Replaced by Comptroller's Handbook – Floor Plan Lending

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Floor Plan and Indirect Lending

Floor plan lending is a form of inventory financing for sellers of retail goods in which each loan advance is made against a specific piece of collateral. Items subject to floor plans include automobiles, manufactured homes, large home appliances, furniture, equipment, boats, and other types of merchandise sold under a sales finance contract. The goods are then sold for cash or under a finance contract, with the sale of inventory the normal repayment source. When inventory is not sold as expected, however, the dealer may be required by the loan agreement to repay the debt with other cash sources.

Floor plan lending involves a high level of risk requiring expertise, experience, and extensive controls. But certain benefits are provided, including: the loans are interest-rate sensitive and could, therefore, complement a fixed-rate, long-term loan portfolio; the institution can cross-sell services by providing financing to the purchasers of the inventory; and the institution's asset base can be diversified. Floor plan borrowers are often primary sources of indirect dealer lending through thrift purchases of retail loans made by dealers.

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Floor Plan Lending

Floor plan loans involve three parties: the supplier of goods, the dealer, and the financial institution. This results in a complex set of legal documents that govern the structure of the arrangement that facilitates inventory purchases by a dealer by guaranteeing payment to the supplier. For this reason, suppliers often provide buy-back agreements to repurchase slow inventory within specified time limits. To secure payment for the amounts advanced, the financial institution must perfect its security interest. Generally, Article 9 of the Uniform Commercial Code (UCC) requires entering into a security agreement with the dealer and providing public notice of this security interest. However, the method of perfecting a security interest varies from state to state, and there are numerous divergences from the UCC.

When a dealer first enters into the financing arrangement with an institution, a master loan agreement is executed. The master loan agreement establishes the basic conditions of the relationship between the dealer and the financial institution. It normally grants the lender a continuing security interest in the dealer's inventory, receipts, and accounts receivable and should also contain provisions for insurance, dealer reserves, and curtailments.

In most institutions, the evidence of debt is the trust receipt. There are generally two methods by which trust receipts are created. An institution may enter a drafting agreement, similar to a letter of credit, with a manufacturer. In this situation the institution agrees to pay documentary sight drafts covering shipments of merchandise to the dealer. The sight drafts often require sight of evidence of the dealer's

receipt of merchandise and the manufacturer's statement of origin (MSO). The drafts are payable when the inventory is received or, if the manufacturer permits, after a grace period that allows the dealer to prepare the inventory for sale. The drafting agreement usually limits the number of units, the per unit cost, and the aggregate cost that can be shipped at one time, and includes the buy-back agreement.

The merchandise remains with the dealer until sold and is evidenced by trust receipts. Title documents, such as MSOs, should be held by the institution. All the documents should be inspected physically, as should the merchandise, during the floor plan inspection to prevent dual financing.

Trust receipts are also created when merchandise is shipped under an invoice system. The dealer receives the merchandise accompanied by invoices and titles (or MSOs) where appropriate. The dealer presents the documents to the institution, which then pays the invoice, attaching duplicates to the trust receipt, which is signed by the borrower. Depending on the type of inventory and dealer, the title may remain with the institution or be released.

Used car inventories are financed with titles or under trust receipts, with a list of the units and their loan values attached to the receipts. The regulator should determine that the security interest has been properly perfected, or that titles are held by the thrift. (The thrift should follow advice of legal counsel on this matter.)

There are two basic forms of repayment for floor plan loans. The lender may receive either cash or indirect loans produced from the sale of inventory. Floor plan lending is ideally structured so that the debt is repaid from the sale of the collateral before the collateral depreciates to a liquidation value that is below the loan amount. If the inventory is sold, the institution will either require cash from the dealer or will provide the purchaser with a loan and will retire the flooring debt.

