



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

June 11, 2002

Interpretive Letter #942
September 2002
12 C.F.R. 32.7

Subject: Pilot program for residential real estate loans and small business loans, 12 C.F.R. § 32.7

Dear []:

This letter responds to your letters of April 12, 2002 and May 8, 2002 regarding the applicability of the two special limits in the lending limit pilot program (Pilot Program or Program), 12 C.F.R. § 32.7, to loans made to finance land development or property construction.

The Pilot Program provides new special lending limits for residential real estate loans and small business loans under certain conditions.¹ A residential real estate loan is defined as a loan or extension of credit that is secured by 1-4 family residential real estate. 12 C.F.R. § 32.2(p). Such loan must be secured by a perfected first-lien security interest in 1-4 family real estate in an amount that does not exceed 80 percent of the appraised value of the collateral at the time the loan is made.² A small business loan is defined as a loan or extension of credit “secured by nonfarm nonresidential properties”³ or ‘a commercial or industrial loan’ as defined in the instructions for preparation of the Consolidated Report of Condition and Income” (Call Report Instructions).⁴ 12 C.F.R. § 32.2(r). A bank must apply for approval to use the special limits in the Program and must meet certain requirements for eligibility. As you note, [*Bank*] has been approved to participate in the Pilot Program.

A loan secured by real estate made to finance land development or property construction cannot qualify for the special limit for small business loans because the loan is excluded from the category of loans “secured by nonfarm nonresidential properties” and from the category of “commercial and industrial loans.” Instead, the Call Report Instructions provide that such construction and land development loans are reported as a separate category of loan, namely,

¹ See 66 Fed. Reg. 31114 (Jun. 11, 2001) (final rule) and 66 Fed. Reg. 55071 (Nov. 1, 2001) (correction).

² 12 C.F.R. § 32.7(a)(1).

³ There is no requirement that the property be owner-occupied.

⁴ The Call Report Instructions are available at <http://www.ffiec.gov>.

“Construction, land development, and other land loans.”⁵ For these reasons, the special limit for small business loans does not extend to a loan secured by real estate to finance land development or property construction.⁶

A bank cannot avoid this result by making a construction or land development loan without taking a security interest in the real estate. It is true that not taking a security interest in the real estate would remove the loan from the “Construction, land development, and other land loans” category in the Call Report Instructions, and potentially put it into the “commercial or industrial loan” category, depending upon its other characteristics. However, as you correctly point out in both your letters, making such a construction or land development loan on an unsecured basis would “not appear to be consistent with prudent banking practices.” The basic purpose of the lending limit regulation is to “protect the safety and soundness of national banks” by preventing excessive loans to one borrower and promoting diversification of loans.⁷ The Pilot Program itself stresses that the higher limits being made available in specified circumstances must be used in a manner that is “consistent with safety and soundness.”⁸

Finally, a loan made to finance land development or property construction will also not generally qualify for the special limit for residential real estate loans. This is because a residential real estate loan must be secured by an existing, completed 1-4 family residence. A loan to finance land development or property construction will not generally meet this requirement.⁹

I trust this letter is responsive to your inquiry.

Sincerely,

-signed-

Ray Natter
Deputy Chief Counsel

⁵ See RC-C-3 (3-01).

⁶ As noted in the preamble to the final rule, the OCC chose to restrict the categories of loans to which the Program would apply with the expectation that our experience with the Program would be the basis for considering whether more categories of loans should be added at a later date. See 66 Fed. Reg. 31114, 31116 (Jun. 11, 2001) (final rule).

⁷ 12 C.F.R. § 32.1(b).

⁸ See 66 Fed. Reg. 31114, 31117 (Jun. 11, 2001) (final rule).

⁹ I include the qualification “generally” since there may be a rare situation in which a bank’s customer is able to borrow under the Program to finance land development or property construction and provide collateral in the form of a first-lien security interest in an existing, completed residence. The bank’s customer might be either an owner-occupier or a developer. If the borrower is a developer, the OCC requires as a prudential matter that the bank ensure that the security interest is taken in a residence that the developer has “pre-sold” to an unaffiliated third party under a binding purchase and sale agreement and that the loan is made on that same “pre-sold” basis and in conformity with OCC guidance regarding residential construction lending conducted on that basis. See Comptroller’s Handbook, Commercial Real Estate and Construction Lending (Nov. 1995) at 17-18.