

[Federal Register: March 9, 1994]

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DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 3

[Docket No. 94-03]

RIN 1557-AB14

Risk-Based Capital: Multifamily Housing Loans

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is issuing this final rule to amend the risk-based capital guidelines to include in the 50% risk weight category certain loans secured by qualifying multifamily residential properties, to clarify that privately-issued mortgage-backed securities (MBS) may qualify for a 50% risk weight, provided the MBSs are secured by qualifying multifamily residential property loans, and to provide that the portion of a multifamily residential property loan that is sold subject to a pro rata loss sharing arrangement may be treated by the selling bank as sold to the extent that the sales agreement provides for the purchaser of the loan to share in any loss incurred on the loan on a pro rata basis with the selling bank. This final rule does not make any changes with respect to the capital treatment of multifamily residential property loans sold subject to forms of recourse other than on a pro rata loss sharing basis. The OCC believes that the issue of non-pro rata recourse for multifamily residential property loans is best addressed in a comprehensive manner by the banking agencies in the Federal Financial Institutions Examination Council (FFIEC) study on recourse.

The purpose of this final rule is to permit national banks to hold less capital against certain loans secured by qualifying multifamily residential property. This final rule implements the Resolution Trust

Corporation Refinancing, Restructuring, and Improvement Act of 1991 (RTCRRIA) and the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). The OCC also believes that this final regulation will help developers, including nonprofit developers, to provide low- and moderate-income multifamily housing.

EFFECTIVE DATE: March 9, 1994.

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SUPPLEMENTARY INFORMATION:

Background and Purpose

The OCC's risk-based capital guidelines were adopted in 1989 (codified at 12 CFR part 3, appendix A). See 54 FR 4168 (January 27, 1989). The risk-based capital guidelines establish capital requirements based on the credit risk profiles of the assets and off-balance sheet activities of a financial institution. The risk-based capital guidelines implement the Agreement on International Convergence of Capital Measurement and Capital Standards of July 1988, as reported by the Basle Committee on Banking Supervision (the Basle Agreement) and were developed in cooperation with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Board (FRB).

The risk-based capital guidelines assign all assets to the 100% risk weight category unless an asset specifically qualifies for some lower risk weight category. See 12 CFR part 3, appendix A, section 3(a)(4). Under the current risk-based capital guidelines, loans secured by a first lien on multifamily rental properties are risk weighted at 100%. However, a loan secured by a first mortgage on a one-to-four family residential property may qualify for a 50% risk weight.<SUP>1 See 12 CFR part 3, appendix A, section 3(a)(3)(iii).

\\1\Under section 3(a)(3)(iii) of this appendix A residential property may be either owner occupied or rented; however, the mortgage cannot be more than 90 days past due, on nonaccrual or restructured.

The purpose of this final rule is to implement section 618(b) of RTCRRIA, Public Law 102-233, 105 Stat. 1761 (December 12, 1991), and section 305(b)(1)(B) of FDICIA, Public Law 102-242, 105 Stat. 2236 (December 19, 1991), by lowering the risk weight for certain qualifying multifamily housing loans to 50%. Section 618(b) of RTCRRIA required regulations to be implemented by April 10, 1992. Because of the nature of the issues involved and the need to coordinate this final rule with the FRB, the FDIC and the Office of Thrift Supervision (OTS), this final rule could not be promulgated by that deadline.

The main purpose of RTCRRIA was to recapitalize the Resolution Trust Corporation. However, RTCRRIA also contains provisions relating to the capital treatment of certain single-family and multifamily residential property loans. Specifically, section 618(b) of RTCRRIA requires the OCC to promulgate regulations assigning a 50% risk weight, with certain conditions, to loans secured by multifamily residential properties.

Under section 618(b)(1)(B) of RTCRRIA, in order for a multifamily residential property loan to qualify for a 50% risk weight: (1) The loan must be secured by a first lien on a multifamily residential property consisting of five or more dwelling units, (2) if the loan has a rate of interest that does not change over the term of the loan, then (A) the loan-to-value ratio cannot exceed 80%, and (B) the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to the annual debt service on the loan cannot be less than 120%, (3) if the loan has a variable rate, then: (A) The loan-to-value ratio cannot exceed 75%, and (B) the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to the annual debt service on the loan cannot be less than 115%, (4) the amortization of principal and interest occurs in not more than 30 years, (5) the loan must have a minimum original maturity for repayment of principal of not less than seven years, (6) the loan must have been performing according to its terms for at least one year, and (7) the loan must satisfy prudent underwriting standards as established by the appropriate federal banking agency.

Section 618(b)(1) of RTCRRIA also provides that any security collateralized by a qualifying multifamily residential property loan shall be considered as a loan or security within the 50% risk weight category. In addition, section 618(b)(2) of RTCRRIA requires that the portion of any loan fully secured by a first lien on a multifamily housing property that is sold by a bank subject to a pro rata loss sharing arrangement shall be treated as a sale to the extent that loss is incurred by the purchaser of the loan. Furthermore, section 618(b)(3) of RTCRRIA directs the OCC to amend its risk-based capital guidelines to take into account other loss sharing arrangements to

determine the extent to which such loans should be treated as sold. In addition to the requirements in RTCRRIA, section 305(b)(1)(B) of FDICIA, among other things, requires the OCC to revise the risk-based capital guidelines to reflect the actual performance and expected risk of loss of multifamily mortgages.

