loans. The LTV limits would be set by the institutions within or below the following ranges of maximum ratios:

Category of real estate loan	Range of maximum permissible LTV ratios (percent)
Raw land	50 to 65
Pre-construction development	55 to 70
Construction and land development	65 to 80
Improved Property[1]	65 to 80
Owner-occupied 1- to 4-family residential property	[2]80 to 95
Home equity	[2]80 to 95

[1] Improved property loans include extensions of credit secured by one of the following types of real property: (a) farmland committed to ongoing agricultural production; (b) non-owner-occupied 1- to 4-family residential property; (c) multi-family residential property; (d) completed commercial property; or (e) other income-producing property that has been completed and is available for occupancy and use.
[2] Any portion of a loan exceeding 85 percent LTV must be covered by private mortgage insurance.

The Joint Proposal indicated that the lower end of each range would be viewed by the agencies as a benchmark, but that each institution would be permitted to establish a higher ratio within the range based on appropriate factors. Institutions would be expected to specify criteria that would be used to qualify loans up to their internal LTV limits, taking into consideration individual lending factors such as the financial strength of the borrower, debt coverage ratios, credit enhancements, and "take-out" commitments. 57 FR 31596. Each institution would be expected to document fully its real estate lending standards in written policies approved by the institution's board of directors and subject to examiner review.

Under the second alternative (Alternative 2), the following uniform maximum LTV ratios for specific categories of real estate loans would be established by the agencies and imposed on all institutions:

Category of real estate loan	Maximum LTV ratio (percent)
Raw land	60
Pre-construction development	65
Construction and land development	[1]75
Improved property	[2]75
Owner-occupied 1- to 4-family residential property	[3]95
Home equity	[3]95

[1] Only if certain conditions are met, otherwise 65 percent.
[2] Only if the credit amortizes, otherwise 65 percent.
[3] Only with private mortgage insurance, otherwise 80 percent.

For both proposed alternatives, institutions would be expected to base real estate loans on proper loan documentation and a recent appraisal or evaluation of the real property underlying the loan, in conformance with the agencies' respective appraisal regulations and guidance. The LTV ratio would be defined by taking the total amount of credit to be extended and dividing that amount by the appraised value or evaluation of the property, as appropriate, at the time the credit is originated. The total amount of credit being extended would be combined with the amount of all senior liens when calculating the ratio.

In the Joint Proposal, the agencies requested comment on a number of issues, including whether the implementation of LTV limits would be an appropriate response to the Congressional directive to set real estate lending standards; whether the proposed LTV categories and ratios would be appropriate; whether the proposed nonconforming loan exemption would be adequate; whether additional loan categories or exceptions for specific lending arrangements were needed; whether the proposed exclusions from the LTV limits would be adequate; whether the proposed lending limits would provide sufficient flexibility to meet credit demands and not restrict the lending programs established by institutions to fulfill their obligations under the Community Reinvestment Act, 12 U.S.C. 2901 *et seq.*; and whether institutions that qualify as "well capitalized" for purposes of Prompt Corrective Action under Section 38 of the Federal Deposit Insurance Act, 12 U.S.C. 1831o, should be given additional flexibility under the proposed standards.

C. Summary of Comments Received

1. Comments Received, by Agency

a. Federal Deposit Insurance Corporation

The FDIC received over 1,360 comment letters in response to the request for comments on the Joint Proposal. Of that number, approximately 342 were received from the financial services industry and related trade associations, as follows: 284 from depository institutions, 12 from depository institution holding companies, and 46 from depository institution trade associations. Approximately 852 of the total number of comment letters were received from the real estate industry and related trade associations, as follows: 421 from real estate brokers and agents, 27 from real estate brokers' trade associations, 145 from residential home builders, 37 from commercial construction firms, 136 from builders and developers, and 86 from home building trade associations. The remaining comment letters were received from approximately 37 professional and trade associations, including community development and affordable housing associations; 9 state regulatory agencies; 8 non-depository institution lenders including mortgage companies; 8 attorneys and law firms; 13 individuals; and 93 asset management, insurance, manufacturing and other firms.

b. Board of Governors of the Federal Reserve System

The Board received approximately 1,300 comments in response to its request for comments on the Joint Proposal. Non-duplicative comments were submitted by approximately 239 banks and bank holding companies, 312 home builders, 112 commercial builders and developers (and building suppliers), 238 real estate brokers and brokers' associations, 5 thrifts, 15 mortgage and finance companies, 24 banking associations, 10 Federal Reserve Banks, 4 state banking regulators, 53 attorneys and law firms, 8 community organizations, 3 title insurance companies, 5 mortgage insurance companies and associations, 20 real estate appraisers, and 39 building associations.

c. Office of the Comptroller of the Currency

The OCC received 1,250 comment letters in response to its request for comments on the Joint Proposal. Of the total received, 245 letters, or approximately 20 percent, were from the financial services industry, consisting of: 139 from national banks and bank holding companies with national bank subsidiaries; 75 from state banks, savings banks, holding companies with state bank subsidiaries, and savings and loan associations; 20 from industry trade associations; and 11 from other industry-related participants, professionals, firms, and governing organizations. The OCC received 960 letters, or about 77 percent of the total, from the real estate industry, consisting of: 370 from real estate and property management firms, associations, brokers, agents, and local real estate boards, 508 from residential home builders and their trade associations; 53 from individuals and firms involved in commercial construction and development; and 29 from other industry-related professionals, councils, and service providers. The remaining letters were from other interested organizations and individuals including: 8 from mortgage insurance underwriters and agents, 6 from mortgage corporations, 8 from appraisers and their trade association,

14 from local affordable housing corporations and associations, and 9 from law firms and bar associations.

d. Office of Thrift Supervision

The OTS received approximately 1,100 comments in response to the Joint Proposal. Approximately 431 comments were received from builders and developers, 404 of whom are primarily involved in residential construction and development, and 57 of whom are primarily involved in commercial construction and development. The remaining comments were submitted by 307 realtors; 147 trade associations representing various industries, including 107 home builders associations; 116 financial institutions, including 38 federal savings banks and 41 savings associations; 15 individuals; 8 federal and state governmental or quasi-governmental agencies; 7 community development associations; 7 building suppliers; 6 public interest/ community groups; 5 appraisers; 5 consulting firms; 5 mortgage insurance companies; 4 law firms; 3 mortgage bankers; 2 title insurance companies; 1 Member of Congress; and 1 unidentified party.

2. Joint Agency Summary

Almost all commenters expressed concern with at least some aspect of the Joint Proposal. While many of the commenters acknowledged the significant real estate lending abuses of the 1980's, and the substantial losses to lenders that have resulted, a majority did not believe that a congressionally mandated regulation providing real estate lending standards offered a solution to the problem.

Numerous commenters characterized the Joint Proposal as unnecessary in the current real estate lending environment and urged that the agencies adopt flexible guidelines, rather than regulations. Comments received from lenders further highlighted their concern over the additional regulatory burden occasioned by the proposal. Numerous lenders asserted that the Joint Proposal would impose significant new monitoring and management costs without ensuring corresponding increases in the safety or soundness of their lending operations.

Commenters also stated that the proposed LTV standards could impede future economic growth, particularly if proposed benchmark LTV limits (as included in Alternative 1) were treated as maximum allowable LTV ratios by lenders and examiners. In particular, commenters expressed concern that the 65 percent LTV benchmark for construction lending could be perceived by lenders as an implied maximum. A few commenters, on the other hand, encouraged the agencies to take a strong stand, even endorsing additional regulatory requirements, in order to prevent a recurrence of abusive real estate practices and resulting losses in the future.

