Office of the Comptroller of the Currency
U.S. Department of the Treasury



**OCC BULLETIN 2017-28**

**Subject: Mortgage Lending**
**Date: August 21, 2017**

**To: Chief Executive Officers of National Banks and Federal Savings Associations, All Department and Division Heads, All Examining Personnel, and Other Interested Parties**

**OMB Control No. 1557-0340**
**Expiration Date: 06/30/19**

**Description: Risk Management Guidance for Higher-Loan-to-Value Lending Programs in Communities Targeted for Revitalization**

## Summary

The Office of the Comptroller of the Currency (OCC) supports efforts by national banks and federal savings associations (collectively, banks) to assist in the revitalization, stabilization, or redevelopment (referred to in this bulletin individually and collectively as revitalization) of distressed communities through responsible residential mortgage lending. The OCC recognizes that banks and other parties have expressed concern that depressed housing values in certain distressed communities in the United States inhibit mortgage lending in these communities. One way that banks can support revitalization efforts in distressed communities is by offering mortgage products for the purchase of, or the purchase and rehabilitation of, one- to four-unit residential properties. This bulletin provides guidance for managing risks to banks and borrowers associated with programs in which residential mortgage loans are originated when the loan-to-value ratio (LTV) at origination exceeds 100 percent (referred to in this bulletin as higher-LTV loans).

## Note for Community Banks

This guidance applies to any OCC-supervised banks wishing to establish a program for originating higher-LTV loans in communities targeted for revitalization. The guidance may offer opportunities for community-focused banks to develop collaborative relationships with one another. Such arrangements should be consistent with the OCC's paper titled "An Opportunity for Community Banks: Working Together Collaboratively," issued on January 13, 2015.[1] As noted in the paper, banks should take care to ensure that collaboration with third parties is subject to effective strategic planning, risk management, and oversight.

## Highlights

This bulletin provides guidance regarding the

- circumstances under which banks may establish a program to originate certain higher-LTV loans.
- OCC's supervisory considerations regarding such programs.

As described in this bulletin, the OCC will actively monitor and evaluate the programs established by banks, including the performance of higher-LTV loans. Additionally, at least annually, the OCC will assess the extent to which banks' programs collectively are contributing to the revitalization of eligible communities and whether banks are adequately controlling the risks associated with originating higher-LTV loans.

**Background**

Home values in some U.S. communities remain depressed, in part because of the financial crisis. These depressed home values contribute to creditworthy borrowers experiencing financing difficulties when seeking home loans in those communities.

As these communities work to stabilize home ownership levels and home values, the rehabilitation of abandoned or distressed housing stock is an important component of broader efforts to strengthen communities. Local governments, government-affiliated entities, community-based organizations, financial institutions (including banks), and others have developed creative solutions for some of these challenges. These solutions include strategies for acquiring and rehabilitating properties in communities targeted for revitalization. Community groups, financial institutions (including banks), non-profit organizations, and state and local entities, including land banks, are working together to develop and implement innovative residential mortgage financing to bring needed lending to economically distressed areas. The efforts include providing second-lien loans to finance rehabilitation costs, interest rate discounts, and down payment and closing cost assistance. Additionally, the Federal Housing Administration, Fannie Mae, and Freddie Mac all currently offer rehabilitation financing.[2]

In addition to participating in these and other third-party efforts, banks have expressed a desire to participate in revitalization efforts of distressed communities by offering their own loan products. The value of the collateral in communities where home values remain depressed often can present challenges to banks' residential lending in part because of current supervisory loan-to-value (SLTV) limits. These SLTV limits generally provide that owner-occupied residential loans with LTVs above 90 percent should have appropriate credit enhancement (for example, mortgage insurance or readily marketable collateral). Distressed sales, including short sales and foreclosures, have negatively affected home values in these communities. Further, in communities with minimal sales activity, finding comparable property sales becomes challenging when appraisals or evaluations are required. All of these factors contribute to buyers of distressed properties experiencing difficulty securing adequate financing to cover the often substantial renovation costs required to make the properties habitable.