As mentioned, the loan is ideally repaid as the inventory is sold. However, a curtailment provision, that requires periodic principal reductions if inventory does not sell within a specified period of time, is also required of the dealer. Curtailments are usually set forth in the loan agreement and establish the required timing and percentage reduction in principal for each loan. Curtailment requirements are structured so that reductions are made in the debt to exceed the market depreciation of the collateral. This is necessary, because stale inventory may depreciate precipitously. Regulators must determine that the structure of the curtailment arrangement is adequate to protect against loss on the loan.

Flooring is a complex and time-intensive process. As a result, operating costs can be high and interest margins should also be very high. Profitability is often marginal due to the credit risk involved combined with inadequate interest margins. To supplement income from this source, the lender often relies on the additional income generated from quality indirect loans granted to purchasers of the dealer's inventory. If the institution does not receive an adequate portion of loans generated by the dealer, or if the loans are of inferior quality, the relationship may be of questionable value to the institution.

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Loan Underwriting Considerations

Floor plan lending exhibits a high degree of risk. In addition to the risks associated with inventory financing, the institution is unable to exercise full control over the floored items. Dealer debt ratios are often high, the collateral margin is low, and the collateral depreciates steadily. The inability of the lender to exercise control over the inventory means that the dealer can possibly sell out of trust.

A dealer sells out of trust when the inventory is sold but the funds are not immediately remitted to the lender to retire the corresponding debt. This situation usually occurs when the dealer is experiencing cash flow shortages or critical financial problems. The lender's recourse to prevent this includes: regularly monitoring financial performance of the dealer; regularly inspecting and verifying the inventory; controlling title documents; and, if necessary, placing physical controls over the inventory. Bonded warehouses are often used to control inventory.

An institution must take certain actions to minimize risk. It must first establish prudent policies for floor plan lending. These policies include limits on the size of the floor plan lending portfolio. In addition, it must define qualified borrowers based on their ability to pay, credit histories, and reputations. Lending limits should be established for each dealer and for each type of product being floor planned.

Floor plan checks must be done at least monthly, but more frequently depending on the reputation and financial condition of the dealer. The inspectors should be rotated regularly as an additional quality control measure. Inventory audit servicers may be used to assist inspections, but should not be relied upon without oversight. The checks include: inspection of the inventory to determine its existence and condition, a follow-up to determine the existence of items that were missing at the last inspection, inspection of identifying documents and comparison with the inventory (verification of serial numbers), and mileage checks on vehicles to determine that depreciation is not occurring at a rate faster than expected.

An important facet of an institution's relationship with a dealer is the dealer reserve and operating deposit accounts, which represent both a compensating balance and a tool by which the loan officer can monitor customer activity. A review of the flow of funds into and out of the account may reveal that inventory has been sold without debt reduction, that the dealer is incurring abnormal expenses, or that unreported financial activity has occurred that might warrant a reconsideration of the credit arrangement.

Institutions must establish and maintain adequate dealer reserve accounts by "holding back" a percent of sales in excess of debt service requirements. The dealer reserve accounts must be replenished when losses occur. Finally, if problems begin to develop, the institution must take immediate action to prevent losses.

Because dealers typically have low capital levels, a close and frequent review of the dealer's financial condition is necessary. When analyzing financial data, institutions should review the number of units sold and the profitability of these sales. They should compare the number of units sold with the number financed to ensure that inventory levels are not excessive. Institutions should monitor the value of the collateral when placing the loan and by continuously inspecting it to determine its condition.

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Institutions should impose curtailments to keep collateral values in line with the principal and interest balances. The book value of inventory should be compared with the book value of debt used to finance inventory.

Other procedures include: establishing lending authorization limits, lines of authority, and dual authorization requirements for loan approvals; perfecting security interests; and conducting internal loan reviews.

Regulatory Considerations

Federal thrifts are authorized to make floor plan loans-pursuant to 12 USC 1464(c)(2)(D) of the HOLA and 12 CFR § 545.50(c) of the regulations- up to 30% of assets. Section 563.170(c)(2) of the regulations establishes minimum documentation requirements. Perfection of security interests on floor plan loans is governed by Section 9 of the UCC but may also vary with state law.

