RESCINDED

Outdated. See OCC 2012-19, Lending Limits: Interim Final Rule.

Loans To One Borrower

Lenders create a form of concentration risk when they extend a significant amount of credit to any one borrower or to borrowers who are related in a common enterprise. As such, savings associations are subject to regulatory limitations on loans to one borrower (LTOB), as specified in 12 CFR § 560.93. Borrower lending limitations are a critical safety and soundness standard enacted by Congress to prevent federally insured banks and savings associations from placing themselves at risk by concentrating too great a portion of their assets in any single borrower.

A savings association's compliance with the regulatory limitations, however, does not diminish regulatory scrutiny over high risk loans within the legal lending limit nor does it relieve the association's board of directors from exercising due diligence. While the LTOB regulation places a limitation on the aggregate dollar amount of an association's loans to each "borrower," it does not limit the number of loans to any one borrower with that aggregate dollar limitation.

LINKS

Program

Management must ensure, and examiners should verify, that lending staff is conversant with the lending limitations applicable to savings associations, that the lending limitations are clearly set forth in underwriting guidance, and that management's practices, recordkeeping and internal controls regarding LTOB limits are adequate and provide a high degree of confidence that the association is in compliance with LTOB regulatory requirements.

This Handbook Section provides an overview of the LTOB regulations applicable for federal savings associations and various exceptions that authorize associations to exceed the LTOB limits.

Overview

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 revised the LTOB requirements for savings associations (HOLA 5(u)) to parallel the lending limitations applicable to national banks. Section 5200 of the Revised Statutes, (12 USC 84), establishes lending limits measured as a percentage of an institution's capital and surplus. The Office of the Comptroller of the Currency's (OCC) implementing regulations are located at 12 CFR Part 32. OTS codifies these requirements for savings associations in its regulations at 12 CFR § 560.93 and incorporates the lending limits of 12 CFR Part 32.

Section 560.93 of the regulations applies to loans and extensions of credit made by a savings association and its subsidiaries. It does not apply to loans made by a savings association or its GAAP-consolidated subsidiary to subordinate organizations or affiliates of the savings association. The terms *subsidiary,*

GAAP-consolidated subsidiary, and subordinate organization have the same meanings as specified in 12 CFR § 559.2. The term *affiliate* has the same meaning as specified in 12 CFR § 563.41.

General Lending Limit

Under the general lending limitation an association's total loans and extensions of credit outstanding to one borrower at one time shall not exceed 15 percent of the association's unimpaired capital and unimpaired surplus. The savings association can have an additional ten percent for loans and extensions of credit fully secured by readily marketable collateral having a market value, determined by reliable and continuously available price quotations, at least equal to the amount of the funds outstanding. To qualify for the additional ten percent limit, the association must perfect a security interest in the collateral under applicable law, and the collateral must have a market value at all times of at least 100 percent of the loan amount that exceeds the 15 percent general limit.

> Under the general lending limitation an association's total loans and extensions of credit outstanding to one borrower at one time shall not exceed 15 percent of the association's unimpaired capital and unimpaired surplus.

The Director of OTS may impose more stringent restrictions on a savings association's loans to one borrower if OTS determines that such restrictions are necessary to protect the safety and soundness of the association. See the HOLA at 12 USC § 1464(u)(3).

Calculation of General Lending Limit

To calculate an association's general lending limitation you should utilize the most recent Thrift Financial Report filed with the OTS prior to the date of granting or purchasing the loan (unless there has been a significant change in capital). The general lending limit is 15 percent of unimpaired capital and unimpaired surplus, which are defined as: core capital and supplementary capital included in total capital, plus any Allowance for Loan and Lease Losses (ALLL) not included in supplementary capital, plus the amount of investment in, and advances to, subsidiaries not included in calculating core capital.

Exceptions To General Lending Limit

$500,000 Exception

If a savings association's general lending limitation, as calculated above, is less than $500,000, such savings association may have total loans and extensions of credit, for any purpose, to one borrower outstanding at one time not to exceed $500,000.

Statutory Exceptions

The following exceptions to the lending limits, as set forth in 12 USC 84 and 12 CFR Part 32, are applicable to savings associations in the same manner and to the same extent as they apply to national banks.

Loans Subject to Special Lending Limits

In addition to the amount allowed under the general lending limit, the following loans have special lending limits under 12 CFR § 32.3, subject to the qualifications in that section:

- Loans secured by bills of lading – 35%
- Discount of installment consumer paper – 10%
- Loans secured by documents covering livestock – 10%
- Loans secured by dairy cattle – 10%.

Refer to 12 CFR § 32.3(b) for a full discussion.

