December 28, 2004

Lee Sapira, Esq.
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Re: Exception to Member Business Loan (MBL) Definition.

Dear Mr. Sapira:

Region II Director Edward Dupcak asked our office to respond to your question about the one-to-four family dwelling exception to the definition of an MBL in the MBL rule. 12 C.F.R. §723.1(b)(1). You have asked if a loan meets the one-to-four family dwelling exception to the MBL definition if it is secured by property that has the member's primary residence and a separate, second building, which is rented as a residence, located on the same parcel of land. No, this loan does not meet the exception.

The exception for loans secured by a one-to-four family dwelling from the definition of an MBL only applies to a loan secured by "a" dwelling that is the member's "primary residence." The exception is stated this way in both the Federal Credit Union Act (Act) and NCUA's MBL rule. 12 U.S.C. §1757a(c)(1)(B)(i); 12 C.F.R. §723.1(b)(1). The plain language of the rule limits the exception to a loan fully secured by <u>one</u> dwelling, not multiple dwellings on the same property. During the 1999 rulemaking process, two commenters asked that the rule's exemption extend to a second, one-to-four family dwelling. The final rule's preamble states "[t]he NCUA Board believes that since Congress used the term 'primary residence,' the exemption cannot be expanded to include other types of homes a member may use as collateral in obtaining a loan." 64 Fed. Reg. 28721, 28722 (May 27, 1999).

You questioned the Region's characterization of the second building as "non-residential" because it houses a family. Our understanding, however, is that this separate, second building is not the residence of the member but is used as residential rental property. You believe a second building on the same land with the member's primary residence should not be distinguished from a one-to-four family dwelling that houses multiple families. As discussed above, the Act and rule expressly limit the exception to a single dwelling that is the member's primary residence.

You also contend that, from a lending perspective, the legal and economic risks of a loan secured by a multi-family dwelling as compared with a loan secured by property with two dwellings are identical. Several years ago, the NCUA Board rejected this contention. In 1987, before the enactment of the MBL restrictions in the Act, NCUA adopted an MBL rule containing exceptions to the MBL definition

for loans fully secured by a lien on a one-to-four family dwelling that was: (1) the member's primary residence; (2) the member's secondary residence; or (3) one other such dwelling owned by the member. 51 Fed. Reg. 12365 (April 16, 1987). NCUA removed the exceptions for a member's secondary residence and a third dwelling in 1991, and, in the final rule's preamble, the NCUA Board stated:

> Loans secured by a member's primary residence are considered a lesser overall risk than loans secured by other residences. In determining whether an exemption is allowable, the credit union must determine whether the subject property is or will be the principal residence of the member-borrower.

56 Fed. Reg. 48421 (Sept. 25, 1991). Congress adopted the 1991 rule's exception in the Act and it remains unchanged in NCUA's rule.

We hope this letter has clarified this issue for you.

Sincerely,

Sheila A. Albin
Associate General Counsel

OGC/CJL:bhs
04-1130

cc: Region II