The OCC recognizes that supporting long-term community revitalization may necessitate responsible, innovative lending strategies. One way that banks can support revitalization efforts is by lending within established exceptions to the SLTV limits for residential loans. Existing regulations and guidelines recognize that it may be appropriate, in individual cases, for banks to make loans in excess of the SLTV limits, based on support provided by other credit factors.[3] The regulations and guidelines also recognize that banks may provide for prudently underwritten exceptions for creditworthy borrowers whose needs do not fit within the banks' general lending policies, including SLTV limits, on a loan-by-loan basis under certain conditions.[4] These conditions include that the aggregate amount of all loans in excess of the SLTV limits (which includes higher-LTV loans) should not exceed 100 percent of total capital, that the boards of directors establish standards for reviewing and approving exception loans, and that written justification setting forth relevant credit factors accompany all approvals of exception loans.[5] Credit factors for these purposes may include the borrower's capacity to adequately service the debt, the borrower's overall creditworthiness, and the level of funds invested in the property.[6]

The OCC believes that in some circumstances, a bank also can design a *program* to offer higher-LTV loans in communities targeted for revitalization in a manner consistent with safe and sound lending practices and current regulations and guidelines. As described in the "Program Criteria" section of this bulletin, such loans may include loans in eligible communities originated in accordance with the bank program's policies and procedures. Important elements of such a program are the bank's policies and procedures for complying with the ability-to-repay standard of Regulation Z[7] and the bank's separate underwriting standards and approval processes for higher-LTV loans.

Bank lending under such a program may serve the credit needs of individual borrowers and the community, and the bank may receive Community Reinvestment Act consideration depending on the specifics of the program. The origination of higher-LTV loans is not, however, without risk. Using internal bank data, the OCC will monitor and evaluate the performance of the bank's program loans and how the bank's program manages risks to the bank and its borrowers. For its aggregate assessment, which will occur at least annually, the OCC will evaluate the collective impact of programs offered by all banks. In assessing the impact of one or more programs, the OCC recognizes that revitalization efforts may be a multi-year undertaking.

## I. Program Criteria

### A. Program Loan

The proceeds of a program loan should be used to finance the purchase of,[8] or purchase and rehabilitation of, an owner-occupied residential property located in an eligible community. A program loan should be a permanent first-lien mortgage with an LTV ratio at the time of origination that exceeds 100 percent, and without mortgage insurance, readily marketable collateral, or other acceptable collateral. A program loan also should have an original loan balance of $200,000 or less and be originated under a program developed pursuant to this bulletin.

For purposes of this bulletin,

- "rehabilitation" means the repairs necessary to improve a property in substandard condition to a level consistent with applicable building codes. A property is in "substandard condition" when its present condition endangers the health, safety, or well-being of the occupant(s) such that it requires extensive repair for the property to be habitable.
- a "purchase and rehabilitation" loan includes a loan that finances
  - the purchase of the property, plus the projected rehabilitation costs, or
  - the amount of a purchase consummated not more than six months before the date of the bank's loan commitment, plus the projected rehabilitation costs

Program loans do not include home equity loans, lines of credit, or refinancing loans.

### B. Eligible Community

An eligible community should be one that has been officially targeted for revitalization by a federal, state, or municipal governmental entity or agency, or by a government-designated entity such as a land bank.



### C. Program Policies and Procedures

Existing regulations and guidelines require that each bank adopt and maintain a general lending policy that establishes appropriate limits and standards for extensions of credit that are secured by liens on, or interests in, real estate or that finance building construction or other improvements.[9] In addition to the general lending policies developed pursuant to existing regulations and guidelines, banks should have specific policies and procedures that address program loans and that are approved by the board of directors, or an appropriate designee. Policies and procedures should address loan portfolio management, underwriting, and other relevant considerations. These policies and procedures should include provisions that address the