Indirect Dealer Lending

Indirect loans are retail loans that are purchased from a seller of retail goods (dealer). The loans are originally granted to consumers by the dealer to finance the purchase of retail products. These loans are often called “dealer paper,” “indirect paper,” or “loan paper.” In many cases the institution may have also provided the dealer with floor plan financing to purchase the inventory being sold.

There are two basic arrangements for the purchase of retail loans and sale contracts from dealers: recourse and nonrecourse.

With nonrecourse purchases, the institution assumes full responsibility for underwriting the retail loan. Although the dealer writes the loan, the thrift carries all of the risk. Therefore, the contracts should fully conform to the institution’s underwriting requirements. Also, controls must be implemented to ensure that the dealer is complying with consumer regulations.

Institutions should segregate accounting and reporting for indirect loan accounts by dealer to determine the reliability of the dealer from the quality of loan paper the institution receives and to determine the profitability of the dealer indirect account. Otherwise, indirect loans should be treated like other consumer loans for underwriting, monitoring, collection, and control and ensuring that consumer regulations are followed by the dealer. (Refer to Examination Handbook Section 217, Consumer Lending.)

With recourse agreements, the institution purchases the contract from the dealer but can also exercise recourse by requiring the dealer to repurchase the contract or pay any deficiencies in the event of nonperformance by the borrower. The arrangement with the dealer will vary depending on the loan agreement terms. Typically, at some point in the delinquency, the institution must notify the dealer and charge back the contract. If this is not handled as stipulated in the recourse agreement, the institution may forfeit its option to require repurchase by the dealer. All past-due loans with recourse must be considered direct debt of the dealer if the dealer is liable for the debt under the recourse agreement.

Although recourse agreements provide additional protection for the thrift buying dealer paper, recourse is no substitute for prudent retail loan underwriting. Unless underwriting is performed in the same manner as with nonrecourse loans, the institution must consider recourse loans both as loans to the dealer and to the borrower. Therefore, a master loan agreement with the dealer is needed, with a thorough underwriting and monitoring of performance. If too many of the dealer's indirect loans go bad, the dealer will also go into default. Primarily, recourse agreements can be considered a repossession and sale service for the indirect lender, providing little credit protection.

An institution usually requires a dealer reserve account. This is a deposit account used to charge back nonperforming loans to the dealer. The account is controlled by the lender. The account is credited with discounts earned by the dealer on the sale of notes to the institution. Dealer reserves must be rigidly controlled for contract compliance, and generally should not be used to bring past-due accounts current but should be used to pay off past-due accounts in full.

One common practice that can cause earnings problems for institutions is for the dealer to receive a fee or discount without a dealer reserve. Institutions have miscalculated the resulting lower yield on the dealer paper.

Dealer lending relationships require analysis similar to that for commercial loans. The legal agreements and controls required for indirect lending are complex. Notify examiners assigned to examination program 201, Lending Operations and Portfolio Risk Management, and 211, Loans to One Borrower, of indirect lending activity so they may be able to assess the appropriate level of review. With recourse, dealer paper is provided exceptional treatment under 12 CFR 32.[illegible]) for loans-to-one-borrower limits.

Manufactured-Home Financing

Manufactured-home financing can involve both dealer floor plan lending and indirect retail lending. 12 USC 1464(c)(1)(J) and § 545.45 of the regulations contain the manufactured-home-lending authority for federal thrifts. This section applies to "HUD-code mobile homes" and not to prefab, modular, or panelized housing components. This discussion sets forth guidelines that, under § 545.45 (c) and (d) are sound practices for mobile-home-loan investments and should be carefully considered in a thrift's operation and in the examination of a manufactured-home loan financing program.