The OCC published a notice of proposed rulemaking (NPRM) on September 17, 1992. Consistent with sections 618(b) of RTCRRIA and 305(b)(1)(B) of FDICIA, the NPRM proposed to include in the 50% risk weight category certain loans secured by qualifying multifamily residential properties. In addition, the NPRM proposed that MBSs also qualify for a 50% risk weight provided the MBSs are secured by qualifying multifamily residential property loans. Consistent with the current OCC policy on recourse arrangements, the NPRM also proposed that the portion of multifamily residential property loans that is sold subject to a pro rata loss sharing arrangement may be treated by the selling bank as sold to the extent that the sales agreement provides for the purchaser of the loan to share in any loss incurred on the loan on a pro rata basis with the selling bank. As for multifamily residential property loans subject to recourse other than on a pro rata loss sharing arrangements, the NPRM did not propose to adopt any special non-pro rata recourse rule specifically for multifamily residential property loans at that time.

Discussion

In the NPRM, the OCC requested comments on several specific issues related to the implementation of section 618(b) of RTCRRIA. The OCC received nine comments in response to the NPRM. Comments were received from trade associations representing both the banking and housing industries, as well as from financial institutions. One commenter opposed the NPRM, while the eight other commenters generally indicated support. After careful consideration of all the comments, the OCC adopts this final rule to amend the risk-based capital guidelines to include in the 50% risk weight category certain loans secured by qualifying multifamily residential properties. This final rule is substantially similar to the rule as proposed in the NPRM. Any significant changes from the proposed rule are discussed below.

A. 50% Risk Weight for Multifamily Housing Loans

This final rule amends the risk-based capital guidelines to include in the 50% risk weight category certain loans fully secured by a first lien on multifamily residential properties. Specifically, loans secured by multifamily residential properties may qualify for a 50% risk weight subject to the following conditions:

- (1) The loan must be secured by a first mortgage on a multifamily

residential property consisting of five or more dwelling units;

(2) The original amortization of principal and interest must not exceed 30 years;

(3) The original minimum maturity for repayment of principal must not be less than seven years;

(4) All principal and interest payments must have been made on a timely basis in accordance with the terms of the loan for at least one year immediately preceding the risk weighting of the loan in the 50% risk weight category;

(5) The loan cannot be otherwise 90 days or more past due, or carried in nonaccrual status;

(6) The loan must be in accordance with applicable lending limit requirements and prudent underwriting standards; and

(7) If the rate of interest does not change over the term of the loan, then the current loan amount must not exceed 80% of the current value of the property, as measured by either the value of the property at origination of the loan (which is the lower of the purchase price or the value as determined by the initial appraisal, or if appropriate, the initial evaluation) or the most current appraisal, or if appropriate, the most current evaluation, and in the most recent fiscal year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service on the loan must not be less than 120%; or

(8) If the rate of interest changes over the term of the loan, then the current loan amount must not exceed 75% of the current value of the property, as measured by either the value of the property at origination of the loan (which is the lower of the purchase price or the value as determined by the initial appraisal, or if appropriate, the initial evaluation) or the most current appraisal, or if appropriate, the most current evaluation, and in the most recent fiscal year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service on the loan must not be less than 115%.

As indicated above, most of the commenters indicated general support for the NPRM; however, two commenters questioned whether multifamily housing loans should be permitted to qualify for the 50% risk weight category considering the greater delinquency rates on multifamily residential properties compared to single-family owner-occupied residential properties. The OCC shares this concern. However, the 50% risk weight is mandated by section 618(b) of RTCRRIA, and as discussed in the NPRM, the OCC believes that subject to the conditions imposed by this final rule, a 50% risk weight for multifamily housing loans can be justified.

1. Definition of Multifamily Residential Property

In the NPRM, the term "multifamily residential property" was defined as residential property² consisting of five or more

dwelling units. The NPRM did not place any upper limit on the number of units that could be in a multifamily residential property. However, in view of the OTS risk-based capital rules, which limit qualifying multifamily residential property to 5 to 36 units, see 12 CFR 567.1(v) and 567.6(a)(1)(iii)(B), the OCC requested specific comments on whether a similar limit on the number of units should be adopted.

\2\12 CFR part 3, appendix A, section 1(c)(21) defines residential property to mean houses, condominiums, cooperative units, and manufactured homes but does not include boats or motor homes, even if used as a primary residence.

The OCC received five comments on this issue. All five commenters opposed any restriction on the number of units for qualifying multifamily residential property. Several commenters noted the absence of any evidence suggesting that multifamily residential properties with a large number of units pose an inherently greater risk than those with fewer units.

The OCC agrees with these commenters. At this time there is no evidence to justify any limitation on the total number of units for qualifying multifamily residential properties. Consequently, the OCC adopts the definition of multifamily residential properties without any restriction on the maximum number of units. As for regulatory uniformity with the OTS, the OCC notes that the OTS is presently considering deletion of the 36 unit restriction on qualifying multifamily residential property for savings and loan associations. See 57 FR 40143 (September 2, 1992).