Many commenters, especially those from the home building industry, requested that loans secured by residential property be excluded from the Joint Proposal. Commenters also expressed a desire that the Joint Proposal be narrowed to focus on what are considered "true" real estate loans and particularly those types on which lenders have suffered substantial losses. The need to exclude ordinary business loans and lines of credit in which real estate is taken as part of the collateral was highlighted by lenders.

Concerning the implementation of a loan-to-value framework, many commenters expressed the view that the Joint Proposal placed too much reliance on LTV ratios as an indicator of credit quality. The commenters generally acknowledged that LTV ratios are typically employed by lenders to determine the extent to which they are willing to lend on particular real estate parcels or projects. Commenters also acknowledged that LTV ratios are generally well-understood in the market and readily calculated, although some concern was expressed over the quality of appraised values. A majority of commenters stressed that the LTV ratio is only one of several credit factors used when determining the overall credit worthiness of a real estate project and is often not the most important. A number of commenters recommended the use of debt service coverage ratios when analyzing credits to emphasize reliance on the primary source of repayment rather than collateral value when analyzing credits. Other commenters thought it inappropriate to adopt standards using a debt service coverage ratio because this ratio is not typically used in all types of real estate lending and acceptable debt coverage ratios vary significantly from one real estate project to another.

Concerning the application to LTV limits to individual real estate lending categories, nearly all commenters from the home building industry and many other commenters requested that residential construction be separated from commercial construction and assigned a higher maximum LTV ratio. A number of commenters also requested higher LTV limits for specific types of real estate lending. Some commenters also sought clarification on applying LTV limits to combination loans, pooling arrangements, and cross-collateralized loans.

Commenters were divided on their preference between Alternatives 1 and 2 for implementing an LTV framework. Generally, they preferred the higher LTV limits and flexibility associated with Alternative 1 but many disliked the concept of a range of maximum LTV ratios. A substantial number of commenters preferred the simplicity and implied lower burden of recordkeeping associated with Alternative 2.

Commenters strongly favored the concept of allowing lenders to make a limited amount of prudently underwritten loans that exceed LTV limits. However, a number of commenters felt that the proposed "basket" for such loans (15 percent of total capital) was too small, with some suggesting that only that portion of a loan exceeding the supervisory LTV limits should be included in the basket. A few commenters suggested that the size of the basket should be based upon something other than total capital.

Commenters also strongly agreed with excluding certain transactions from the LTV framework, as provided in the Joint Proposal. Moreover, commenters asked that the rule clearly exclude loans with a partial government guarantee (or insurance) from LTV limits and allow some new funds for renewals, refinancings, and restructurings of loans, particularly when needed to preserve collateral value.

Finally, the comment letters raised numerous questions about the application of the proposed rules in particular circumstances and made many suggestions for amendments.

D. The Final Rule

As explained above, a significant number of commenters expressed concern that rigid application of a regulation implementing LTV ratios would constrict credit, impose additional lending costs, reduce lending flexibility, impede economic growth, and cause other undesirable consequences. Many commenters urged the adoption of guidelines establishing general real estate lending standards in lieu of regulatory standards focused substantially on LTV limits as a means of implementing section 304 of FDICIA without producing such adverse consequences.

After reviewing the numerous comments received in response to the Joint Proposal, and considering the risk posed to the federal deposit insurance funds, the need for safe and sound operation of insured depository institutions, and the availability of

credit, the agencies have decided against adopting specific LTV ratios or ranges in the final regulation. Instead, the agencies have adopted a final rule that prescribes a number of standards with regard to real estate lending.

The final rule requires institutions to establish and maintain written internal real estate lending policies. Each institution's lending policies must be consistent with safe and sound banking practices and appropriate to the size of the institution and the nature and scope of its operations. The policies must establish loan portfolio diversification standards; establish prudent underwriting standards, including LTV limits, that are clear and measurable; establish loan administration procedures for the institution's real estate portfolio; and establish documentation, approval, and reporting requirements to monitor compliance with the institution's real estate lending policies.

The institution's written real estate lending policies must be reviewed and approved by the institution's board of directors at least annually. Further, each institution is expected to monitor conditions in its real estate market to ensure that its lending policies continue to be appropriate for current market conditions. Finally, the rule provides that the lending policies established by the institution should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies adopted by the agencies in conjunction with the final rule.

E. The Interagency Guidelines for Real Estate Lending Policies

In order to supplement and clarify the standards stated in the final rule, the agencies have adopted Interagency Guidelines for Real Estate Lending Policies (Guidelines). The Guidelines describe the criteria and specific factors that the agencies expect insured institutions to consider in establishing their real estate lending policies.

1. Summary of the Guidelines

In general, the Guidelines identify the loan portfolio management and underwriting considerations that the agencies believe should be addressed in a sound real estate lending policy. The Guidelines also address the need to establish loan administration procedures for real estate loans, and the need for an appropriate review and approval process for loan proposals that would be exceptions to the institution's general lending policies. In addition to identifying the types of underwriting standards and requirements that should be included in a sound real estate lending policy, the Guidelines provide specific guidance on loan-to-value limits for various categories of real estate loans.

2. Issues Raised by Commenters and Addressed by Guidelines

Many commenters expressed the view that the approach taken in the Joint Proposal placed too much emphasis on LTV ratios. Numerous comments urged the agencies to include a measure of flexibility to permit institutions to lend beyond stated LTV limits when other underwriting factors indicated that an extension of credit could be made on a safe and sound basis. The agencies have developed the final rule, together with the Guidelines, in response to these comments. The agencies recognize that creditworthy loans may be underwritten at LTV levels that exceed those stated in the Joint Proposal. The agencies also recognize that simply satisfying an LTV ratio requirement does not necessarily ensure a prudent and collectable loan. The agencies have concluded that a rule that emphasizes only one element of the underwriting process may not ensure sound real estate lending or contribute to the safety and soundness of the financial system. The approach adopted in the final rule and the Guidelines is intended to provide insured depository institutions and borrowers additional flexibility while promoting prudent real estate lending.

Many commenters objected to the complexity and recordkeeping burden associated with Alternative 1 as proposed by the agencies; others believed that the ratios stated in Alternative 2 were too low and would constrict the availability of credit. In response, the agencies have incorporated a substantially revised LTV framework into the Guidelines. The LTV framework has been adopted in guideline form, rather than in a regulation, in order to add flexibility. Under the Guidelines, institutions may lend in excess of the supervisory LTV limits where credit is justifiable under the specific circumstances. Nevertheless, the agencies believe that LTV limits are an important element of prudent underwriting criteria and that lenders should carefully set and follow such limits.

In specifying LTV ratios in the Guidelines, the agencies have made a number of other modifications to take account of suggestions or objections stated by commenters. Many commenters, especially those from the home building industry, requested that loans secured by residential property be excluded from the Joint Proposal, or that a higher LTV limit be applied to loans secured by residential property as compared to loans secured by commercial property. In response to these comments, and based on the lower risk generally associated with 1- to 4-family residential lending, the LTV standards incorporated into the Guidelines differentiate between construction loans for 1- to 4-family residential property and other property. In addition, the Guidelines do not specify an LTV limit for permanent mortgages on owner-occupied 1- to 4-family residential property and for home equity loans, as a general matter. The Guidelines do specify, however, that a permanent residential mortgage or home equity loan originated with a loan-to-value that equals or exceeds 90 percent should have appropriate credit enhancement in the form of mortgage insurance or readily marketable collateral.[2]

Many commenters raised objections to the scope of the Joint Proposal. Generally, as indicated above, a number of commenters urged that the rule focus only on "true" real estate loans, and exclude business loans and lines of credit in which real estate is taken as part of the collateral. The agencies agree that an institution may appropriately craft its lending policies to address extensions of credit secured by an interest in real estate but not principally underwritten in reliance upon the real estate collateral. The Guidelines permit such an approach.