The successful operation of a manufactured-home lending program depends largely on an institution's knowledge of and relationship with manufactured- home dealers in its lending area. There will be instances when the purchaser will seek direct financing, but dealers will usually constitute the major source of purchase loans. A dealer's sales are normally closed and financed on the dealer's lot. In most instances, the loan is "made" by a dealer and "sold" to a permanent lender. Thrifts are authorized certain practices that are intended to foster a good business relationship with dealers. The most important of these is the authority to make wholesale or floor plan loans on the dealer's inventory. However, due to the high risk of loss in this market, certain precautions should be observed.

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Dealer Approval

Thrifts should do business with dealers only after formal approval by their board of directors. Dealer approval should be based on careful analysis of the dealership and should include review of at least the following documents:

Dealer Loan Application: The application should show the locations of all of the sales and storage lots operated by the dealer as well as the dealer's primary business address. It should name all manufacturers supplying the dealer and include a general description of the type and price ranges of units the dealer sells. Advertising literature is helpful. The application should state that each mobile-home manufacturer subscribes to the Truth in Invoicing Practices Statement adopted by the Manufactured Housing Institute. This statement requires disclosure of all discounts and updates applicable to individual units, but not volume discounts or rebates. The applications should also state whether the dealer is willing to sign recourse or repurchase agreements in favor of the institution. Terms of a manufacturer or supplier's buy-back or repurchase agreement should be provided. The application should name all persons having a proprietary interest in the dealership and state the amount of that interest in terms of percentage of the whole.

Balance Sheet: A current balance sheet of the dealership certified to be true and accurate, and signed by the dealer should be reviewed. A statement dated no earlier than the last business day of the preceding month is considered current. Financial statements of any guarantor should be reviewed.

Profit and Loss Statement: A profit and loss statement for the last fiscal year, supplemented by a similar statement for the months since the close of that year should be reviewed. To ensure that a dealer maintains high financial standards, current balance sheets and profit and loss statements should be obtained at least every month. These monthly statements should be reviewed by senior officers.

Credit Report: Written credit reports on the dealer and principals from a recognized credit reporting agency should be reviewed.

On-Site Review of Dealer Operations: An officer should prepare a written report of findings from an on-site visit to the dealer's place of business, indicating a review of sales and inventory areas and the accounting system.

The purpose of the board's reviewing the above items is to ensure that thrifts limit their relationships to dealers who show sufficient financial strength to maintain a viable dealer operation, as well as sound business ethics, integrity, and common sense. This will be reflected in the quality of the assets originated through individual dealers.

Dealer Supervision

After a dealer has been approved by the directors, an institution may operate through that dealer to the extent permitted by regulation. The following should be considered when doing business with any dealer:

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Inventory Financing: § 545.45 of the regulations authorizes federal thrifts to make loans to finance both wholesale and retail purchases of mobile homes. Wholesale lending, or inventory financing, is a necessary part of manufactured-home lending since most dealers are not sufficiently capitalized to finance their own inventory. It has become customary for inventory financing to be provided by the same lenders who fund the retail loans. While inventory- finance loans are interest bearing, they also encourage a good business relationship with the dealer as a source of retail loans. In addition to the dealer investigation discussed above, the following are some of the considerations that should be negotiated in establishing a dealer relationship.

- An average successful dealer operating in a normal economy will turn over his stock approximately four times each year (as measured by the cost of sales divided by inventory). This fixes the average period for the inventory finance term at 90 days, which should be considered maximum by a lending institution.

- In the event a dealer is unable to sell the merchandise within the original inventory finance term, the loan may be renewed for successive 90-day periods, but the due date of the second renewal should not be later than nine months from the date of the original loan. Inventory refinancing should be limited since a dealer's inability to reduce inventory indicates a serious marketing problem and will lead to stale unsalable inventory.

- At the first renewal of any inventory finance loan, the dealer should be required to pay all interest to date and at least a 10% curtailment of the principal. Thereafter 10% or 20% curtailments and interest should be established in negotiations. The purpose of the curtailments is to both limit risk of loss to the thrift and to push the dealer into moving slow inventory, by wholesale if necessary, to minimize losses and strengthen the dealership.