In addition, this final rule further clarifies the definition of multifamily residential property by adding a separate definition for multifamily residential property. In the NPRM, multifamily residential property was not separately defined, but instead the NPRM made reference to the current definition of residential property. The new definition in this final rule is not intended to change the meaning of multifamily residential property. The purpose of the new definition is to make clear that while multifamily residential property would include apartment buildings, condominiums, cooperatives, and other similar structures primarily for residential use, it would not include such facilities as nursing homes and hospitals. Because multifamily residential property is defined as property primarily for residential use, this definition also clarifies that some limited commercial use would be permitted. Therefore, a commercial establishment, such as a convenience store located in an apartment building, would not automatically disqualify the apartment building as a multifamily residential property.

2. 80% Occupancy Rate

In the NPRM, the OCC proposed an additional 80% occupancy rate requirement, which would have required that the multifamily residential property securing the loan have a sustained average annual occupancy rate of at least 80% of the total units. The OCC received 3 comments on this issue. All of the commenters generally believe that the 80% occupancy rate requirement was unnecessary because of the annual net income requirement which requires timely payment of all principal and interest for one year and the loan-to-value requirements. As one commenter explained, any decrease in income resulting from declining occupancy would be reflected in the annual cash flows and would be captured by the annual net income requirement. In addition, the commenter also indicated that the 80% occupancy requirement only relates to the degree of physical space leased and is not dispositive of the ability to service the debt.

The OCC has considered these comments and agrees with the commenters. Therefore, the 80% occupancy requirement has been removed from this final rule. The OCC agrees that a high occupancy rate, in itself, does not guarantee sufficient cash flow to service the debt. The OCC believes that the annual net income requirement in conjunction with the loan-to-value requirements and the 90-day past due requirement should provide sufficient prudential safeguards. In addition, the OCC believes that removing the 80% occupancy requirement will also benefit developers renovating older buildings for low- and moderate-income occupants. These developers frequently encounter difficulty in achieving 80% occupancy during project startup. Removal of the requirement will enable more loans for these types of projects to qualify for the 50% risk weight.

3. One-Year Timely Payment Requirement

As required by section 618(b)(1)(B)(iii)(III) of RTCRRIA, the NPRM required that all principal and interest payments have been made on a timely basis in accordance with the terms of the loan for at least one year before the multifamily residential property loan can qualify for the 50% risk weight. In addition, for prudential reasons, the OCC proposed to require that the multifamily residential property loan could not be more than 90 days past due or on nonaccrual status.

This final rule adopts both the one-year timely payment requirement and the 90-day past due requirement. With respect to the one-year timely payment requirement, this final rule clarifies that the one-year timely payment requirement must be satisfied in the year immediately preceding the risk weighting of the loan in the 50% risk weight category. It also should be noted that the one-year timely payment requirement is a one-time only requirement. Once the multifamily residential property loan has performed in accordance with its terms for at least one year immediately preceding the risk weighting of the loan in the 50% risk weight category, the loan may continue to qualify

for the 50% risk weight without any further regard to that requirement. Unlike the one-year timely payment requirement, the 90-day past due requirement is an ongoing requirement. As such, the OCC does not believe that it is necessary to apply the one-year timely payment requirement on a continuous basis.

It also should be noted that this final rule slightly changes the wording of the 90-day past due requirement. In the NPRM this requirement was stated as a loan ``not more than 90 days past due." This final rule revises the wording of the 90-day past due requirement to a loan ``not otherwise 90 days or more past due." Under this revised language, a loan would be considered past due on the ninetieth day, instead of the ninety-first day. Adoption of this language will make the 90-day past due requirement in the risk-based capital guidelines more consistent with the Instructions to the Reports of Condition and Income (Call Report).

4. Loan-to-Value Requirements

In the NPRM, the OCC expressed concern that sections 618(b)(1)(B)(ii) (I) and (II) of RTCRRIA are unclear as to when the specified loan-to-value ratios for qualifying multifamily residential property loans would have to be satisfied. The OCC requested comment on the application of these loan-to-value requirements. Specifically, the OCC requested comment on: (1) Whether a multifamily residential property loan that does not satisfy the loan-to-value requirements at the time of origination should be permitted to do so at some later time, and (2) whether a multifamily residential property loan that satisfies the loan-to-value requirements at the time of origination, but subsequently does not, thereafter should be ineligible for a 50% risk weight.

The OCC received four comments on this issue. Three commenters supported the reclassification of multifamily residential property loans into the 50% risk weight category if the loans subsequently satisfy the loan-to-value requirements. However, these commenters did not believe that multifamily residential property loans that already qualify for the 50% risk weight category should be reclassified in the 100% risk weight category even if the loans subsequently failed to satisfy the loan-to-value requirements. The commenters generally believed that once a multifamily residential property loan qualifies for the 50% risk weight category, any deterioration in the loan-to-value ratio should be addressed through the loan loss reserve and not through reclassification of the loan to the 100% risk weight category. One commenter specifically expressed caution against establishing a regulatory requirement for the periodic reappraisal of multifamily residential property that would determine if the loan can continue to qualify for the 50% risk weight category.