Although most commenters generally favored the concept of allowing lenders to make a limited amount of prudently underwritten loans in excess of the LTV limits, many commenters expressed concern that the size of the basket proposed by the agencies for such loans was not meaningful, and that the task of managing the contents of the basket would be burdensome. In addition to redesignating such loans as "loans in

[2] This requirement is a change from the current OTS regulation on private mortgage insurance (PMI) requirements. The current OTS rule requires a home loan with an LTV ratio in excess of 90 percent to have PMI coverage for the amount of the loan in excess of the 80 percent LTV ratio. The OTS is revising its current regulatory requirement to comport with the Guidelines. OTS is not, however, revising its current risk-based capital home loans, to be eligible for the favorable 50 percent risk-weight category, to be no greater than an 80 percent LTV ratio (or have PMI coverage for the amount of the loan in excess of 80 percent). Thus, thrift institutions will have the option, for high-LTV-ratio home loans, of either obtaining PMI coverage for the amount of home loans in excess of 80 percent and holding 4 percent capital, or of obtaining less (or no) PMI coverage and holding 8 percent capital. OTS believes that this differential capital treatment is appropriate, given the difference in risk of loss of such loans. OTS plans to work with the other agencies on the adoption of a uniform capital treatment of home loans.

excess of the supervisory LTV limits", loans as "loans in excess of the supervisory LTV limits", the Guidelines address this concern in two ways. First, the size of the basket has been increased to 100 percent of an institution's total capital[3], with a 30 percent sub-limit for extensions of credit secured by property other than 1- to 4-family residential property. Second, the nature of the basket has been altered. As specified in the Guidelines, the aggregate level of these loans will serve as an indicator of an institution's compliance with its internal policies. A high level of such loans may indicate the need for an institution to re-evaluate the effectiveness of its internal lending policies or signal problems with its underwriting practices.

F. Other Considerations

1. Subsidiaries of Thrifts and State-Chartered Banks

In the Joint Proposal, the FDIC and the Board indicated that they were considering the application of the proposed standards to lending subsidiaries of state banks. The OCC generally applies provisions of Federal banking laws and parent national bank to its operating subsidiaries and its bank service corporations. 12 CFR 5.34(d)(2) and 5.35(e)(3)(i) (1992). As of December 19, 1992, Section 24(d) of the Federal Deposit Insurance Act (12 U.S.C. 1831a(d)) generally prohibits subsidiaries of insured state banks from engaging as principal in any type of activity that is not permissible for subsidiaries of national banks, unless the FDIC has made certain determinations, including a determination that the activity does not pose a significant risk to the appropriate deposit insurance fund.

Some commenters sought clarification on whether insured state bank subsidiaries would be subject to limitations on real estate lending as set forth in the Joint Proposal. Although the final rule does not expressly state that it applies to subsidiaries of insured state banks, it may apply to such subsidiaries by operation of section 24(d) of the Federal Deposit Insurance Act.[4] The FDIC intends to consider in the context of an upcoming rulemaking concerning section 24(d) the issue of whether insured state bank subsidiaries engaging in real estate lending are subject to the requirements of the final real estate lending rule. The Board intends to apply the final rule to subsidiaries of state member banks engaged in real estate lending activities.

For thrift institutions, the OTS stated in the Joint Proposal that it was the OTS's intent to subject all subsidiaries and service corporations to the proposed rule. Little public comment was received on this issue. The OTS has revised the final rule to cover only subsidiaries of thrifts that are not subject to the "deduction from regulatory capital" requirement under 12 CFR part 567 and over which the thrift exercises control. Subsidiaries subject to the "deduction from regulatory capital" requirement are, in general, those that engage in activities are not permissible for national banks. As a thrift institution's investments in and loans to such subsidiaries are deducted from the thrift's capital for capital adequacy purposes, the OTS believes that the institution and the deposit insurance fund are insulated from the risk of investments in such subsidiaries. As such, the final rule prescribing real estate lending standards does not apply to them.

Other thrift subsidiaries—those that are not subject to the "deduction from regulatory capital" requirement—are subject to the final rule only if the thrift exercises control over the subsidiary. This includes operating subsidiaries that are defined as entities that are more than 50 percent owned by a thrift institution and which engage only in activities permissible for a Federal savings association. The OTS has determined that it is inappropriate to subject entities that thrifts do not control to the regulation.

2. Bank Holding Companies and Their Nonbank Subsidiaries

The Board sought comment on whether, to what extent, and the manner in which the proposed real estate lending standards should be imposed on bank holding companies and their nonbank subsidiaries. In seeking such comment, the Board indicated that it was not clear by virtue of the text of section 304 of FDICIA whether such standards should be applicable to bank holding companies and their nonbank subsidiaries.

Several commenters addressed this question. Some commenters recommended that the proposed real estate standards be applied to bank holding companies and their nonbank subsidiaries because, in the commenters' view, all lenders should be held to the same prudent lending standards. Also, several commenters expressed concern that banking organizations may choose to underwrite loans with LTV ratios in excess of supervisory limits in their nonbank subsidiaries or move such loans from insured depository institutions to nonbank affiliates to avoid imposition of the rule.

In contrast, a larger number of commenters argued that the proposed real estate lending standards should not be imposed on bank holding companies and their nonbank subsidiaries because, in their opinion, the federal deposit insurance funds will not be at risk with respect to real estate loans made by such entities, and finance or mortgage company subsidiaries of bank holding companies may be placed at a competitive disadvantage with respect to other nonbank real estate lenders. Some commenters also noted that real estate loans made by bank holding companies and nonbank subsidiaries for sale to secondary market investors already are subject to significant underwriting requirements established by these investors.

For the reasons expressed by the commenters on this issue, the Board has determined, for the present time, not to adopt the real estate lending standards for bank holding companies and their nonbank subsidiaries. The Board notes that the real estate lending activities of bank holding companies and their nonbank subsidiaries are not funded by insured deposits, and are subject to limitations imposed on transactions between an insured depository institution and its affiliates by sections 23A and 23B of the Federal Reserve Act. Accordingly, the final rule has been revised to remove the proposed revisions to the Board's Regulation Y. However, the Board will expect bank holding companies and their nonbank subsidiaries to conduct any real estate lending activities in a prudent manner consistent with safe and sound lending standards.

3. U.S. Branches and Agencies of Foreign Banks

A few commenters raised a question as to how U.S. branches and agencies of foreign banks will be treated for purposes of applying the required standards. The agencies intend to apply the final rule to insured branches of

[3] For state member banks, the term "total capital" means "total risk-based capital" as defined in appendix A to 12 CFR part 208. For insured state non-member banks, "total capital" refers to that term as described in Table I of appendix A to 12 CFR part 325. For national banks, the term "total capital" is defined at 12 CFR 3.2(e). For savings associations, the term "total capital" is defined at 12 CFR 567.5(c).

[4] If the requirements of the rule apply by virtue of the operation of section 24(d), an insured state bank would be required to obtain the FDIC's prior consent for any of its subsidiaries to make real estate loans other than in compliance with the final rule.

foreign banks, since these institutions are considered insured depository institutions for other regulatory purposes and would typically be subject to such rules. At this time, the agencies do not intend to apply the rule directly to uninsured branches or agencies of foreign banks. However, the agencies may consider the final rule as general supervisory guidance when reviewing credit portfolios and practices at such branches and agencies.

The FDIC has revised its final rule to clarify that the rule applies to state-licensed insured branches of foreign banks.