Loans Not Subject to the Lending Limits

Section 32.3 also defines loans that are not subject to the lending limits, provided they meet the qualifications in the subsections of 12 CFR § 32.3(c). Refer to 12 CFR § 32.3(c) for a detailed discussion. Such loans are as follows:

- Loans arising from discounts of negotiable commercial paper that evidences an obligation of the person negotiating the paper.
- Banker's acceptances.
- Loans secured by U.S. obligations.
- Loans to or guaranteed by a federal agency.
- Loans to or guaranteed by a general obligation of a State or political subdivision.
- Loans secured by segregated deposit accounts in the lending institution.
- Loans to financial institutions with permission of the OTS Director.
- Loans to the Student Loan Marketing Association.

- Loans to industrial development authorities, which will be deemed a loan to the lessee.

- Loans to leasing companies, where a security interest in the leases is perfected and several other conditions are met.

Exception for Loans to Develop Domestic Residential Housing Units

Pursuant to 12 CFR § 560.93(d)(3), a savings association may make loans to one borrower to develop domestic residential housing units, not to exceed the lesser of $30,000,000 or 30 percent of the savings association's unimpaired capital and unimpaired surplus, including all loans made under the general lending limit, provided that:

- The association must be, and continue to be, in compliance with its capital requirements pursuant to 12 CFR Part 567.

- If the association falls out of compliance with this capital requirement it may no longer avail itself of this exception until it again qualifies and, if eligible, submits a notice or, if ineligible for the notice procedure, applies for and receives approval from the Regional Director. OTS will permit lenders to continue funding a legally binding loan commitment made under this exception if the association should fall out of compliance with its capital requirement, provided such binding commitment to the borrower was made when the association was in capital compliance.

- A savings association eligible under 12 CFR Part 516 for using the notice procedure must submit a notice prior to using the higher limit and must have received a written approval by the Regional Director. An association that is not eligible under 12 CFR Part 516 to file a notice, must submit an application to the Regional Director requesting prior approval to use the exception for domestic residential housing development.

- Such approvals do not constitute a "waiver" of the LTOB limits, but merely permission to use the exception under 12 CFR § 560.93(d)(3), and may contain additional requirements or set forth additional conditions or restrictions governing the exercise of this exception.

- All loans made under this exception are limited in the aggregate to 150 percent of the savings association's unimpaired capital and unimpaired surplus.

- Loans made by an association under this exception must comply with the loan-to-value requirements applicable to federal savings association under 12 CFR § 560.101.

Definitions

"Residential housing unit" has the same meaning as the term *residential real estate* in 12 CFR § 541.23, which means: homes (including condominiums and cooperatives); combinations of homes and business property; other real estate used for primarily residential purposes other than a home (but which may

include homes); combinations of such real estate and business property involving only minor business use; farm residences and combinations of farm residences and commercial farm real estate; property to be improved by the construction of such structures; or leasehold interests in the above real estate.

"Single-family dwelling unit" has the meaning set forth in 12 CFR § 541.25.

The term "domestic," as used in this section, includes units within the fifty states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, and the Pacific Islands.

The rule defines the term "to develop" to include the various combinations of phases necessary to produce housing units as an end product. This includes:

- Acquisition, development, and construction
- Development and construction
- Construction
- Rehabilitation
- Conversion.

Domestic residential housing units must be the end product. The acquisition of real estate for holding or for later developing does not fulfill the requirement of this exception.

Permanent financing of either individual units within a development or of a multi-unit complex is permissible under this exception provided that the financing is related to any of the five combinations of construction phases.

Guidelines for Approval of Use of Exception For Domestic Residential Housing Development

A Regional Director may provide a blanket approval for an association to use higher LTOB limits for lending to develop domestic residential housing upon determination that the higher limits pose no undue risk to the safety and soundness of the association.

Notices and applications for approval must include sufficient information to permit a thorough evaluation of the merits and risks of approving the higher LTOB limits.

Notices and applications for approval of use of the exception for domestic residential housing development will be processed in accordance with Section 820 of the Applications Processing Handbook, Lending Exceptions - Loans to One Borrower.

Special Lending Limits for One- to Four-Family Residential Loans, Small Business Loans, and Small Farm Loans

In 2001, the OCC, recognizing that many states have higher limits for the banks they charter, implemented a pilot program for one- to four-family (1-4) residential real estate and small business loans to allow national banks to compete more effectively with state-chartered banks. The pilot program was extended for an additional three years in 2004 and also amended to include small farm loans to the loans eligible for the special lending limits. In June 2007, OCC published an interim final rule that removed the expiration date from the program. Because the lending limits of 12 CFR Part 32 is incorporated in OTS's lending limits at 12 CFR § 560.93, eligible savings associations may participate in the special lending limits under this program.