- Disbursement of new inventory finance loans should be based on the original copy of the manufacturer's invoice, which is retained in the institution's file. To ensure that the manufacturer is paid for the merchandise, loan proceeds should always be made payable-either directly to the manufacturer or to the manufacturer and the dealer jointly-by draft payable on sight of the manufacturer's statement of origin (MSO) if possible.

- It should be recognized by thrifts that some dealers will finance inventory with two or more lenders simultaneously. Even when inventory financing is limited to one lender, that lender should not expect to make a retail loan on every unit sold. Some units will be sold for cash, other purchasers will have arranged their own financing, and still others will simply not meet the standards required by the institution.

- If an institution makes any inventory financing loans to a dealer, the institution is responsible for determining that the merchandise so financed is not sold out-of-trust, i.e., sold without repaying the institution's wholesale loan. The only effective way of doing this is to make unannounced physical inventories of that merchandise at least monthly. Individuals doing the inventory check should be rotated from time to time, or accompanied by a witness or auditor to deter collusion with the dealer. The records of the inventories should be retained in the dealer file along with the application for approval, financial statements, etc. If the inventory should

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reveal that any merchandise has been sold out-of-trust, steps should be taken to see that the loan on that merchandise is repaid immediately. The institution should investigate the facts regarding such sale and determine if fraud was involved. If so, effective measures should be undertaken to prevent or limit loss.

- Recourse and buy-back (repurchase) provisions are customary procedures in manufactured-home lending. They are intended to provide the lender with an additional margin of safety and to ensure the quality of loans made to the dealer. A recourse or repurchase agreement may be given by a manufacturer to a dealer to support an inventory finance loan.

Indirect Retail Lending: Retail purchase loans are usually completed and the home delivered to the customer before the loan is presented to the institution for purchase.

However, underwriting standards should be established by the institution's board of directors, relating to the credit and financial ability of the borrower, as well as loan-to-price ratio, amount, and term of the loan, and other pertinent factors. The approval of a dealer is an expression of willingness to accept those loans that meet the institution's standards, and no obligation to buy loans should be made or implied.

For every loan made or purchased by the thrift, the following documents should be retained in the thrift's loan file:

- A security agreement enforceable in the jurisdiction where the collateral is located, whereby the thrift can acquire title and repossess the collateral property in the event of default;
- Original credit application;
- Credit report submitted by a credit reporting agency;
- Original copy of manufacturer's invoice; and
- Copy of the retail sales contract.

An institution must maintain a continuous register of loans originated through a dealer in order to have readily available knowledge of its status with that dealer. The following items are considered the minimum:

- Loan number,
- Amount of loan,
- Date of loan, or date of purchase,
- Borrower's name,

- Dealer's name,
- Recourse provision included in assignment,
- Repurchase provision included in assignment,
- Interest rate,
- Term of loan, and
- Date loan repaid.

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Dealer indirect loans are sometimes bought with recourse. Recourse means that the dealer is liable to the lender at any time for the unpaid balance of a defaulted sales contract or note, less the amount of unearned interest. In exercising this provision, the lender passes all of its title rights to the dealer who acquires title to the property. Enforcing this provision would protect the lender against all loss if it were applied to every defaulted contract, provided the dealer remains capable of buying the contracts. It is important to consider that the indiscriminate enforcement of the recourse provision could quickly exhaust a dealer's resources and is, therefore, no substitute for prudent loan underwriting.

A dealer buy-back or repurchase agreement is somewhat less dependent upon the dealer. This agreement typically states that the dealer will actually repossess the defaulted unit for the lender. The dealer then has the option of buying or reselling the unit at a price based on the dealer's market and the condition of the unit. If the price is less than the thrift's carrying value of the unit, the deficit is absorbed as a loss by the thrift.

Regulators should investigate any material losses that the thrift sustains under a repurchase agreement and ascertain if the institution's interests were protected to the fullest practical extent.

