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OCC ADVISORY LETTER

Comptroller of the Currency
Administrator of National Banks

Subject: Guidelines for Real Estate Lending Policies

Replaced by OCC Bulletin 2013-19

TO: Chief Executive Officers of All National Banks and National Bank Operating Subsidiaries, Department and Division Heads, and All Examining Personnel

INTRODUCTION AND PURPOSE

Recently, we have received numerous inquiries from bankers and examiners about the OCC's real estate lending standards. [12 CFR 34, Subpart D, Appendix A] These inquiries center on three issues:

- The proper calculation of a loan-to-value (LTV) ratio when multiple properties secure a loan;
- The supervisory LTV limit for a finished lot loan; and
- Classifying high loan-to-value (HLTV) loans for reporting purposes.

This issuance reiterates and expands guidance contained in Appendix B of the "Commercial Real Estate and Construction Lending" booklet of the *Comptroller's Handbook* (pp. 97–105), and defines a finished lot loan for lending standard purposes. Risk management insurance products and nonconforming loan amounts are also addressed.

Supervisory Loan-to-Value Limits

Calculation of a loan-to-value ratio when multiple properties secure a loan

The calculation of the loan-to-value ratio is complicated when two or more properties with different supervisory LTV limits secure a loan. Appendix A of the lending standards states, "the appropriate maximum loan amount under the supervisory loan-to-value limits is the sum of each property, less senior liens, multiplied by the appropriate loan-to-value limit for each property."

The confusion surrounding this calculation concerns the order in which the arithmetic calculations are performed. The correct way to perform this calculation is to multiply each property by the appropriate supervisory LTV ratio, then deduct any existing senior liens associated with the property, and finally add the individual results. If the total exceeds the loan amount, the loan conforms to the supervisory limits. If the results are less than the loan amount, a nonconforming HLTV loan exists.

For example, if a collateral pool is comprised of raw land valued at $75,000 (subject to a $25,000 prior lien), and an improved commercial property valued at $250,000 (subject to a $125,000 prior lien) the total aggregate amount that could be loaned against the collateral pool and conform to the supervisory LTV limit is $111,250.[1]

That is:

($75,000 X 0.65) -	$25,000 =	$23,750
($250,000 X 0.85) -	$125,000 =	<u>$87,500</u>
		$111,250

Supervisory LTV limit for finished and buildable lot loans

Questions also have arisen about the supervisory LTV for “finished lots” and “buildable lots.” The crux of the issue involves terminology and timing. When the standards were issued in December 1992, loans for finished lots and buildable lots were included in land development loans.

A land development loan is defined in 12 CFR 34, Subpart D, as “an extension of credit for the purposes of improving unimproved real property prior to the erection of structures. The improvement may include the laying or placing of sewers, water pipes, utility cables, streets, and other infrastructure necessary for future development.” Finished lot loans and buildable lot loans are synonymous with land development loans.

The supervisory LTV ratio for a land development loan, a finished lot loan, or a buildable lot loan is 75 percent. The LTV ratio remains at 75 percent until construction of a permanent building commences.

The OCC has received inquiries concerning the conversion of a raw land loan and when the 65 percent supervisory ratio level is increased to a higher ratio. A bank may use the higher appropriate LTV ratio *when actual construction begins on the next phase of development*. For example, a bank may advance 65 percent for raw land and up to 75 percent when converting the raw land into finished lots. A bank may advance up to 80 percent of the appraised value when construction of a permanent commercial, multifamily or other non-residential building commences or up to 85 percent when construction of 1- to 4- family residences commences.

Classifying high loan-to-value (HLTV) loans for reporting purposes

HLTV loans are loans that exceed the supervisory loan-to-value limits. Because bankers and examiners continue to seek clarification on this topic, we are providing a recap of what banks should do to comply with the lending standards.

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[1] 12 CFR 34, Subpart D, Appendix A establishes conforming supervisory LTV limits for different property types. The LTV limit for: raw land is 65 percent; land development – 75 percent; commercial, multifamily and other nonresidential construction - 80 percent; 1- to 4-family residential construction - 85percent; improved property - 85 percent; and owner-occupied 1- to 4-family and home equity – less than 90 percent.

- Banks are expected to identify and record all HLTV loans and report these loans to the board of directors at least quarterly. A loan continues to be designated HLTV until the LTV ratio falls below the supervisory limit either through principal reduction or collateral appreciation.

- The aggregate amount of a bank's HLTV loans (the bank's "basket" for nonconforming loans) should not exceed 100 percent of the bank's total capital as defined in 12 CFR 3.2(e).[2]

- Within this basket of nonconforming loans, the aggregate amount of all *non-1- to 4-family residential loans* should not, collectively, exceed 30 percent of total capital. This segment is *generally described as the commercial basket*.

- The commercial basket includes the following types of loans:

  – Raw land with a LTV ratio greater than 65 percent.
  – Commercial land development with a LTV ratio greater than 75 percent.
  – Commercial, multifamily, and other nonresidential construction with a LTV ratio greater than 80 percent.
  – Improved property[3] with a LTV ratio greater than 85 percent.

- The remainder of the basket (up to 100 percent) is available for all categories of *nonconforming loans on 1- to 4-family residential property*, including:

  – Raw land rezoned for development with a LTV ratio greater than 65 percent.
  – Land development loans with a LTV ratio greater than 75 percent.
  – Construction loans with a LTV ratio greater than 85 percent.
  – Loans on non-owner-occupied property with a LTV ratio greater than 85 percent.
  – Permanent mortgages and home-equity loans on owner-occupied property equal to or exceeding 90 percent LTV, without mortgage insurance, readily marketable collateral or other acceptable collateral.

Nonconforming loan amounts

Finally, the entire amount of a nonconforming loan is to be included in the nonconforming basket, not just the portion exceeding the supervisory LTV limit. Further, if a bank holds a first and second lien on a parcel of real estate and the combined loans exceed the appropriate LTV ratio, both loans should be included in a bank's basket. Refer to the "Commercial Real Estate and Construction Lending" booklet of the *Comptroller's Handbook*, November 1995, and OCC Bulletin 99–38, dated October 13, 1999, for additional clarification on this matter.

[2] Total capital means the sum of a national bank's core (Tier 1) and qualifying (Tier 2) capital elements.
[3] Farmland, ranchland, timberland or agricultural production facilities being actively managed; multi-family (5 or more units) residential units; completed commercial property available for occupancy; and other income-producing property available for occupancy.

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Insurance products for mortgages or home-equity loans

Over the past few years, new insurance products have been introduced to help banks mitigate the risks of HLTV loans. To date, the insurance products have been confined to nonconforming 1- to 4- family residential loans. Some of these products may provide sufficient credit enhancement to reduce the LTV ratio to conform to the supervisory limits. Insurance policies that reduce the LTV to 89.99 percent or lower on an individual loan basis will generally be accepted by the OCC.

ORIGINATING OFFICE

Questions or inquiries concerning this issuance should be directed to the Credit Risk Division at (202) 874-5170.

Barbara J. Grunkemeyer
Deputy Comptroller for Credit Risk