The OCC agrees that a multifamily residential property loan that does not satisfy the loan-to-value requirements at the time of the

origination of the loan should be permitted to do so at some later time. Therefore, this final rule has been changed to make clear that multifamily residential property loans that do not satisfy the appropriate loan-to-value ratio at origination, may still qualify for the 50% risk weight category if the loan-to-value requirements are satisfied subsequently. However, the OCC does not believe that once a multifamily residential property loan qualifies for the 50% risk weight category the loan should never be reclassified into the 100% risk weight category if the loan subsequently fails to satisfy the loan-to-value requirements or any other relevant requirement. Such treatment would be inconsistent with the general principles and application of the risk-based capital guidelines.

Under the risk-based capital guidelines, an asset may qualify for a lower risk weight only if all requirements imposed for that risk weight have been satisfied. The requirements generally must be met continuously and not only on a one time basis. Failure to satisfy the requirements for a lower risk weight could be indicative of an increase in risk for that asset. Therefore, the risk-based capital guidelines would properly require more capital to be held against that asset. For these reasons, the OCC believes that a multifamily residential property loan, like any other asset under the risk-based capital guidelines, may be reclassified into the 100% risk weight category if the loan subsequently fails to satisfy the requirements established by this final rule.

The OCC agrees that any deterioration in a multifamily residential property loan also should be managed through the loan loss reserve. However, this does not mean that multifamily residential property loans that no longer satisfy the loan-to-value ratio requirements should continue to have the benefit of a preferential risk weight. While the loan loss reserve and the capital requirements strive to achieve similar results, the purpose of the two are distinct. The loan loss reserve recognizes estimated inherent losses, whereas the risk-based capital guidelines recognize relative risk in the portfolio.

In the NPRM the loan-to-value ratio calculation was based on the ratio of the loan amount at origination to the appraised value of the multifamily residential property. Limiting the calculation of the loan-to-value ratio requirement to the loan amount at origination suggested that the loan-to-value ratio was a static requirement. However, the loan-to-value ratio requirement is intended to be an ongoing requirement, which must be satisfied on a continuous basis in order for a multifamily residential property loan to qualify for the 50% risk weight. Therefore, this final rule makes clear that the calculation of the loan-to-value ratio requirement is not limited to the loan amount at origination and the initial appraised value of the property, but instead is based on both the current loan amount outstanding and the current value of the property. In determining the current value of a

multifamily residential property, the final rule specifies that current value may be measured by either the value of the property at origination of the loan (which is the lower of the purchase price or the value as determined by the initial appraisal, or if appropriate, the initial evaluation) or the most current appraisal, or if appropriate, the most current evaluation.

Two points should be emphasized. First, while appraisals serve an important role in the determination of the loan-to-value ratio, this is not to imply that periodic appraisals are required. Rather, the OCC believes that with prudent management of the loan portfolio, a bank would be aware of changes in market conditions which could negatively impact the loan-to-value ratio. Second, in some instances a less formal evaluation of the multifamily residential property may be more appropriate than a full appraisal.

In addition to the loan-to-value requirements, sections 618(b)(1)(B)(ii) I and II of RTCRRRIA also specified certain net operating income-to-debt service coverage ratios that must be satisfied. The OCC recognizes that certain multifamily residential properties developed as low- to moderate-income multifamily housing may not be able to generate sufficient income to satisfy the net operating income-to-debt service requirements. The OCC believes that organizations that develop low- to moderate-income multifamily residential properties may meet the net operating income-to-debt service requirements by generating sufficient cash flows to provide comparable protection to the institution. Therefore, this final rule permits other forms of debt service coverage that generate sufficient cash flows to provide comparable protection to the institution to be considered for multifamily residential property loans, if the purpose of the loan is for the development or purchase of residential property primarily intended to provide low- to moderate-income housing. Forms of comparable debt service coverage that may be considered include, but are not limited to, special operating reserve accounts or special operating subsidies provided by federal, state, local or private sources. However, the OCC does reserve the right to review, on a case-by-case basis, the adequacy of any other form of comparable debt service coverage relied on by the bank.

5. Other Legal Requirements and Prudent Underwriting Standards

In addition to the requirements specified by section 618(b) of RTCRRRIA, the NPRM also proposed that a multifamily residential property loan must be in accordance with applicable lending limit requirements and prudential underwriting standards. This final rule does not contain any reference to the legal lending limit. As explained in the NPRM, the reference to the legal lending limit was intended to impose an additional prudential requirement by using the legal lending limit as a proxy for a general concentration limitation.

The OCC still believes that any particular multifamily residential

property loan must be within the legal lending limit and that the overall concentration of multifamily residential property loans by any bank should be reasonable and not excessive. However, after further consideration of this issue, the OCC believes that a specific reference in the risk-based capital guidelines to the legal lending limit is unnecessary. The legal lending limit already would apply to all loans, including multifamily residential property loans provided for in this final rule.