4. Phase-in Provision

Section 304(a)(4) of FDICIA provides, among other things, that the regulations adopted pursuant to section 304 "shall become effective not later than 15 months after the date of enactment of [FDICIA]." FDICIA was enacted on December 19, 1991. In the Joint Proposal, the agencies sought comment on whether it would be appropriate, in order to accommodate credit needs, to phase-in the real estate lending standards after the final rule becomes effective.

Comments were received on both sides of this question. Many commenters felt that some additional time would be needed for lenders to adopt LTV limits, revise lending guidelines and policies, re-train loan officers, prepare compliance and auditing programs and procedures, re-evaluate Community Reinvestment Act and other special lending programs, and change bank lending literature. A number of these commenters also noted that a phase-in period would ensure that extensions of credit currently being processed, but not yet funded, under existing underwriting requirements will remain unaffected by the final rule. A few commenters also recommended that the final rule could be phased-in by category of loan, starting with those categories representing the greatest risk to lenders and the federal deposit insurance funds.

In contrast, other commenters asserted that a phase-in period is not required by FDICIA. Many of these commenters also opined that a phase-in period would not be beneficial for lenders because most properly managed insured depository institutions extend credit in a prudent and responsible manner consistent with the proposed regulations. These commenters maintained that, if the proposed real estate lending standards are truly required to protect the safety and soundness of banking, they should be implemented immediately.

The agencies note that, by adopting a final rule at this time, insured institutions will have approximately three months to prepare to implement the requirements of the rule prior to the March 19, 1993, statutory effective date. In view of this delayed effective date, the revisions made to the Joint Proposal, and the incorporation of LTV ratios in the Guidelines rather than in a regulation, the agencies believe that it is not necessary to provide for a phase-in period.

5. OTS Regulations

In the Joint Proposal, the OTS specifically sought comments on the interaction between this rulemaking and the OTS' current regulations. Few commenters addressed this issue. The OTS has determined in the interest of regulatory consistency, as well as interagency consistency, to revise its current lending regulations to ensure that they conform to the real estate lending requirements consistent with this rulemaking. The OTS therefore has deleted duplicative or conflicting requirements, including specific maturity limits and repayment requirements, and, where appropriate, substituted explicit cross-references to this rulemaking.

6. Well-Capitalized Institutions

The agency requested comment on whether they should distinguish among lending institutions in implementing section 304 of FDICIA on the basis of the institution's financial and managerial strength. Several comment letters were received from banks and thrifts that supported special consideration for well-capitalized, well-managed institutions, such as affording them higher LTV limits or increasing the size of their basket of loans in excess of the supervisory LTV limits. In addition, some commenters suggested that well-capitalized institutions be exempted from the final rule because, in the commenters' opinion, these institutions pose minimal risk to the federal deposit insurance funds.

Other commenters objected to exempting well-capitalized institutions from the rule. These commenters cited examples of insured depository institutions that had been well-capitalized but later incurred substantial losses as a result of real estate lending.

Although the agencies recognize that well-capitalized, well-managed institutions pose less risk to the federal deposit insurance funds than other institutions, the agencies have decided to apply the regulation to all institutions. The agencies are concerned that the financial condition of any institution, including a well-capitalized institution, could deteriorate very quickly if prudent real estate lending policies are not followed. While the rule adopted by the agencies does not include special provisions for strong institutions, the Guidelines identify internal characteristics, such as financial condition, as factors to be considered with regard to the real estate lending policies adopted by the institutions.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b), the agencies hereby certify that the final rule will not have a significant impact on a substantial number of small entities.

The agencies have concluded that the final rule will not have a disparate impact on smaller depository institutions in part because such lenders are likely to make fewer loans, or a narrower range of loans, than larger institutions. Thus, it is expected that the final rule's impact, of the nature contemplated by the Regulatory Flexibility Act, on smaller institutions should be proportionate to its impact on larger institutions.

Moreover, while the final rule applies uniformly to insured depository institutions regardless of size, lenders are required to adopt policies that are appropriate to the size of the institution and the nature and scope of its operations. Similarly, the Guidelines identify as factors to be considered by an institution in formulating its loan policies such internal characteristics as the size of the institution and of its lending staff.

The agencies received and considered comments regarding the likely impact of the Joint Proposal on small depository institutions. As previously described, the agencies have revised the proposal in a number of ways that address the concerns raised by these commenters. The agencies believe that, to the extent that these commenters were concerned about a disproportionate impact on such entities, the flexibility incorporated into the final rule and the Guidelines should adequately address their concerns.

Executive Order No. 12291

The Director of the OTS and the Comptroller of the Currency have independently determined that this regulation does not constitute a "major rule" within the meaning of Executive Order No. 12291 and Treasury Department Guidelines. The final rule requires institutions to adopt real estate lending policies and procedures. Such policies have customarily been an

integral part of an institution's prudent lending operations. Because the final regulation merely codifies practices that are already usual and customary, the OTS and OCC believe that this regulation: (1) Would not have an overall effect on the economy of $100,000,000 or more; (2) would not result in a major increase in the cost of financial institution operations or government supervision; and (3) would not have a significant adverse effect on competition, employment, investment, productivity, or innovation, within the meaning of the Executive Order. Accordingly, a regulatory impact analysis is not required.

Paperwork Reduction Act

The collection of information requirements contained in the Joint Proposal have been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)). Due to the changes reflected in the final rule, a resubmission was made to and approved by OMB under control numbers 1550–0078 (OTS), 1557–0190 (OCC), 7100–AB42 (BOARD), and 3064–0112 (FDIC). The revised annual reporting burden for the collection of information from insured depository institutions is estimated as follows:

Estimated number of recordkeepers:
- State nonmember banks (FDIC)....7,550
- State member banks (Board)....985
- National banks (OCC)....3,750
- Savings associations (OTS)....2,000

Estimated average annual burden per recordkeeper (based on an initial 3-year period)....40 hours

Estimated total annual recordkeeping burden:
- FDIC....302,000 hours
- Board....39,400 hours
- OCC....150,000 hours
- OTS....80,000 hours

Comments concerning the accuracy of this estimate and suggestions on reducing the burden should be sent to Gary Waxman, Office of Information and Regulatory Affairs, Attention—Paperwork Reduction Project Number: 3064–0112 (FDIC); 7100–AB42 (BOARD); 1557–0190 (OCC); 1550–0078 (OTS), OMB, New Executive Office Building, room 3208, Washington, DC 20503; and to the appropriate agency, as follows:

FDIC. Assistant Executive Secretary (Administration), room F–453, Paperwork Reduction Project Number 3064–0112, Federal Deposit Insurance Corporation, Washington, DC 20429.

Board. Mr. William W. Wiles, Secretary, Paperwork Reduction Project Number 7100–AB42, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

OCC. Legislative, Regulatory, and International Activities Division, Paperwork Reduction Project Number 1557–0190, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

OTS. Supervision Policy, Paperwork Reduction Project Number 1550–0078, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

The recordkeeping and collection of information in this interagency rulemaking is required in 12 CFR part 365 (FDIC); 12 CFR part 208, subpart C (FRB); 12 CFR part 34, subpart D (OCC); and 12 CFR 563.100–101 (OTS). The likely recordkeepers are insured depository institutions. The recordkeeping is required by the agencies to protect the deposit insurance funds and to ensure safe and sound operation of insured depository institutions.

Institutions will use the lending policies to guide their lending operations in a manner that is consistent with safe and sound banking practices and appropriate to their size and nature and scope of their operations. These policies should address certain lending considerations, including loan-to-value limits, loan administration policies, portfolio diversification standards, and documentation, approval, and reporting requirements. The agencies will use this information in their examination of institutions to ensure that the real estate loans made by those institutions are consistent with existing statutory and regulatory criteria, with principles of safety and soundness, and with relevant policy guidance.

