

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, N. Y. 10045-0001

AREA CODE 212 720-5692

ROBERT A. O'SULLIVAN
VICE PRESIDENT

March 26, 1993

TO THE CHIEF EXECUTIVE OFFICERS OF ALL STATE MEMBER BANKS,
BANK HOLDING COMPANIES, AND DOMESTIC OFFICES OF FOREIGN
BANKS IN THE SECOND FEDERAL RESERVE DISTRICT

SUBJECT: REAL ESTATE LENDING STANDARDS

On December 31, 1992, the Federal Reserve Board, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation published in the Federal Register¹ the final uniform rule on real estate lending by insured depository institutions. The final rule prescribes real estate lending standards as required by section 304 of the FDIC Improvement Act (FDICIA). Since the publication of the final rule, the Federal Reserve has received several questions concerning the effective date and the application of the supervisory loan-to-value limits which warrant further clarification.

The final rule became effective on March 19, 1993. Thus, as of that date, insured depository institutions are expected to have in place written policies that establish appropriate limits and standards for their real estate lending activity. As prescribed in the real estate lending guidelines, an appendix to the regulation, institutions are expected to establish internal loan-to-value limits which should not exceed stated supervisory limits.

There has, however, been some confusion over whether these supervisory limits apply to existing credits. In this regard, the final rule exempts extensions of credits (including legally binding, but unfunded, lending commitments) originated prior to March 19, 1993. In the event that such a loan has a loan-to-value ratio (LTV) in excess of the supervisory LTV and is subsequently refinanced, renewed, or restructured, the loan will continue to be treated as an excluded transaction so long as there is no advancement of new funds or an increase in the line of credit (except for reasonable closing costs), or the loan involves a workout with a clearly defined and well-documented workout program.

A second question has arisen on what was meant by the language in the guidelines regarding the calculation for the

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¹ Federal Reserve Board 12 CFR Part 208. Federal Register 57 FR 62890 (December 31, 1992).

maximum loan amount where there is a cross-collateralization of two or more properties with different supervisory LTVs. The text states:

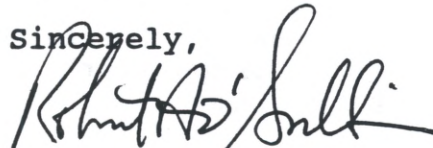
"...the appropriate maximum loan amount under supervisory loan-to-value limits is the sum of the value of each property, less senior liens, multiplied by the appropriate loan-to-value limit for each property."

The current text may be misleading because the order of the arithmetical operations could be taken to imply that the collateral value should be reduced by the senior lien before applying the LTV limit. This was not the intent of the agencies. As intended by the agencies, the maximum loan amount is determined by first multiplying each property's collateral value by the loan-to-value ratio appropriate to that property and then deducting from that product any existing senior liens on that property. The sum of the results of these calculations is the maximum loan amount that may be extended under cross-collateralization.

There also have been several requests to clarify the guidelines' capital limitations on loans in excess of supervisory LTV limits. Institutions are expected to identify those loans in excess of the supervisory LTV limits (i.e., nonconforming loans) in their records. The aggregate amount of such loans is not to exceed 100 percent of a bank's total risk-based capital (referred to as the nonconforming basket). Within this limit, the aggregate amount of non-1-to-4 family residential loans (e.g., raw land, commercial, multifamily, and agricultural) that do not conform to supervisory LTV limits may not exceed 30 percent of total risk-based capital. The remaining portion of the nonconforming basket includes the aggregate amount of 1-to-4 family residential construction loans and non-owner occupied 1-to-4 family residential loans with a LTV greater than 85 percent and owner-occupied 1-to-4 family residential loans with a LTV equal to or exceeding 90 percent without mortgage insurance or readily marketable collateral.

If there are any questions, contact Barbara A. Klein, Manager, Domestic Banking Department, at (212) 720-8324.

Sincerely,



Robert A. O'Sullivan
Vice President