6. Treatment of Refinanced Loans

This final rule amends the risk-based capital guidelines to clarify the treatment of multifamily residential property loans that have been refinanced by the borrower. This final rule clarifies that the prior payment history of a refinanced loan and previous net operating income of the multifamily residential property are considered in determining whether the one-year timely payment requirement and the annual debt service requirement have been satisfied. Specifically, this final rule provides that if the loan was refinanced by the borrower then: (1) All principal and interest payments on the loan being refinanced, which were made in the preceding year prior to refinancing, shall apply in determining the one-year timely payment requirement, and (2) the net operating income generated by the property in the preceding year prior to refinancing shall apply in determining the applicable annual debt service ratio requirements.

The OCC believes that a multifamily residential property loan that otherwise would qualify for the lower 50% risk weight category under this final rule should not be disqualified simply because the loan has been refinanced by the borrower. The OCC generally believes that a multifamily residential property loan that has been refinanced by the same borrower typically would not result in any increase in risk with respect to either the one-year timely payment requirement or the applicable annual debt service ratio requirement. Therefore, under this final rule, if a borrower refinances a multifamily residential property loan that previously qualified for the 50% risk weight category, the refinanced loan generally should not be disqualified by virtue of the one-year timely payment requirement or the applicable annual debt service ratio requirement.

7. Optional Capital Treatment

One commenter expressed concern that the final rule should be amended to make clear that the lower 50% risk weight category, with its attendant requirements for multifamily residential property loans, is optional and not mandatory. The OCC agrees, and reiterates that a bank can always decide to risk weight any asset in a higher risk weight category. As explained by the commenter, this could be particularly relevant to a multifamily residential property loan where a bank might determine that it would be more prudent to keep the loan in the 100% risk weight category than having to justify a 50% risk weight at some

later date.

8. Credit Enhancements

One commenter suggested that credit enhancements, such as letters of credit, certificates of deposit, and other enhancements provided by the borrower, should be considered in determining whether a multifamily residential property loan qualifies for the lower 50% risk weight. As an example, the commenter cited the situation where a borrower may offer some credit enhancement to cover an income shortfall. The OCC agrees that in some instances credit enhancements should be considered in determining the proper risk weight of multifamily residential property loans. Under the current risk-based capital guidelines, claims that otherwise would be required to be in a higher risk weight category may qualify for a 20% risk weight if supported by a credit enhancement such as a financial guarantee-type letter of credit from an OECD financial institution. Therefore, to a degree, credit enhancements issued by OECD financial institutions are already considered. However, as with other types of credit enhancements generally issued by private sector entities, the OCC does not believe that a lower risk weight for multifamily residential property loans supported by credit enhancements issued by non-OECD financial institutions is warranted at this time. See 54 FR 4168, 4172 (January 27, 1989).

9. Cooperative Housing

One commenter raised the issue of whether the 50% risk weight for multifamily residential property loans would include a cooperative housing loan in which the master mortgage is a joint obligation of the shareholders in the cooperative. The OCC believes that the final rule, as adopted, would include loans to cooperatives.

As discussed above, this final rule provides a separate definition of multifamily residential housing which includes both condominiums and cooperatives. Therefore, a loan consisting of a master mortgage on a cooperative would be included within the definition of a multifamily residential property loan and would qualify for the 50% risk weight category, if the loan otherwise satisfies the requirements of this final rule. It should be noted, however, that with respect to the debt service requirement, this final rule would also permit other forms of debt service coverage to be considered, if the other form of debt service coverage generates sufficient cash flows to provide comparable protection to the institution.

As explained by one commenter, the unique structure of financing for cooperative housing would normally make it impossible for the cooperative borrower to satisfy the debt service requirements in the conventional sense. The OCC does not believe that a cooperative housing loan should be automatically disqualified from the 50% risk weight category for this reason alone. Therefore, this final rule would also permit comparable debt service coverage to be considered for cooperative housing loans as well as loans for the development or

purchase of multifamily residential property housing intended to provide low- to moderate-income housing.

B. Mortgage-Backed Securities

This final rule amends the risk-based capital guidelines to clarify that privately-issued mortgage-backed securities (MBS) may qualify for a 50% risk weight, if at the time of origination of the MBSs, the MBSs are secured by or otherwise represent a sufficiently secure interest in qualifying multifamily residential property loans. Absent this change in the risk-based capital guidelines, MBSs secured by multifamily residential property loans generally could never have qualified for a 50% risk weight.

As explained in the NPRM, section 3(a)(3)(iv) of RTCRRIA of the current risk-based capital guidelines would assign a risk weight to privately issued MBSs based on the risk weight of the underlying mortgage loans at the time of origination of those loans. Under this final rule all loans secured by a multifamily residential property are assigned to the 100% risk weight at origination, and may be reassigned to the 50% risk weight only after one year, if the loans satisfy the one-year timely payment requirement and are not otherwise 90 days or more past due or on nonaccrual status. Thus, MBSs secured by multifamily residential loans would all be assigned to the 100% risk weight category absent any change to the risk-based capital guidelines.

In the NPRM the OCC requested specific comment on the proper treatment for MBSs secured by qualifying multifamily residential property loans. The OCC received two comments on this issue. Both of the commenters supported the proposed change.