It is a practice in manufactured-home lending for the dealer to participate in the retail financing charge with the lender through the operation of dealer reserves. Dealers and lenders have looked upon this as a legitimate source of income to the dealer. In such an arrangement, the dealer writes a loan to yield, say 18%, and then discounts the loan to the thrift to yield, say 14%, with the discount credited to the dealer reserve account. Normally, the discount is set aside in this reserve at the time a loan is made or purchased. The typical reserve agreement states that the purpose of reserve is to absorb losses, and that amounts not so used will be paid to the dealer periodically on a percentage basis.

As loan amounts increase and loan terms lengthen, the practices of recourse and participatory financing may become less desirable. Dealers may be reluctant to participate in such long-term financing and lenders may be reluctant to accept this type of long-term liability. Thrifts should recognize this possibility when developing lending policies.

Section 545.45 (d)(2) of the regulations establishes a maximum term for retail loans of 20 years, for both new and used manufactured homes. This is, in effect, unlimited. Thrifts should establish reasonable retail loan terms based upon the quality of construction and expected durability of the home, assuming normal maintenance.

Particular care should be exercised in determining the loan term for a used manufactured home. The condition of the home should be given the most consideration since an older home will depreciate slowly if it is well maintained.

A thorough on-site inspection affords the best means of ascertaining the condition of a used home. Inspections should be conducted by qualified persons and the overall condition of the home should be evaluated. Particular attention should be given to such major items as plumbing, electrical, and fuel systems.

Well-prepared inspection reports are excellent aids to the lender in the determination of the loan term, and should be retained in the loan file.

Section 545.4[illegible] of the regulations does not prescribe maximum amounts, related to value, that thrifts may lend on manufactured homes. However, manufactured home loans are limited to 90% of the buyer's cost of items specified in the regulation. Implicit in this regulation is the requirement that a minimum 10% down payment must be paid by the borrower. Any portion of the loan balance (principal and earned interest) that exceeds wholesale value is unsecured and reliant entirely on the borrower's ability to repay.

The ability of the borrower to pay principal, interest, taxes, insurance, and site rent or acquisition costs should be carefully considered. Low-income borrowers may not be able to afford as high a percent of income for housing as moderate-income borrowers due to limited discretionary income and an inability to save for unexpected expenses and interruption of employment. Individual borrower's cash flow, living expenses, credit history, and employment history are very important factors to consider in addition to collateral in the underwriting of loans.

Two dealer practices can serve to increase a manufactured-home lender's risk exposure. These two practices are the selling of mobile homes at excessive mark-ups and the giving of buyers' rebates.

Prior to determining the amount of the loan on a new manufactured home, the institution should have a copy of the executed retail sales contract and the manufacturer's invoice. These documents should be retained in the loan file. Since a portion of the dealer's mark-up (profit) will often be included in the amount financed, thrifts should compare the retail selling price of the home with the manufacturer's invoice price. This comparison will show those instances where a dealer's mark-up exceeds the local market's acceptable profit margins. Excessive mark-ups dilute a borrower's real equity in the home and the financing of such mark-ups exposes the institution to additional unsecured risk. Such mark-ups can serve to mask undisclosed rebates (a form of fraud against lenders), which would further dilute the borrower's equity and increase the institution's exposure. Furthermore, the lender is then funding the dealer's profit while absorbing the dealer's risk on the sale.

While reasonable mark-ups are acceptable, thrifts should avoid including total sales price in the financing formula when homes are being sold in excess of the local market-accepted profit margins. A prudent limit on retail sale financing is dealer's invoice cost or wholesale value. This lets the thrift finance the dealer's cost but not the dealer's profit. The dealer's profit is funded by the down payments. A hold-back arrangement may allow a thrift to hold dealer profit-included in loan proceeds-in a dealer reserve account, provided that losses on loans from the dealer will be absorbed by the reserve account.

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This allows the dealer to have more profit financed by the thrift in exchange for the dealer's carrying more risk of loss.

