

Questions and Answers on Real Estate Lending Standards (RELS)
Regulation and Guidelines

1. **What is the private mortgage insurance (PMI) requirement for owner-occupied, one-to four- (1-4) family residential and home equity mortgage loans?**

Owner-occupied, 1-4 family residential and home equity mortgage loans of 90 percent LTV ratio or greater have “appropriate” PMI or readily marketable collateral. There is no requirement to have PMI coverage that would bring the effective LTV ratio down to 80 percent. If an association makes a 95 percent LTV loan and requires PMI that insures losses down below 90 percent, the loan would not be considered a high LTV loan for purposes of the real estate lending standards policy.

2. **Can a savings association originate 100 percent LTV ratio loans without PMI?**

A savings association can originate 100 percent LTV home mortgage loans without PMI, though they would be included in the “Loans in excess of the supervisory LTV limits” category, which must be reported to the board of directors and limited, in aggregate, to 100 percent of capital. While examiners would not take exception to a moderate amount of such loans, they may criticize the association if the loans are underwritten in an unsafe and unsound manner.

3. **What is the loan category for a loan to purchase a developed residential lot where the roads and sewers, etc., are in place, but there are no immediate plans to build a home?**

The association should treat the loan as a land development loan. Although the purpose of the loan is not to develop the lots, the end product is the same. OTS expects savings associations that make higher-risk loans to do so at lower LTV ratios. Those with lower risk, such as loans to purchase finished lots, could be made at the maximum LTV ratio.

4. **Do uninsured deposits that are in excess of the FDIC insurance limit (currently \$100,000) count as “financial instruments” for “readily marketable collateral?”**

Yes.

5. **How would the maximum supervisory LTV ratio limit be calculated for loans fully cross-collateralized by two or more properties or secured by a collateral pool of two or more properties?**

For cross-collateralized loans, the maximum loan that the association can make within the supervisory LTV ratio limits is based on the following formula: [(Value of each property X appropriate maximum LTV ratio) less any senior liens].

6. **What is the loan category of a loan to construct a single-family home, where the borrower has a take-out commitment (made by either the same lender or a different lender) for permanent financing when completed?**

A construction-permanent loan secured by a single-family residence to the owner-occupant is treated as a permanent mortgage loan for purposes of categorizing the loan in the supervisory LTV ratio limits. In other words, if the LTV ratio equals or exceeds 90 percent, the loan should have credit enhancement in the form of PMI or readily marketable collateral. A construction loan by one lender with the permanent take-out by a second lender is treated as a 1-4 family construction loan (with an 85 percent supervisory LTV ratio limit) until construction is complete and the permanent lender refinances the loan. If the permanent lender is a closely held affiliate of the construction lender, then the loan can be treated as a permanent loan. Of course, as in all construction loans, a lender should always maintain appropriate disbursement controls during the construction period.

7. **Are unsecured loans (with loan proceeds used to purchase or improve real estate) subject to the rule?**

Yes. In drafting the statutory language that required the banking agencies to draft regulations requiring federally insured depository institutions to issue regulations on real estate lending standards, Congress was concerned that, without a requirement to include unsecured loans used to finance real estate transactions, some institutions would be tempted to make unsecured loans to avoid having to comply with the rule.

8. **Are loans underwritten as “unsecured” loans where the lender takes a security interest in real estate at borrower’s request (i.e., for tax purposes) subject to the RELS rule?**

Yes. The “abundance of caution” exception only applies when a loan is otherwise well collateralized, such as a loan to purchase an automobile that is collateralized by the vehicle, and the underwriting criteria and loan terms were more indicative of an auto loan.

9. **How should associations categorize, for supervisory LTV ratio limit purposes, mortgage loans that are not principal residences?**

Unless such residences meet the Internal Revenue Service (IRS) test of residency, the loans are considered improved property loans (85 percent LTV ratio limit) since they are not

owner-occupied, 1-4 family residences. (The definition of owner-occupied requires that the home be the borrower's principal residence.) If the loan is made with an LTV ratio higher than 85 percent, it is placed in the larger 100 percent of capital "bucket" (which does not have a principal residence requirement).