As required by section 618(b) and for prudential reasons, the OCC believes that multifamily residential property loans should be required to perform in accordance with the terms of the loans for at least one year before qualifying for the lower 50% risk weight. However, the OCC does not believe that this requirement should prohibit MBSs secured by multifamily residential property loans from ever qualifying for the 50% risk weight. Consequently, the OCC adopts this final rule to amend section 3(a)(3)(iv) of this appendix A to permit MBSs to qualify for a 50% risk weight if fully secured by or otherwise represent a sufficiently secure interest in qualifying multifamily residential property loans that have performed in accordance with their terms for at least one year and the loan is not otherwise 90 days or more past due, or on nonaccrual status.³ The OCC believes that permitting MBSs to qualify for the 50% risk weight will benefit low- to moderate-income housing projects. The lower 50% risk weight will enhance the attractiveness of these MBSs. As a result, this should assist in the expansion of the secondary market for the sale of loans on low- to moderate-income multifamily properties.

3 Generally, once a MBS qualifies for a lower risk weight, the MBS would not have to be reclassified to the 100% risk weight category unless it subsequently fails to perform as provided for in the agreement. Similarly, MBSs secured by multifamily residential property loans that qualify for the 50% risk weight category would not have to be reclassified to the 100% risk weight category even if the underlying multifamily residential property loans subsequently fail to satisfy the requirements for the 50% risk weight, provided that the MBSs themselves continue to perform as agreed and are not otherwise 30 days or more past due.

C. Recourse Arrangements

This final rule amends the risk-based capital guidelines to permit the portion of multifamily residential property loans that is sold subject to a pro rata loss sharing arrangement to be treated by the selling bank as sold to the extent that the sales agreement provides for the purchaser of the loan to share in any loss incurred on the loan on a pro rata basis with the selling bank. This amendment is required by section 618(b)(2) of RTCRRIA, which provides that any loan fully secured by a first lien on a multifamily housing project that is sold subject to a pro rata loss sharing arrangement shall be treated as sold to the extent that loss is incurred by the purchaser of the loan.⁴ In addition, the OCC notes that while sales treatment is required by section 618(b)(2) of RTCRRIA for that portion of multifamily residential property loans sold on a pro rata loss sharing basis, this amendment is consistent with, and merely restates the current OCC policy on assets sold with recourse on a pro rata basis as applied to multifamily residential property loans. Under the risk-based capital guidelines, the definition of the sale of assets with recourse is adopted from the definition contained in the Instructions to the Call Report. See 12 CFR part 3, appendix A, section 3(b)(1)(iii) (footnote 14). Specifically, the Instructions to the Call Report state:

4 Section 618(b)(2) of RTCRRIA further defines pro rata loss sharing arrangement as an agreement providing that the purchaser of a loan shares in any loss incurred on the loan with the selling institution on a pro rata basis.

[I]f the risk retained by the seller is limited to some fixed percentage of any loss that might be incurred and there are no other provisions, resulting in retention of risk, either directly or

indirectly, by the seller, the maximum amount of possible loss for which the selling bank is at risk (the stated percentage times the sale proceeds) shall be reported as a borrowing and the remaining amount of the assets transferred reported as a sale.

See Call Report, Glossary--Sale of Assets: Interpretation and illustrations of the general rule 2, A-50 (5-89). Therefore, the sale of a loan fully secured by a first lien on a multifamily residential property is accorded sales treatment and is not treated as recourse to the extent that loss is shared proportionately by the purchaser of the loan.

Section 618(b)(3) of RTCRRIA also requires the OCC to take into account other loss sharing arrangements (besides pro rata loss sharing arrangements) for the purpose of determining the extent to which multifamily residential property loans shall be treated as sold.

As for other recourse arrangements (not on a pro rata basis), the OCC has decided not to adopt any rule for other loss sharing arrangements specifically relating to the sale of multifamily residential property loans at this time. As explained in the NPRM, the OCC, as part of the Federal Financial Institutions Examination Council (FFIEC), is currently studying the overall treatment of asset sales with recourse. See 55 FR 26766 (June 29, 1990). In this context, the OCC will also be considering the possible adoption of other recourse arrangements for the sale of multifamily residential property loans. Until the FFIEC study is complete, the OCC believes that any adoption of other recourse arrangements specifically for the sale of multifamily residential property loans would be premature.

In the NPRM, the OCC requested specific comment on this issue. The OCC received two comments. Both commenters generally supported the proposed rule on recourse based on a pro rata loss sharing arrangement. However, with respect to other loss sharing arrangements, one commenter believed that the proposed rule did not fully satisfy the requirement in section 618(b) of RTCRRIA to take into account other risk sharing arrangements.

The OCC has reviewed the statutory requirement in section 618(b) of RTCRRIA and believes that the OCC has discretion with respect to the adoption of other loss sharing arrangements. In pertinent part, section 618(b) provides that the OCC shall amend the regulations to take into account other loss sharing arrangements for the purposes of determining the extent to which such loans shall be treated as sold. The OCC believes that section 618(b) of RTCRRIA only requires that the OCC determine the extent to which multifamily residential property loans sold on a non-pro rata recourse basis should be afforded sales treatment but that section 618(b) of RTCRRIA does not automatically require sales treatment for such loans. In this regard, the OCC believes that the capital treatment of multifamily residential property

loans sold on a non-pro rata basis should be considered in a comprehensive manner by the banking agencies in the broad context of the FFIEC recourse study.