Text of Final Common Rule

The text of the final common rule appears below:

Appendix to —Interagency Guidelines for Real Estate Lending Policies

The agencies' regulations require that each insured depository institution adopt and maintain a written policy that establishes appropriate limits and standards for all extensions of credit that are secured by liens on or interests in real estate or made for the purpose of financing the construction of a building or other improvements.[5] These guidelines are intended to assist institutions in the formulation and maintenance of a real estate lending policy that is appropriate to the size of the institution and the nature and scope of its individual operations, as well as satisfies the requirements of the regulation.

Each institution's policies must be comprehensive, and consistent with safe and sound lending practices, and must ensure that the institution operates within limits and according to standards that are reviewed and approved at least annually by the board of directors. Real estate lending is an integral part of many institutions' business plans and, when undertaken in a prudent manner, will not be subject to examiner criticism.

Loan Portfolio Management Considerations

The lending policy should contain a general outline of the scope and distribution of the institution's credit facilities and the manner in which real estate loans are made, serviced, and collected. In particular, the institution's policies on real estate lending should:

- Identify the geographic areas in which the institution will consider lending.
- Establish a loan portfolio diversification policy and set limits for real estate loans by type and geographic market (e.g., limits on higher risk loans).
- Identify appropriate terms and conditions by type of real estate loan.
- Establish loan origination and approval procedures, both generally and by size and type of loan.
- Establish prudent underwriting standards that are clear and measurable, including loan-to-value limits, that are consistent with these supervisory guidelines.
- Establish review and approval procedures for exception loans, including loans with loan-to-value percentages in excess of supervisory limits.
- Establish loan administration procedures, including documentation, disbursement, collateral inspection, collection, and loan review.
- Establish real estate appraisal and evaluation programs.
- Require that management monitor the loan portfolio and provide timely and adequate reports to the board of directors.

The institution should consider both internal and external factors in the formulation of its loan policies and strategic plan. Factors that should be considered include:

- The size and financial condition of the institution.
- The expertise and size of the lending staff.
- The need to avoid undue concentrations of risk.
- Compliance with all real estate related laws and regulations, including the Community Reinvestment Act, anti-discrimination laws, and for savings associations, the Qualified Thrift Lender test.
- Market conditions.

The institution should monitor conditions in the real estate markets in its lending area so that it can react quickly to changes in market conditions that are relevant to its lending decisions. Market supply and demand factors that should be considered include:

- Demographic indicators, including population and employment trends.

[5] The agencies have adopted a uniform rule on real estate lending. See 12 CFR part 365 (FDIC); 12 CFR part 208, subpart C (FRB); 12 CFR part 34, subpart D (OCC); and 12 CFR 563.100–101 (OTS).

- Zoning requirements.
- Current and projected vacancy, construction, and absorption rates.
- Current and projected lease terms, rental rates, and sales prices, including concessions.
- Current and projected operating expenses for different types of projects.
- Economic indicators, including trends and diversification of the lending area.
- Valuation trends, including discount and direct capitalization rates.

Underwriting Standards

Prudently underwritten real estate loans should reflect all relevant credit factors, including:

- The capacity of the borrower, or income from the underlying property, to adequately service the debt.
- The value of the mortgaged property.
- The overall creditworthiness of the borrower.
- The level of equity invested in the property.
- Any secondary sources of repayment.
- Any additional collateral or credit enhancements (such as guarantees, mortgage insurance or takeout commitments).

The lending policies should reflect the level of risk that is acceptable to the board of directors and provide clear and measurable underwriting standards that enable the institution's lending staff to evaluate these credit factors. The underwriting standards should address:

- The maximum loan amount by type of property.
- Maximum loan maturities by type of property.
- Amortization schedules.
- Pricing structure for different types of real estate loans.
- Loan-to-value limits by type of property.

For development and construction projects, and completed commercial properties, the policy should also establish, commensurate with the size and type of the project or property:

- Requirements for feasibility studies and sensitivity and risk analyses (*e.g.*, sensitivity of income projections to changes in economic variables such as interest rates, vacancy rates, or operating expenses).
- Minimum requirements for initial investment and maintenance of hard equity by the borrower (*e.g.*, cash or unencumbered investment in the underlying property).
- Minimum standards for net worth, cash flow, and debt service coverage of the borrower or underlying property.
- Standards for the acceptability of and limits on non-amortizing loans.
- Standards for the acceptability of and limits on the use of interest reserves.
- Pre-leasing and pre-sale requirements for income-producing property.
- Pre-sale and minimum unit release requirements for non-income-producing property loans.
- Limits on partial recourse or nonrecourse loans and requirements for guarantor support.
- Requirements for takeout commitments.
- Minimum covenants for loan agreements.

Loan Administration

The institution should also establish loan administration procedures for its real estate portfolio that address:

- Documentation, including:
- Type and frequency of financial statements, including requirements for verification of information provided by the borrower.
- Type and frequency of collateral evaluations (appraisals and other estimates of value).
- Loan closing and disbursement.
- Payment processing.
- Escrow administration.
- Collateral administration.
- Loan payoffs.
- Collections and foreclosure, including:
- Delinquency follow-up procedures.
- Foreclosure timing.
- Extensions and other forms of forbearance.
- Acceptance of deeds in lieu of foreclosure.
- Claims processing (*e.g.*, seeking recovery on a defaulted loan covered by a government guaranty or insurance program).
- Servicing and participation agreements.

Supervisory Loan-to-Value Limits

Institutions should establish their own internal loan-to-value limits for real estate loans. These internal limits should not exceed the following supervisory limits:

Loan category	Loan-to-value limit (percent)
Raw land	65
Land development	75
Construction:	
Commercial, multifamily,[1] and other nonresidential	80
1- to 4-family residential	85
Improved property	85
Owner-occupied 1- to 4-family and home equity	[2]

[1] Multifamily construction includes condominiums and cooperatives.

[2] A loan-to-value limit has not been established for permanent mortgage or home equity loans on owner-occupied, 1- to 4-family residential property. However, for any such loan with a loan-to-value ratio that equals or exceeds 90 percent at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral.

The supervisory loan-to-value limits should be applied to the underlying property that collateralizes the loan. For loans that fund multiple phases of the same real estate project (e.g., a loan for both land development and construction of an office building), the appropriate loan-to-value limit is the limit applicable to the final phase of the project funded by the loan; however, loan disbursements should not exceed actual development or construction outlays. In situations where a loan is fully cross-collateralized by two or more properties or is secured by a collateral pool of two or more properties, the appropriate maximum loan amount under supervisory loan-to-value limits is the sum of the value of each property, less senior liens, multiplied by the appropriate loan-to-value limit for each property. To ensure that collateral margins remain within the supervisory limits, lenders should redetermine conformity whenever collateral substitutions are made to the collateral pool.

In establishing internal loan-to-value limits, each lender is expected to carefully consider the institution-specific and market factors listed under "Loan Portfolio Management Considerations," as well as any other relevant factors, such as the particular subcategory or type of loan. For any subcategory of loans that exhibits greater credit risk than the overall category, a lender should consider the establishment of an internal loan-to-value limit for that subcategory that is lower than the limit for the overall category.

The loan-to-value ratio is only one of several pertinent credit factors to be considered when underwriting a real estate loan. Other credit factors to be taken into account are highlighted in the "Underwriting Standards" section above. Because of these other factors, the establishment of these supervisory limits should not be interpreted to mean that loans at these levels will automatically be considered sound.