- defined geographies of an eligible community where the bank will consider making program loans[10] and describe how the program loans are intended to support revitalization efforts in the eligible community (for example, how the origination of program loans is expected to contribute to the normalization of a distressed housing market).
- amount and duration of the bank's financial commitment to the program.
- limitation on the aggregate level of committed program loans as a percentage of tier 1 capital (as defined in 12 CFR 3.2), which should not exceed 10 percent.
- characteristics of program loans, including loan structure, credit terms, interest rate and fees, and maximum loan size, which should not exceed $200,000.
- underwriting standards and approval processes for program loans, including appropriate documentation of relevant credit factors and document retention standards.
- real estate appraisal and evaluation criteria applicable to program loans.[11]

- credit administration requirements for program loans, including detailed guidelines regarding oversight of the rehabilitation process, such as controls over contracts, disbursements, inspections, and project management.
- compliance with all applicable laws and regulations, including the ability-to-repay and other requirements of 12 CFR 1026, anti-discrimination laws, and section 5 of the Federal Trade Commission Act.
- content, form, and timing of notice(s) the bank will provide in connection with program loans to clearly inform the borrower that
  - the market value of a property securing a higher-LTV loan is less than the loan amount at origination.
  - the market value of a rehabilitated property likely will be less than the original loan amount upon completion of the rehabilitation.
  - the market value may continue to be less than the original loan amount thereafter and for the duration of the loan.
  - there may be financial implications for the borrower if the borrower seeks to sell the property and the sale price is less than the outstanding loan balance at the time of such sale, and explain the implications.
- incentives that may be available to qualifying borrowers (for example, assistance or grants for down payments, fees, and closing costs, at or below market interest rates; or rewards for long-term occupancy) and home buyer education or other counseling that may be provided by or through the bank or its third-party partners.
- monitoring and internal reporting requirements sufficient to (1) assess program performance and trends and (2) inform the board, or an appropriately designated committee, at least quarterly, of the aggregate dollar amount, and percentage of tier 1 capital, of committed program loans in relation to the program limitations.

D. **Notice to the OCC**

The bank should notify the appropriate OCC supervisory office in writing at least 30 days before the bank intends to begin originating program loans or to make any substantive change to a previously submitted program. Substantive changes may include the addition of a new eligible community, an increase in the financial commitment or duration of a program, or material changes to program loan characteristics or underwriting standards. Such notice should include

- the date the bank's board (or appropriately designated committee) approved the program policies and procedures.
- a copy of the program policies and procedures.

II. **OCC Supervisory Considerations**

A. **Supervision of Individual Banks**

After receiving the bank's notice to the OCC, examiners will evaluate the bank's program to assess whether it is consistent with safe and sound lending practices and the guidelines outlined in this bulletin. Examiners' assessment will include reviewing the

- characteristics of program loans and incentives, if available, to qualifying borrowers.
- standards for the underwriting, collateral review, credit administration, and approval of program loans.
- borrower notice(s).
- monitoring and reporting procedures for program loans.
- process for ensuring compliance with all applicable laws and regulations.
- planned financial commitment (as a dollar amount and a percentage of tier 1 capital)
- defined geographies for originating program loans.

In connection with the evaluation of the bank's program, examiners may request clarification or changes to the bank's policies and procedures before the bank's first origination of a program loan or the bank's making of any substantive change to a previously submitted program. Such requests may include clarification or changes to ensure the program is consistent with safe and sound lending practices.

Thereafter, examiners will monitor and evaluate the bank's program during scheduled supervisory activities and may consider the

- bank's governance of the program and whether the program adequately manages the various risks.
- performance of program loans and whether delinquent program loans are managed and accurately classified consistent with the OCC's existing guidance on delinquent loans and in compliance with applicable laws pertaining to loans in delinquency.[12]
- bank's internal reporting of program performance and trends.
- process to establish and document community development consideration, if applicable, under the Community Reinvestment Act.

Banks with programs that are found to have unsatisfactory governance or controls will be expected to undertake corrective action in order to continue the program and ensure the lending activity is conducted in a safe and sound manner. In addition, examiners may review individual program loans to assess asset quality, credit risk, and consumer compliance.