To reduce excess inventory, increase volume, etc., dealers will at times offer the buyer a rebate or discount. These discounts may be structured so that they reduce the borrower's down payment and thereby raise the actual ratio of loan to buyer's cost. When such discounts are offered, thrifts should adjust the loan amount of the home to reflect these discounts.

Loan amounts on used manufactured homes should be based on the wholesale value of the home as determined in the local market area. Values may be determined by an appraisal by a qualified manufactured-home appraiser, value guides, or other generally accepted systems of valuation used in the local area.

Thrifts should ascertain that appropriate insurance protection is continuously in force, covering all units financed. Credit insurance, similar to mortgage insurance, is available and should be used when needed for underwriting considerations. As a minimum, insurance coverage should include:

- A comprehensive manufactured-home policy or equivalent with loss payable to the thrift for the investment in the loan; or
- A lender's single-interest policy in favor of the institution.

Servicing Corporations: The use of a servicing corporation can be an important adjunct to manufactured-home financing. Employing the expertise of a well-established servicer relieves the lender of many of the details of this complex field and can minimize losses. Thrifts are authorized to engage the services of servicing companies, but should observe the following precautions:

- Before engaging the services of any company, the thrift should make a careful review of the background and strength of the firm. It is important that the company have an excellent record of meeting its obligations in settling defaulted contracts, as well as have a sound financial structure. A thrift should investigate the performance records of more than one company and should select the one that seems best qualified.
- The minutes of the institution's board of directors' meeting should reflect consideration and approval of the servicing company. Financial statements, proposals, and servicing contracts should be retained in the institution's records.
- An institution should not enter into a contract that requires the investment of a specified sum in mobile home loans in a given period of time.
- An institution should retain the option of establishing its own credit standards as well as its right to reject loans.
- As with all contracts, they should be approved by the thrift's legal counsel.

Mobile Home Loan Portfolios: Thrifts whose service corporations engage in manufactured-home lending should monitor such operations closely. Such service corporations should apply sound underwriting standards when originating loans and should be fully staffed in order to properly service such loans. Since service corporations may sell whole loans to the parent, while retaining none of the risk, thrifts should assure themselves that the service corporation does not become a mere "production center" with little or no regard for proper underwriting and servicing.

Subject to certain conditions, § 545.45 of the regulations permits federal thrifts to sell and purchase participation interests in manufactured-home chattel paper on a nationwide basis.

Thrifts purchasing participations in manufactured home loan portfolios under this nationwide authority should assure themselves through detailed loan reviews and audit confirmations that they are purchasing quality loans that fully conform to applicable regulations and prudent underwriting standards. The purchaser should also assure itself that the entity servicing its loans has an adequately staffed office capable of rendering the expected servicing under strict control procedures. Purchase contracts are often negotiated with a buy-back provision for rejected loans during a brief period to allow the purchaser to confirm the credit quality of the purchased loans.

Problems with purchased portfolios have included: previously past-due loans rewritten with capitalized interest; loans financed as assumptions of loans on repossessed collateral identified as new; loans without timely credit checks on borrowers; loans for which borrowers were not qualified as having ability to pay. Due diligence loan reviews should identify these details and prevent losses from purchases of poorly underwritten portfolios.

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REFERENCES

United States Code (12 USC)

§ 1464(c)(1)(J)	Home Improvement and Manufactured-Home Loans
§ 1464(c)(2)(D)	Consumer Loans

Code of Federal Regulations (12 CFR)

Chapter I: Office of the Comptroller of the Currency

§ 32.6(h)	Discount of Consumer Paper

Chapter V: Office of Thrift Supervision

Subchapter C: Regulations for Federal Savings Associations

§ 545.45	Manufactured-Home Financing
§ 545.50(c)	Loans to Dealers in Consumer Goods

Subchapter D: Regulations Applicable to All Savings Associations

§ 563.170(c)(2)	Records
§ 590	Preemption of State Usury Laws
§ 591	Preemption of State Due-on-Sale Laws

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