Loans in Excess of the Supervisory Loan-to-Value Limits

The agencies recognize that appropriate loan-to-value limits vary not only among categories of real estate loans but also among individual loans. Therefore, it may be appropriate in individual cases to originate or purchase loans with loan-to-value ratios in excess of the supervisory loan-to-value limits, based on the support provided by other credit factors. Such loans should be identified in the institutions's records, and their aggregate amount reported at least quarterly to the institution's board of directors. (See additional reporting requirements described under "Exceptions to the General Policy.")

The aggregate amount of all loans in excess of the supervisory loan-to-value limits should not exceed 100 percent of total capital.[2] Moreover, within the aggregate limit, total loans for all commercial, agricultural, multifamily or other non-1-to-4 family residential properties should not exceed 30 percent of total capital. An institution will come under increased supervisory scrutiny as the total of such loans approaches these levels.

In determining the aggregate amount of such loans, institutions should: (a) Include all loans secured by the same property if any one of those loans exceeds the supervisory loan-to-value limits; and (b) include the recourse obligation of any such loan sold with recourse. Conversely, a loan should no longer be reported to the directors as part of aggregate totals when reduction in principal or senior liens, or additional contribution of collateral or equity (e.g., improvements to the

[2] For the state member banks, the term "total capital" means "total risk-based capital" as defined in appendix A to 12 CFR part 208. For insured state non-member banks, "total capital" refers to that term described in table I of appendix A to 12 CFR part 325. For national banks, the term "total capital" is defined at 12 CFR 3.2(e). For savings associations, the term "total capital" is defined at 12 CFR 567.5(c).

real property securing the loan), bring the loan-to-value ratio into compliance with supervisory limits.

Excluded Transactions

The agencies also recognize that there are a number of lending situations in which other factors significantly outweigh the need to apply the supervisory loan-to-value limits. These include:

- Loans guaranteed or insured by the U.S. government or its agencies, provided that the amount of the guaranty or insurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit.
- Loans backed by the full faith and credit of a state government, provided that the amount of the assurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit.
- Loans guaranteed or insured by a state, municipal or local government, or an agency thereof, provided that the amount of the guaranty or insurance is at least equal to the portion of the loan that exceeds the supervisory loan-to-value limit, and provided that the lender has determined that the guarantor or insurer has the financial capacity and willingness to perform under the terms of the guaranty or insurance agreement.
- Loans that are to be sold promptly after origination, within recourse, to a financially responsible third party.
- Loans that are renewed, refinanced, or restructured without the advancement of new funds or an increase in the line of credit (except for reasonable closing costs), or loans that are renewed, refinanced, or restructured in connection with a workout situation, either with or without the advancement of new funds, where consistent with safe and sound banking practices and part of a clearly defined and well-documented program to achieve orderly liquidation of the debt, reduce risk of loss, or maximize recovery on the loan.
- Loans that facilitate the sale of real estate acquired by the lender in the ordinary course of collecting a debt previously contracted in good faith.
- Loans for which a lien on or interest in real property is taken as additional collateral through an abundance of caution by the lender (e.g., the institution takes a blanket lien on all or substantially all of the assets of the borrower, and the value of the real property is low relative to the aggregate value of all other collateral).
- Loans, such as working capital loans, where the lender does not rely principally on real estate as security and extension of credit is not used to acquire, develop, or construct permanent improvements on real property.
- Loans for the purpose of financing permanent improvements to real property, but not secured by the property, if such security interest is not required by prudent underwriting practice.

Exceptions to the General Lending Policy

Some provision should be made for the consideration of loan requests from creditworthy borrowers whose credit needs do not fit within the institution's general lending policy. An institution may provide for prudently underwritten exceptions to its lending policies, including loan-to-value limits, on a loan-by-loan basis. However, any exceptions from the supervisory loan-to-value limits should conform to the aggregate limits on such loans discussed above.

The board of directors is responsible for establishing standards for the review and approval of exception loans. Each institution should establish an appropriate internal process for the review and approval of loans that do not conform to its own internal policy standards. The approval of any such loan should be supported by a written justification that clearly sets forth all of the relevant credit factors that support the underwriting decision. The justification and approval documents for such loans should be maintained as a part of the permanent loan file. Each institution should monitor compliance with its real estate lending policy and individually report exception loans of a significant size to its board of directors.

Supervisory Review of Real Estate Lending Policies and Practices

The real estate lending policies of institutions will be evaluated by examiners during the course of their examinations to determine if the policies are consistent with safe and sound lending practices, these guidelines, and the requirements of the regulation. In evaluating the adequacy of the institution's real estate lending policies and practices, examiners will take into consideration the following factors:

- The nature and scope of the institution's real estate lending activities.
- The size and financial condition of the institution.
- The quality of the institution's management and internal controls.
- The expertise and size of the lending and loan administration staff.
- Market conditions.

Lending policy exception reports will also be reviewed by examiners during the course of their examinations to determine whether the institutions' exceptions are adequately documented and appropriate in light of all of the relevant credit considerations. An excessive volume of exceptions to an institution's real estate lending policy may signal a weakening of its underwriting practices, or may suggest a need to revise the loan policy.

Definitions

For the purposes of these Guidelines:

Construction loan means an extension of credit for the purpose of erecting or rehabilitating buildings or other structures, including any infrastructure necessary for development.

Extension of credit or *loan* means:

(1) The total amount of any loan, line of credit, or other legally binding lending commitment with respect to real property; and

(2) The total amount, based on the amount of consideration paid, of any loan, line of credit, or other legally binding lending commitment acquired by a lender by purchase, assignment, or otherwise.

Improved property loan means an extension of credit secured by one of the following types of real property:

(1) Farmland, ranchland or timberland committed to ongoing management and agricultural production;

(2) 1- to 4-family residential property that is not owner-occupied;

(3) Residential property containing five or more individual dwelling units;

(4) Completed commercial property; or

(5) Other income-producing property that has been completed and is available for occupancy and use, except income-producing owner-occupied 1- to 4-family residential property.

Land development loan means an extension of credit for the purpose of improving unimproved real property prior to the erection of structures. The improvement of unimproved real property may include the laying or placement of sewers, water pipes, utility cables, streets, and other infrastructure necessary for future development.

Loan origination means the time of inception of the obligation to extend credit (i.e., when the last event or prerequisite, controllable by the lender, occurs causing the lender to become legally bound to fund an extension of credit).

Loan-to-value or *loan-to-value ratio* means the percentage or ratio that is derived at the time of loan origination by dividing an extension of credit by the total value of the property(ies) securing or being improved by the extension of credit plus the amount of any readily marketable collateral and other acceptable collateral that secures the extension of credit. The total amount of all senior liens on or interests in such property(ies) should be included in determining the loan-to-value ratio. When mortgage insurance or collateral is used in the calculation of the loan-to-value ratio, and such credit enhancement is later released or replaced, the loan-to-value ratio should be recalculated.

Other acceptable collateral means any collateral in which the lender has a perfected security interest, that has a quantifiable value, and is accepted by the lender in accordance with safe and sound lending practices. Other acceptable collateral should be appropriately discounted by the lender consistent with the lender's usual practices for making loans secured by such collateral. Other acceptable collateral includes, among other items, unconditional irrevocable standby letters of credit for the benefit of the lender.

Owner-occupied, when used in conjunction with the term *1- to 4-family residential property* means that the owner of the underlying real property occupies at least one unit of the real property as a principal residence of the owner.

Readily marketable collateral means insured deposits, financial instruments, and bullion in which the lender has a perfected interest. Financial instruments and bullion must be salable under ordinary circumstances with reasonable promptness at a fair market value determined by quotations based on actual transactions, on an auction or similarly available daily bid and ask price market. Readily marketable collateral should be appropriately discounted by the lender consistent with the lender's usual practices for making loans secured by such collateral.