> The special lending limits program allows banks and savings associations to request expanded LTOB lending authority up to an additional ten percent of unimpaired capital and unimpaired surplus.

The Rule

The OCC's special limits provision for 1-4 family residential loans, small business loans, and small farm loans is codified in 12 CFR § 32.7. You should read it carefully. This Handbook Section only clarifies some eligibility and application procedures for savings associations to use this program.

The program covers perfected first lien 1-4 family residential (either owner-occupied or not) real estate mortgages in the amounts that do not exceed 80 percent of the appraised values of the collateral at the time the loans are made, small business loans, and small farm loans.

For 1-4 family residential mortgages, the lending limit under the program for approved OTS institutions is based on the state's lending limit for state-chartered banks for residential real estate loans or unsecured loans. For small business and small farm loans, the lending limit is based on the state's lending limit for state-chartered banks for small business, small farm, or unsecured loans. In general, the expanded limits are available for commercial loans as described in the instructions for the Thrift Financial Report, and small farm loans as defined below. [1]

The lending limits of 12 CFR § 560.93 and 12 CFR Part 32 are limits on loans that a savings association may make to one borrower. The limits do not affect the percentage of assets or capital lending and investment limits specified in the Home Owners' Loan Act. The lending limits of the state where the approved savings association's home office is located establish the limits for the institution, regardless of the state in which the borrower or branch is located.

[1] OCC defines farm loans as: "loans or extensions of credit secured by farmland (including farm residential and other improvements) or loans or extensions of credit "to finance agricultural production and other loans to farmers."

Loans or extensions of credit made under this program must be secured by residential real estate, or must be small business or small farm loans. The residential loan needs to be a first lien and not exceed 80 percent of appraised value. The small business and small farm loans are to be full documentation loans and not to be originated under a low documentation program.

In addition to amounts that it can already lend under the general lending limits, an approved savings association may make qualifying 1-4 family residential, small business, and small farm loans to a single borrower, that are the lesser of:

- Ten percent of its unimpaired capital and surplus, or
- The percentage of its capital and surplus, in excess of 15 percent, that a state bank is permitted to lend.

Additionally:

- The total outstanding amount of all loans and extensions of credit to any one borrower cannot exceed 25 percent of the savings association's unimpaired capital and surplus, and
- The additional outstanding amount of loans and extensions of credit to all borrowers made under this program cannot exceed 100 percent of the savings association's unimpaired capital and surplus.

Eligibility

An eligible savings association is "well capitalized," has a composite rating of 1 or 2 in connection with its most recent examination or subsequent review, and has a rating of at least 2 for both asset quality and for management, and typically will have experience and expertise in making loans of the types for which it is applying for the additional lending authority.

Application Process

This program is intended for well-capitalized savings associations who compete with state chartered institutions that have higher single borrower limits. The association must file an application and receive prior approval from its Regional Office before using the program's special lending limits. The application must include a certification that the institution is eligible, a citation to the relevant state law or regulation, a copy of the written resolution by the majority of the board of directors approving of the use of the program's special lending limits, and a description of how the board will oversee the use of the special lending limits. Specific guidance on the details of the application procedures and the approval process is located in Section 850 of the Applications Processing Handbook.

This program is directed towards savings associations with a proven management team and board of directors, stable operations, and a demonstrated history of prudent lending over an extended period of time. The Regional Office may approve a completed application if it finds that the savings association meets the requirements of the program and the approval is consistent with safety and soundness.

Savings associations that were approved under the pilot program continue to be approved under the expanded program unless they become ineligible or are advised otherwise by their Regional Office.

Regional Offices have the discretion to deny an application from a savings association whose past performance or current credit culture raise questions or concerns regarding its ability to operate in a safe and sound manner with the additional lending limit authority, even if the savings association meets the eligibility requirements detailed above.

A savings association that has received OTS approval may make loans and extensions of credit under the special lending limits as long as it remains eligible. An approved institution must cease making new loans or extensions of credit in reliance on the special limits if it becomes ineligible or OTS rescinds its authority.

Any loans made by the savings association to a borrower in compliance with the requirements of this program will not be deemed a lending limit violation and will not be treated as nonconforming if the savings association becomes ineligible, its authority to participate in the program is rescinded, or the program is terminated or discontinued.

Ongoing Monitoring

Approved institutions should maintain current data on the number and amount of small business, small farm, and 1-4 family residential loans made under the special lending limits program and the percentage of the institution's capital and surplus that the additional lending represents. Periodically, the Regional Offices may contact approved institutions for these data.