B. **Overall Evaluation of Programs**

At least annually, the OCC will evaluate the extent to which banks' programs in aggregate are contributing to the revitalization efforts in eligible communities. The OCC's evaluations will consider, among other matters, the effect such programs have had on the housing markets and other economic indicators in eligible communities targeted by the programs, whether the programs adequately control the various risks, and the general performance of program loans. The OCC recognizes that it may take multiple years before revitalization efforts in eligible communities result in material changes.

Based on these evaluations, the OCC may amend or rescind this bulletin. Any decision by the OCC to materially amend or rescind this bulletin will apply only to the origination of new higher-LTV loans. Any loans originated that are consistent with this bulletin, or any subsequent revisions thereof, when made will not be deemed to be unsafe or unsound solely because of any measurable amendment or rescission of this bulletin.



III. **Other Revitalization Efforts**

The OCC encourages banks to continue to develop responsible, innovative lending strategies intended to meet the credit needs of individual borrowers and support revitalization efforts in their communities. The OCC will consider other bank efforts to support revitalization in distressed communities that fall outside the scope of this bulletin, as long as such efforts are consistent with safe and sound lending practices, promote fair access to credit and fair treatment of borrowers, and comply with all applicable laws.

**Further Information**

Please contact Kimberly Hebb, Compliance Risk Policy, at (202) 649-5470; Joseph Smith, Credit Policy, at (202) 649-6670; Krista LaBelle, Community and Consumer Law, at (202) 649-6350; or Ammar Askari, Community Affairs, at (202) 649-6420.

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[1] Refer to OCC NR 2015-1 "Collaboration Can Facilitate Community Bank Competitiveness, OCC Says."

[2]Programs include the Federal Housing Administration's Limited 203(k) Rehabilitation Mortgage Insurance Program, Fannie Mae HomeStyle Renovation, and Freddie Mac Construction Conversion and Renovation Mortgages.

[3] For national banks, refer to 12 CFR 34, appendix A to subpart D, "Interagency Guidelines for Real Estate Lending Policies." For federal savings associations, refer to 12 CFR 160.101, appendix to 12 CFR 160.101, "Interagency Guidelines for Real Estate Lending Policies."

[4] Id.

[5] Id.

[6] Id.

[7] The Dodd-Frank Wall Street Reform and Consumer Protection Act amended the Truth in Lending Act to require creditors to make a reasonable, good faith determination of a consumer's ability to repay a mortgage loan, absent specified exceptions. Refer to 15 USC 1639c. The Consumer Financial Protection Bureau issued a final rule amending Regulation Z to implement these ability-to-repay requirements, which became effective January 1, 2014. Refer to 78 Fed. Reg. 6621 [https://www.federalregister.gov/citation/78-FR-6621], January 30, 2013.

[8] An example is the purchase of a recently rehabilitated property.

[9] For national banks, refer to 12 CFR 34, "Real Estate Lending and Appraisals," appendix A to subpart D, "Interagency Guidelines for Real Estate Lending Policies." For federal savings associations, refer to 12 CFR 160.101, "Real estate lending standards," appendix to 12 CFR 160.101, "Interagency Guidelines for Real Estate Lending Policies."

[10] Banks should retain documentation indicating (1) the eligible community is one targeted for revitalization by a government entity or agency, (2) the specific revitalization criteria used by the government entity or agency, and (3) the type of financing and other support, if any, that the governmental entity or agency provides to the community.

[11] For all mortgage loan transactions based on an appraisal, banks should select and engage appraisers with local market competency in valuing the property securing a program loan. Similarly, any evaluation, if applicable, should be credible and consistent with safe and sound banking practices. Given the unique underwriting considerations, banks should not use automated valuation models in connection with these programs.

[12] Applicable laws may include (1) Regulation X, 12 CFR 1024, which provides mortgage servicing standards, including early intervention requirements and loss mitigation procedures; and (2) Regulation Z, 12 CFR 1026, which establishes requirements for including delinquency-related information on the periodic statements required for residential mortgage loans.