Value means an opinion or estimate, set forth in an appraisal or evaluation, whichever may be appropriate, of the market value of real property, prepared in accordance with the agency's appraisal regulations and guidance. For loans to purchase an existing property, the term "value" means the lesser of the actual acquisition cost or the estimate of value.

1- to 4-family residential property means property containing fewer than five individual dwelling units, including manufactured homes permanently affixed to the underlying property (when deemed to be real property under state law).

Adoption of a Final Common Rule

The agency specific adoption of the final common rule, which appears at the end of the common preamble, appears below.

List of Subjects

12 CFR Part 34

Mortgages, National banks, Real estate appraisals, Real estate lending standards, Reporting and recordkeeping requirements.

12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential business information, Currency, Federal Reserve System, Real estate lending standards, Reporting and recordkeeping requirements, Securities.

12 CFR Part 365

Banks, banking, Credit, Mortgages, Real estate appraisals, Real estate lending standards, Savings associations.

12 CFR Part 545

Accounting, Consumer protection, Credit, Electronic funds transfers, Investments, Manufactured homes, Mortgages, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 563

Accounting, Advertising, Crime, Currency, Flood insurance, Investments, Reporting and recordkeeping requirements, Savings associations, Securities, Surety bonds.

I. Office of the Comptroller of the Currency

12 CFR Part 34

For the reasons set out in the preamble, part 34 of chapter I of title 12 of the Code of Federal Regulations is amended as set forth below:

PART 34—[AMENDED]

1. The authority citation for part 34 is revised to read as follows:

Authority: 12 U.S.C. 1 *et seq.*, 93a, 371, 1701j–3, 1828(o), and 3331 *et seq.*

2. A new Subpart D—Real Estate Lending Standards is added to part 34 to read as follows:

Subpart D—Real Estate Lending Standards

Sec.
34.61 Purpose and scope.
34.62 Real estate lending standards.

Appendix A to Subpart D of Part 34—Interagency Guidelines for Real Estate Lending Policies

Subpart D—Real Estate Lending Standards

§ 34.61 Purpose and scope.

This subpart, issued pursuant to section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. 1828(o), prescribes standards for real estate lending to be used by national banks in adopting internal real estate lending policies.

§ 34.62 Real estate lending standards.

(a) Each national bank shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing permanent improvements to real estate.

(b)(1) Real estate lending policies adopted pursuant to this section must:

(i) Be consistent with safe and sound banking practices;

(ii) Be appropriate to the size of the institution and the nature and scope of its operations; and

(iii) Be reviewed and approved by the bank's board of directors at least annually.

(2) The lending policies must establish:

(i) Loan portfolio diversification standards;

(ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;

(iii) Loan administration procedures for the bank's real estate portfolio; and

(iv) Documentation, approval, and reporting requirements to monitor compliance with the bank's real estate lending policies.

(c) Each national bank must monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies established by the Federal bank and thrift supervisory agencies.

3. Appendix A is added to subpart D of part 34 to read as set forth at the end of the preamble.

Appendix A to Subpart D of Part 34—Interagency Guidelines for Real Estate Lending

II. Federal Reserve System

12 CFR Part 208

For the reasons set out in the preamble, the Board of Governors amends 12 CFR part 208 as set forth below:

PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM

1. The authority citation for 12 CFR part 208 is revised to read as follows:

Authority: Secs. 9, 11(a), 11(c), 19, 21, 25 and 25(a) of the Federal Reserve Act, as amended (12 U.S.C. 321–338, 248(a), 248(c), 461, 481–486, 601, and 611, respectively); secs. 4, 13(j), 18(o), and 38 of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1814, 1823(j), 1828(o), and 1831o, respectively); sec. 7(a) of the International Banking Act of 1978 (12 U.S.C. 3105); secs. 907–910 of the International Lending Supervision Act of 1983 (12 U.S.C. 3906–3909); secs. 2, 12(b), 12(g), 12(i), 15B(c)(5), 17, 17A, and 23 of the Securities Exchange Act of 1934 (15 U.S.C. 78b, 781(b), 781(g), 781(i), 78o–4(c)(5), 78q, 78q–1, and 78w, respectively); sec. 5155 of the Revised Statutes (12 U.S.C. 36) as amended by the McFadden Act of 1927; and secs. 1101–1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3310 and 3331–3351).

2. A new Subpart C, comprising §§ 208.51 through 208.52, is added to part 208 to read as follows:

Subpart C—Real Estate Lending Standards

Sec.
208.51 Purpose and scope.
208.52 Real estate lending standards.

Subpart C—Real Estate Lending Standards

§ 208.51 Purpose and scope.

This subpart, issued pursuant to section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. 1828(o), prescribes standards for real estate lending to be used by state member banks in adopting internal real estate lending policies.

§ 208.52 Real estate lending standards.

(a) Each state bank that is a member of the Federal Reserve System shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the

purpose of financing permanent improvements to real estate.

(b)(1) Real estate lending policies adopted pursuant to this section must:

(i) Be consistent with safe and sound banking practices;

(ii) Be appropriate to the size of the institution and the nature and scope of its operations; and

(iii) Be reviewed and approved by the bank's board of directors at least annually.

(2) The lending policies must establish:

(i) Loan portfolio diversification standards;

(ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;

(iii) Loan administration procedures for the bank's real estate portfolio; and

(iv) Documentation, approval, and reporting requirements to monitor compliance with the bank's real estate lending policies.

(c) Each state member bank must monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies established by the Federal bank and thrift supervisory agencies.

3. A new Appendix C is added to part 208 to read as set forth at the end of the preamble.

Appendix C to Part 208—Interagency Guidelines for Real Estate Lending Policies

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III. Federal Deposit Insurance Corporation

12 CFR Part 365

For the reasons set out in the preamble, the Board of Directors of the Federal Deposit Insurance Corporation amends 12 CFR chapter III as set forth below:

1. Part 365 is added to read as follows:

PART 365—REAL ESTATE LENDING STANDARDS

Sec.

365.1 Purpose and scope.

365.2 Real estate lending standards.

Appendix A to Part 365—Interagency Guidelines for Real Estate Lending Policies

Authority: 12 U.S.C. 1828(o).

§ 365.1 Purpose and scope.

This part, issued pursuant to section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. 1828(o), prescribes standards for real estate lending to be used by insured state nonmember banks (including state-licensed insured branches of foreign banks) in adopting internal real estate lending policies.

§ 365.2 Real estate lending standards.

(a) Each insured state nonmember bank shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing permanent improvements to real estate.

(b)(1) Real estate lending policies adopted pursuant to this section must:

(i) Be consistent with safe and sound banking practices;

(ii) Be appropriate to the size of the institution and the nature and scope of its operations; and

(iii) Be reviewed and approved by the bank's board of directors at least annually.

(2) The lending policies must establish:

(i) Loan portfolio diversification standards;

(ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;

(iii) Loan administration procedures for the bank's real estate portfolio; and

(iv) Documentation, approval, and reporting requirements to monitor compliance with the bank's real estate lending policies.

(c) Each insured state nonmember bank must monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies established by the Federal bank and thrift supervisory agencies.

2. Appendix A is added to part 365 to read as set forth at the end of the preamble.

Appendix A to Part 365—Interagency Guidelines for Real Estate Lending Policies

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IV. Office of Thrift Supervision

12 CFR Parts 545 and 563

For the reasons set out in the preamble, the Office of Thrift Supervision amends parts 545 and 563, chapter V, title 12 of the Code of Federal Regulations, as follows:

SUBCHAPTER C—REGULATIONS FOR FEDERAL SAVINGS ASSOCIATIONS

PART 545—[AMENDED]

1. The authority citation for part 545 continues to read as follows:

Authority: 12 U.S.C. 1462a, 1463, 1464, 1828.