D. Section 305(b)(1)(B) of FDICIA

Section 305(b)(1)(B) of FDICIA, among other things, requires the OCC to revise the risk-based capital guidelines to reflect the actual performance and expected risk of loss of multifamily mortgages. This final rule satisfies the requirement of section 305(b)(1)(B) of FDICIA. As indicated by the table published in the NPRM, the overall credit risk for multifamily residential property loans is significantly greater than the credit risk for qualifying single-family residential property loans. While multifamily residential property loans generally may have more credit risk than single-family residential property loans, the OCC believes that multifamily residential property loans merit a 50% risk weight if they are well-secured, demonstrate consistent good performance, conform with prudent underwriting standards and otherwise satisfy the requirements imposed by this final rule.

E. Impact on Low- and Moderate-Income Multifamily Housing

In implementing this final rule, the OCC is particularly concerned with the impact of this amendment on low- and moderate-income multifamily housing. In the NPRM, the OCC requested comment on whether the proposed rule would assist organizations in their ability to provide low and moderate-income multifamily housing (rehabilitated or new construction). The OCC received five comments on this issue. Three of the commenters believed that the proposed rule would provide a needed stimulus to the housing sector and the economy. However, one commenter expressed concerns about credit allocation through bank capital requirements. Another commenter indicated support for sound minority and low- and moderate-income mortgage lending but cautioned against using the capital rule as the only means to accomplish those goals.

The OCC has carefully considered these comments and basically agrees with the commenters. The OCC believes that this final rule strikes a balance between the support for affordable housing and prudent lending.

F. Technical and Conforming Amendments

In addition to the substantive changes, this final rule makes two technical and conforming amendments to the risk-based capital guidelines. First, the cross-references to section 3(a)(3)(iv) in the

introductory text and footnote 10 of section 3 are revised to cross-reference section 3(a)(3)(vi). This amendment is necessary to correct an error created when a new paragraph was added to section 3(a)(3) relating to residential construction loans secured by presold homes. See 57 FR 40302 (September 3, 1992). These cross-references should refer to the paragraph on privately issued mortgage-backed securities and not to the paragraph on residential construction loans.

Second, the wording of the 90-day past due requirement is changed to conform to the language adopted elsewhere in this final rule.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, it is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required.

This final rule reduces the amount of capital required to be maintained by national banks for qualifying multifamily residential property loans. While the exact overall impact of this final rule will depend on the amount of qualifying multifamily residential property loans that are held by any particular bank, the OCC does not believe that lowering the capital requirements for these types of loans should significantly impact national banks, regardless of size. In addition, while this final rule would apply to all national banks, this final rule should not have a disproportionate effect on small banks.

Executive Order 12866

The OCC has determined that this final rule is not a significant regulatory action. This final rule will reduce the amount of capital required to be maintained by national banks for qualifying multifamily residential property loans. Although the exact overall impact of this final rule will depend on the amount of qualifying multifamily residential property loans held by any particular bank, the OCC does not believe that lowering the capital requirements for these types of loans should significantly impact national banks. Additionally, the OCC believes that this final rule will generally benefit banks and the housing industry by reducing somewhat the cost of bank operations and by encouraging multifamily housing lending.

Immediate Effective Date

Section 4(c) of the Federal Administrative Procedure Act (12 U.S.C. 553(d)) requires a final rule to be published 30 days prior to its effective date unless the agency provides otherwise for good cause found and published with the rule. This amendment to the capital

adequacy rule is needed immediately to foster lending for the reconstruction of multifamily housing in areas of the country recently devastated by natural disaster. For this reason, the OCC finds good cause to waive the usual 30-day delay in effectiveness of a final rule. Accordingly, this final rule is effective immediately upon publication in the Federal Register.

List of Subjects in 12 CFR Part 3

Administrative practice and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

Authority and Issuance

For the reasons set forth in the preamble, appendix A of part 3 of chapter I of title 12 of the Code of Federal Regulations is amended as set forth below.

PART 3--AMENDED

1. The authority citation for part 3 continues to read as follows:

Authority: 12 U.S.C. 93a, 161, 1818, 1828(n), 1831n note, 3907, and 3909.

2. In appendix A, section 1, paragraphs (c)(14) through (c)(28) are redesignated as paragraphs (c)(15) through (c)(29), respectively, and a new paragraph (c)(14) is added to read as follows:

Appendix A--Risk-Based Capital Guidelines

* * * * *

Section 1 Purpose, Applicability of Guidelines, and Definitions

* * * * *

(c) * * *

(14) Multifamily residential property means any residential property consisting of five or more dwelling units including apartment buildings, condominiums, cooperatives, and other similar structures primarily for residential use, but not including hospitals, nursing homes, or other similar facilities.

