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|  <b>Office of Credit Unions</b><br><b>Policies and Procedures</b> | <b>POLICY NUMBER</b>  |
|  | <b>10315</b>          |
| <b>LENDING</b>   | <b>EFFECTIVE DATE</b> |
|  | <b>11/01/2018</b>     |
| <b>SUBJECT</b>   | <b>REVISION DATE</b>  |
|  | <b>11/01/2018</b>     |
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## I. PURPOSE

Examiners must determine the levels of credit and interest rate risk in the real estate loan portfolio, the potential impact to the financial condition, and ascertain compliance with state and federal regulations. Examiners must assess management’s knowledge and capacity to grant quality loans and adequately manage the real estate loan portfolio.

## II. PRIMARY REFERENCES

1. Michigan Credit Union Act:
  - a. [Section 421](#): Credit Committee; Powers; Loan Officers; etc.
  - b. [Section 422](#): Loan Agreement with Member or Another Other Domestic Credit Union.
  - c. [Section 423](#): Loan Conditions; Rates, Terms or Conditions to Officials or Family Member; etc.
2. [Real Estate Settlement Procedures Act](#) (RESPA, Regulation X)
3. [Truth in Lending Act](#) (Regulation Z)
4. [Equal Credit Opportunity Act](#) (Regulation B)
5. [S.A.F.E. Mortgage Licensing Act](#) – Federal Registration of Residential Mortgage Loan Originators (Regulation G)
6. [S.A.F.E. Mortgage Licensing Act](#) – State Compliance and Bureau Registration System (Regulation H)
7. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) - Section [1411](#) and [1412](#) - Ability to Repay Rule
8. [NCUA Regulatory Alert 14-RA-09](#) Updated Ability-to-Repay and Qualified Mortgage Requirements from the Consumer Financial Protection Bureau (CFPB)
9. [NCUA Regulatory Alert 14-RA-05](#) Mortgage Loan Originator Compensation Requirements for the Consumer Financial Protection Bureau (CFPB)
10. [NCUA Rules and Regulations 722](#) “Appraisals”
11. [Home Mortgage Disclosure Act](#) (HMDA, Regulation C)
12. [Flood Disaster Protection Act](#)
13. [Fair Credit Reporting Act](#) (Regulation V)
14. [Fair Debt Collection Practices Act](#) (Regulation F)
15. [Fair Housing Act](#)


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### III. MINIMUM PROCEDURES

The following provides basic guidelines for reviewing real estate lending practices and documentation.


#### 1. Real Estate Lending Policy

- a. The Board of Directors must develop and adopt comprehensive, written loan policies which define each type of loan product offered. These policies must promote safety and soundness within the credit union. At a minimum, the loan policy should address the following:
  - i. Individual, aggregate, and portfolio limits for each type or class of loan.
  - ii. Loan application and underwriting documentation requirements, and loan approval criteria. Loan approval criteria must include such factors as debt ratios, loan-to-value ratios, disposable income, recent verification of income and employment, credit history, tax returns, and financial statements.
  - iii. Procedures and documentation to approve exceptions to the loan policy.
  - iv. Payment terms, amortization periods, and maximum maturity for each loan type.
  - v. Collateral requirements and valuation methods, including criteria and procedures for substitution and release of security.
  - vi. Criteria for real estate and commercial lending, including approved loan structures and participations, loan-to-value limitations, trade areas, assumption criteria, appraisals and valuation requirements, title and hazard insurances, annual monitoring, and other risk management factors.
  - vii. Controls and practices to ensure compliance with all applicable state and federal regulations governing disclosure and underwriting requirements.
  - viii. Policies, procedures, and tracking systems to ensure receipt of perfected liens, recorded mortgages, current insurance, and loss payee status.
  - ix. Criteria and timeframes for classifying and charging off various loan types.
  - x. Collection procedures and timeframes.
  - xi. Extension and refinancing criteria and limitations.

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## 2. General Real Estate Lending Review:

- a. Review the real estate files to ensure they document the following:
  - i. Signed loan application
  - ii. Evidence of the borrower(s) ability to repay the loan. Loan files should contain documentation of a debt ratio calculation or other evidence of financial capacity to repay. Examiners should review both the total and unsecured debts in relation to a borrower's total income.
  - iii. Review of the borrower's payment history demonstrating the historical willingness/ability to repay (generally, through the review of a current credit report).
  - iv. Adequate homeowner's insurance showing the credit union as loss payee.
  - v. Proof of paid real estate taxes on the collateral property.
  - vi. Compliance with the [Flood Disaster Protection Act](#).
  - vii. Adequate title insurance, including:
    - (1) Title Commitment (with evidence of conditions being met); and Final Title Policy.
    - (2) Other evidence the risk of faulty title is being mitigated sufficiently.
  - viii. Properly recorded mortgage completed in an appropriate time frame.
  - ix. Verified valuation of the property through either:
    - (1) Professional appraisal
    - (2) State Equalized Valuation (SEV), used in conjunction with a reasonable factor
    - (3) Other independent and reliable valuation method
  - x. Compliance with [RESPA](#) requirements (as applicable).
  - xi. Compliance with [Truth in Lending](#) disclosures including Right of Rescission (as applicable).
  - xii. Verification of senior liens (if any), and their impact on the loan-to-value.
  - xiii. For purchase money loans, ensure the file contains the following additional documentation:
    - (1) Warranty deed
    - (2) Purchase agreement (if applicable)
- b. Home Equity Lines of Credit (HELOC), additional procedures:
  - i. Ensure reasonable credit limits are established and controls exist to prevent borrowers from exceeding their approved credit limits.

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- ii. Ensure management is reviewing and monitoring existing lines of credit, including recognizing the expiration of draw periods (as applicable).
- iii. For adjustable rates, ensure the rate is tied to a publicly disclosed index and test a sample of loans to ensure rates are adjusting appropriately.
- c. Construction loans, additional procedures:
  - i. Ensure that appropriate draw schedules are implemented.
  - ii. Review the cost estimates for reasonableness.
  - iii. Review the “subject to” appraisal for reasonableness.
  - iv. Ensure loan covenants exist which require periodic progress and inspection reports.
  - v. Ensure a Notice of Commencement was received.
  - vi. Ensure builder’s risk insurance is in effect.
  - vii. Review the title search and adequacy of the title insurance.
  - viii. Ensure lien waivers are received when contractors are paid.
  - ix. Determine if a mortgage loan commitment has been received ensuring end financing is available, after the property is completed.

**3. Evaluate Risk:**

Evaluate the overall level of risk of loss posed to net worth by the real estate loan portfolio, including:

- a. The potential risk of loss through possible foreclosures, short sales, etc., resulting from:
  - i. Poor borrower capacity
  - ii. Questionable collateral values relative to the loan amounts (including senior liens)
  - iii. Questionable end-financing commitments
- b. The liquidity risk posed by:
  - i. Weakened ability to liquidate the loan(s) resulting from the quality of the underwriting and/or documentation.
  - ii. Weakened ability to liquidate the loan(s) resulting from loan terms granted (e.g. extended maturity, lower rates, or atypical index/margin used for rate adjustments).