Loans that meet the IRS test of residency are treated as owner-occupied, 1-4 family residences.

10. How should loans under the FHA Title I program be treated?

Similar to the OTS capital rule treatment of such loans, FHA Title I program loans are not considered guaranteed loans, so if the association makes loans with LTV ratios of 90 percent or higher without PMI, they would go in the loans in excess of the supervisory limits "bucket."

11. Does the REELS rule cover manufactured homes?

The rule applies to real estate loans. Loans secured by "manufactured homes" that are not affixed to real property are not real estate loans and the REELS rule does not apply to them. Other "similar" personal property – mobile homes, RVs, etc. – are chattel and are not considered home loans under the rule. If a mobile home and a lot secure the loan, the security property is categorized as chattel and land, and the lot loan would be subject to the REELS rule. If a manufactured loan is permanently attached to the property, it is a home loan and covered by the rule.

12. How should loans guaranteed by the Federal government or state governments be treated for purposes of the supervisory LTV ratio limit if the guarantee is less than the loan amount?

All loans, or portion of loans, guaranteed by the U.S. Government or its agencies, and all loans backed by the full faith and credit of a state government, are excluded from the supervisory LTV ratio limit guidelines. Consequently, any portion of a loan that is so guaranteed should not be categorized as a high LTV loan.

13. Do we include non-owner-occupied, 1-4 family loans in the 100 percent of capital exception bucket?

Yes. Non-owner-occupied 1-4 family loans are subject to the 85 percent LTV ratio for improved property loans; such loans with LTV ratios greater than 85 percent are placed in the 100 percent exception bucket.

14. **Are loans in excess of the supervisory LTV limit secured by developed lots for 1-4 family residential homes placed in the 100 percent of capital exception bucket?**

Yes. All loans related to 1-4 family residential properties go into the 100 percent exception bucket. For developed lots, the lots should be in a 1-4 family residential subdivision and properly zoned to be treated as 1-4 family residential properties.

15. **Should home improvement loans be treated like permanent mortgages or construction loans?**

Yes, home improvement loans should be treated like permanent mortgages for purposes of determining the maximum supervisory LTV.

16. **If an association has a firm take-out commitment on a construction loan, can it be treated as an excluded transaction under the fourth exclusion (loans to be sold)?**

No, because the borrower has not met the conditions of the ultimate lender (complete construction, obtain an occupancy permit, etc.).

17. **How do you determine the supervisory LTV ratio limits for multi-stage projects?**

The maximum LTV ratio for multi-stage projects is ultimately limited by the LTV ratio applicable to the final stage of the loan. Associations should establish, as part of their loan administration policies, procedures on loan disbursements, based on the value of the project less the cost to complete it less a completion reserve, during the entire construction process. In general, prudent loan disbursement means that funding of the initial acquisition of raw land should not exceed 65 percent of the cost of the land and funding the development stage should not exceed 75 percent of the costs of development, etc.

18. **For cross-collateralized loans, we calculate the maximum LTV ratio based on a weighted average method. If one loan in the pool is over the LTV ratio limits, what goes into the high LTV ratio “bucket?”**

If the weighted-average LTV ratio of the pool is over the maximum supervisory LTV ratio, the whole pool goes into the bucket. If the weighted-average LTV ratio is less than the supervisory maximum, nothing goes into the bucket, even if one loan is above the maximum supervisory LTV ratio. This is in recognition that with cross-collateralization, the association has “excess LTV ratio cushion” in one loan to “cover” another loan’s lack of LTV ratio cushion. Conversely, if the entire excess cushion is used, then the whole pool presents a higher degree of risk. This will give associations an incentive to structure pools to exclude any loans that might cause the pool to be put in the bucket, but that is acceptable. We can review any individual loan for safety and soundness, and associations should only be making prudent loans.

19. **If a bank makes a loan to a borrower to purchase a property and make improvements that will enhance the value over the original cost, on what value should the LTV be based?**

In general, the LTV should be based on the original cost plus the improvements, however, use the fair market value (per the appraisal or evaluation) as completed after the improvements are made.