2. Section 545.32 is amended by removing paragraph (b)(2), redesignating paragraph (b)(1) as paragraph (b)(2); removing the phrase "Subject to the limitations of § 545.33(e)" where it appears in paragraph (b)(3) and adding in lieu thereof the phrase "Subject to the limitations of § 545.33(c)"; by adding a new paragraph (b)(1); and by revising paragraph (d) to read as follows:

§ 545.32 Real estate loans.

* * * * *

(b) *General*—(1) *Real estate lending standards.* Federal savings associations shall establish prudent real estate lending standards, including requirements on disbursements, maximum loan terms, amortization, and repayment.

* * * * *

(d) *Loan-to-value ratios.* (1) Loan-to-value ratios shall be determined in accordance with §§ 563.100 and 563.101 of this chapter.

(2) For private mortgage insurance requirements in accordance with §§ 563.100 and 563.101 of this chapter, a Federal savings association shall require insurance or guarantees by a mortgage insurance company that the Federal Home Loan Mortgage Corporation of the Federal National Mortgage Association have determined to be a "qualified private insurer."

§ 545.33 [Amended]

3. Section 545.33 is amended by:

a. Removing paragraphs (a) and (b);

b. Redesignating paragraphs (c) through (h) as paragraphs (a) through (f), respectively;

c. By removing the phrase "pursuant to § 545.32(d) of this part" where it appears in the first sentence of newly designated paragraph (b)(1) and adding in lieu thereof the phrase "pursuant to §§ 563.100 and 563.101 of this chapter";

(d) By removing the phrase "authorized by paragraph (c) or (e) of this section" where it appears in the second sentence of newly designated paragraph (b)(1) and adding in lieu thereof the phrase "authorized by paragraph (a) or (c) of this section";

e. By removing the phrase "the requirements of this paragraph (d),"

where it appears in the third sentence of the newly designated paragraph (b)(1) and adding in lieu thereof the phrase "the requirements of this paragraph (b),".

f. By removing the phrase "pursuant to the paragraph (e)(2)(i) of this section" where it appears in the third sentence of newly designated paragraph (b)(1) and adding in lieu thereof the phrase "pursuant to paragraph (c)(2)(i) of this section";

g. By removing the phrases "pursuant to paragraph (c) or (e) of this section" and "permissible under § 545.32(d) of this part" where they appear in the introductory text of newly designated paragraph (b)(2) and adding in lieu thereof the phrases "pursuant to paragraph (a) and (c) of this section" and "permissible under §§ 563.100 and 563.101 of this chapter", respectively;

h. By removing the phrase "and shall be repayable within eighteen months" where it appears in newly designated paragraph (e);

i. And by removing the phrase "§ 545.33(c) and (e)" where it appears in newly designated paragraph (f) and adding in lieu thereof the phrase "§ 545.33(a) and (c)".

4. Section 545.35 is amended by removing paragraphs (a) through (c), by redesignating paragraph (d) as paragraph (b), and by adding a new paragraph (a) to read as follows:

§ 545.35 Other real estate loans.

* * * * *

(a) A Federal association shall apply standards as established in accordance with § 545.32(b)(1) of this part.

* * * * *

5. Section 545.36 is amended by revising paragraphs (a) and (b) to read as follows:

§ 545.36 Loans to acquire or improve real estate.

* * * * *

(a) Such loans shall adhere to the standards adopted under §§ 563.100 and 563.101 of this chapter.

(b) Such loans shall be repayable in accordance with § 545.32(b)(1) of this part.

* * * * *

6. Section 545.37 is amended by removing paragraphs (c) and (d) and revising paragraph (b) to read as follows:

§ 545.37 Combination loans.

* * * * *

(b) The standards applicable in § 545.32(b)(1) shall apply with respect to a combination of loans to finance development of real estate and loans on building lots and sites and/or construction loans, whether or not development has been completed.

§ 545.40 [Amended]

7. Section 545.40 is amended by removing the phrase "in this part" where it appears in the introductory text to the section; and by removing the phrase "specified in § 545.32(d)" where it appears in the concluding text of the section and adding in lieu thereof the phrase "specified in §§ 563.100 and 563.101 of this chapter".

8. Section 545.42 is revised to read as follows:

§ 545.42 Home improvement loans.

For any home improvement loan, with or without security, made pursuant to section 5(c)(1)(J) of the Act, Federal savings associations shall establish prudent lending standards, including requirements on disbursements, maximum loan terms, amortization and repayment. No loan contract may provide for the deferral and capitalization of interest on a loan made under this section.

§ 545.45 [Amended]

9. Section 545.45 is amended by removing the phrase "authorized under § 545.33(c) and (e) of this part" where it appears in paragraph (d)(2)(ii) and adding in lieu thereof the phrase "authorized under § 545.33(a) and (c) of this part"; and by removing the phrase "may be treated as a home loan under § 545.33" where it appears in paragraph (d)(3)(i) and adding in lieu thereof the phrase "may be treated as a home loan under §§ 563.100 and 563.101 of this chapter".

SUBCHAPTER D—REGULATIONS APPLICABLE TO ALL SAVINGS ASSOCIATIONS

PART 563—OPERATIONS

10. The authority citation for part 563 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1468, 1817, 1828, 3806; 42 U.S.C. 4106; Pub. L. 102–242, sec. 306, 105 Stat. 2236, 2355 (1991).

§ 563.97 [Amended]

11. Section 563.97 is amended by removing the phrase "may do so only if such loans comply with § 545.38(a) or § 545.32(d)(2) of this chapter" where it appears in paragraph (a) and adding in lieu thereof the phrase "may do so only if such loans comply with § 545.38(a) or §§ 563.100 and 563.101 of this chapter".

12. New §§ 563.100 and 563.101 are added to subpart D of part 563 to read as follows:

§ 563.100 Real estate lending standards; purpose and scope.

This section, and § 563.101 of this subpart, issued pursuant to section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. 1828(o), prescribes standards for real estate lending to be used by savings associations and all their includable subsidiaries, as defined in 12 CFR 567.1 (l), over which the savings associations exercise control, in adopting internal real estate lending policies.

§ 563.101 Real estate lending standards.

(a) Each savings association shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing permanent improvements to real estate.

(b)(1) Real estate lending policies adopted pursuant to this section must:

(i) Be consistent with safe and sound banking practices;

(ii) Be appropriate to the size of the institution and the nature and scope of its operations; and

(iii) Be reviewed and approved by the savings association's board of directors at least annually.

(2) The lending policies must establish:

(i) Loan portfolio diversification standards;

(ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;

(iii) Loan administration procedures for the savings association's real estate portfolio; and

(iv) Documentation, approval, and reporting requirements to monitor compliance with the savings association's real estate lending policies.

(c) Each savings association must monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies established by the Federal bank and thrift supervisory agencies.

13. Appendix A is added to subpart D of part 563 to read as set forth at the end of the preamble.

Appendix A to Subpart D of Part 563—Interagency Guidelines for Real Estate Lending

Dated: November 22, 1992.

By the Office of the Comptroller of the Currency.

Stephen R. Steinbrink,

Acting Comptroller of the Currency.

Dated: December 2, 1992.

By the Board of Governors of the Federal Reserve System.

William W. Wiles,

Secretary of the Board of Governors of the Federal Reserve System.

Dated: October 27, 1992.

By The Federal Deposit Insurance Corporation.

Hoyle L. Robinson,

Executive Secretary.

Dated: November 5, 1992.

By the Office of Thrift Supervision.

Timothy Ryan,

Director.

[FR Doc. 92-31481 Filed 12-30-92; 8:45 am]

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