* * * * *

Appendix A--[Amended]

3. In Appendix A, section 3, paragraph (a)(3)(v) is redesignated as paragraph (a)(3)(vi), the introductory text of newly designated paragraph (a)(3)(vi) is revised, a new paragraph (a)(3)(v), including new footnotes 11a and 11b, is added, the last sentence in the second paragraph of the introductory text of section 3 and the last sentence in footnote 10 in paragraph (a)(2)(vii) are amended by replacing the phrase "section 3(a)(3)(iv) of this appendix A" with the phrase "section 3(a)(3)(vi) of this appendix A", and the first sentence in paragraph (a)(3)(iii) is amended by replacing the phrase "not more than 90 days past due," with the phrase "not otherwise 90 days or more past due," to read as follows:
* * * * *

Section 3 Risk Categories/Weights for On-Balance Sheet Assets and Off-Balance Sheet Items

* * * * *

(a) * * *

(3) * * *

(v) Loans secured by a first mortgage on multifamily residential properties :<SUP>11a

11a The portion of multifamily residential property loans that is sold subject to a pro rata loss sharing arrangement may be treated by the selling bank as sold to the extent that the sales agreement provides for the purchaser of the loan to share in any loss incurred on the loan on a pro rata basis with the selling bank. The portion of multifamily residential property loans sold subject to any loss sharing arrangement other than pro rata sharing of the loss shall be accorded the same treatment as any other asset sold under an agreement to repurchase or sold with recourse under section 3(b)(1)(iii) (footnote 14) of this appendix A.

(A) The amortization of principal and interest occurs in not more than 30 years;

(B) The minimum original maturity for repayment of principal is not less than 7 years;

(C) All principal and interest payments have been made on a timely basis in accordance with the terms of the loan for at least one year immediately preceding the risk weighting of the loan in the 50% risk weight category, and the loan is not otherwise 90 days or more past due, or on nonaccrual status;

(D) The loan is made in accordance with all applicable

requirements and prudent underwriting standards;

(E) If the rate of interest does not change over the term of the loan:

(I) The current loan amount outstanding does not exceed 80% of the current value of the property, as measured by either the value of the property at origination of the loan (which is the lower of the purchase price or the value as determined by the initial appraisal, or if appropriate, the initial evaluation) or the most current appraisal, or if appropriate, the most current evaluation; and

(II) In the most recent fiscal year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service on the loan is not less than 120%;<SUP>11b

\1\1bFor the purposes of the debt service requirements in sections 3(a)(3)(v)(E)(II) and 3(a)(3)(v)(F)(II) of this appendix A, other forms of debt service coverage that generate sufficient cash flows to provide comparable protection to the institution may be considered for (a) a loan secured by cooperative housing or (b) a multifamily residential property loan if the purpose of the loan is for the development or purchase of multifamily residential property primarily intended to provide low- to moderate-income housing, including special operating reserve accounts or special operating subsidies provided by federal, state, local or private sources. However, the OCC reserves the right, on a case-by-case basis, to review the adequacy of any other forms of comparable debt service coverage relied on by the bank.

(F) If the rate of interest changes over the term of the loan:

(I) The current loan amount outstanding does not exceed 75% of the current value of the property, as measured by either the value of the property at origination of the loan (which is the lower of the purchase price or the value as determined by the initial appraisal, or if appropriate, the initial evaluation) or the most current appraisal, or if appropriate, the most current evaluation; and

(II) In the most recent fiscal year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service on the loan is not less than 115%; and

(G) If the loan was refinanced by the borrower:

(I) All principal and interest payments on the loan being refinanced which were made in the preceding year prior to

refinancing shall apply in determining the one-year timely payment requirement under paragraph (a)(3)(v)(C) of this section; and

(II) The net operating income generated by the property in the preceding year prior to refinancing shall apply in determining the applicable debt service requirements under paragraphs (a)(3)(v)(E) and (a)(3)(v)(F) of this section.

(vi) Privately-issued mortgage-backed securities, i.e. those that do not carry the guarantee of a government or government-sponsored agency, if the privately-issued mortgage-backed securities are at the time the mortgage-backed securities are originated fully secured by or otherwise represent a sufficiently secure interest in mortgages that qualify for the 50% risk weight under paragraphs (a)(3) (iii), (iv) and (v) of this section,¹² provided that they meet the following criteria:

\1\2If all of the underlying mortgages in the pool do not qualify for the 50% risk weight, the bank should generally assign the entire value of the security to the 100% risk category of section 3(a)(4) of this appendix A; however, on a case-by-case basis, the OCC may allow the bank to assign only the portion of the security which represents an interest in, and the cash flows of, nonqualifying mortgages to the 100% risk category, with the remainder being assigned a risk weight of 50%. Before the OCC will consider a request to risk weight a mortgage-backed security on a proportionate basis, the bank must have current information for the reporting date that details the composition and cash flows of the underlying pool of mortgages.

* * * * *

4. In appendix A, table 1 is amended by adding paragraph 5 to Category 3 to read as follows:

* * * * *

TABLE 1--SUMMARY OF RISK WEIGHTS AND RISK CATEGORIES

* * * * *

Category 3: 50 Percent

* * * * *

5. Assets secured by a first mortgage on multifamily residential properties.

* * * * *

Dated: January 14, 1994.

Eugene A. Ludwig,
Comptroller of the Currency.
[FR Doc. 94-5385 Filed 3-8-94; 8:45 am]
BILLING CODE 4810-33-P