Approved institutions that extend credit or make loans under the additional lending authority should also monitor such activities to ensure that they are conducted in a safe and sound manner, that there is no adverse effect on the savings association's operations or capital, and that the loans and extensions of credit comply with all other relevant laws, regulations, and policies.

Termination for Supervisory Reasons

OTS may terminate a savings association's authority to extend credit or make loans under this additional authority if the savings association's continued participation in the program raises supervisory concerns about credit quality, undue concentrations, or concerns about the savings associations overall credit risk management, systems, or controls.

Other LTOB Exceptions

Government Sponsored Agency obligations

The HOLA at 12 USC § 1464(c) authorizes savings associations to invest in debt and equity issues of Fannie Mae, Freddie Mac, Sallie Mae, Ginnie Mae, and the Federal Home Loan Banks, or in the obligations issued by, or fully guaranteed as to principal and interest by, any agency of the United States. Although § 560.93 of the OTS regulations does not specify limitations on such investments, the investments must be prudent and appropriate for the association. OTS may establish individual limits on such investments if an association's concentration presents a safety and soundness concern.

Commercial Paper and Corporate Debt

Commercial paper and corporate debt securities are obligations of commercial entities and are treated as loans or extensions of credit for purposes of the LTOB rule. OTS regulation 12 CFR § 560.40 addresses the requirements for commercial paper and corporate debt securities. It states: A federal association's investment in the commercial paper and corporate debt securities of any one issuer, or issued by any one person or entity affiliated with such issuer, together with other loans (of the issuer), shall not exceed the general lending limit contained in 560.93(c). Notwithstanding the general lending limits, savings associations may invest ten percent of unimpaired capital and unimpaired surplus in the obligations of one issuer evidenced by commercial paper that is rated by at least two nationally recognized investment rating services in the highest category; and corporate debt securities that are rated in the two highest grades by a nationally recognized investment rating service, provided the obligations may be sold with reasonable promptness at a price that reasonably reflects their fair value.

Asset-backed Securities, Loan Sales, and Loan Participations

Typically, OTS considers asset-backed securities, loan sales, and loan participations obligations of the borrowers of the underlying loans that collateralize the security. There are exceptions, however. When the association relies on the credit of the issuer (or seller) for repayment of the obligation, the LTOB limits will apply. This may be demonstrated under the following conditions:

- When the loans, leases, or securities are sold with recourse.
- When the association relies on the seller/issuer (as opposed to a reliable independent third party) to service the underlying loans or leases and remit payments from the borrowers.
- When the association purchases loans or leases or participation interests in pools of loans or leases and the seller services the loans or leases, retains the collateral documents, and the buying association has not perfected a security interest in the assets.

Bank Owned Life Insurance (BOLI)

Savings associations should limit their BOLI investments in any one carrier to the 15 percent of their unimpaired capital and unimpaired surplus reserves. (See TB 84, Interagency Statement on the Purchase and Risk Management of Life Insurance.)

RECORDKEEPING

Section 560.93(f) addresses requirements for documenting compliance with the LTOB limitations. When a savings association or its subsidiary makes a loan or loans to any one borrower that, in aggregate, exceed the greater of $500,000 or 5 percent of the association's unimpaired capital and surplus, it must include documentation showing that such loans were made within the limitations of 12 CFR § 560.93.

DEFINITIONS

For purposes of applying the lending limitations under 12 CFR § 560.93, savings associations shall apply the definitions and interpretations promulgated by the OCC at 12 CFR Part 32 including those discussed below.

Borrower

The term *borrower* has the same meaning as the term *person* set forth in 12 CFR Part 32. For purposes of determining LTOB limitations, a *"borrower"* means a person who is named as a borrower or debtor in a loan or extension of credit, or any other person, including a drawer, endorser, or guarantor, who is deemed to be a borrower under the "direct benefit" or the "common enterprise" tests set forth in 12 CFR § 32.5.

Generally, loans or extensions of credit to one borrower will be attributed to another person and each person will be deemed an individual borrower when either of the following occurs:

- The proceeds of a loan or extension of credit are to be used for the direct benefit of the other person. *Direct benefit* will be attributed to the other person when the proceeds, or assets purchased with the proceeds, are transferred to another person, other than in a bona fide arm's length transaction.

- A common enterprise is deemed to exist between the persons.

  A common enterprise will be deemed to exist and loans to separate borrowers will be aggregated when any of the following occur:

  — The expected source of repayment for each loan or extension of credit is the same for each borrower and neither borrower has another source of income from which the loan (together with the borrower's other obligations) may be fully repaid.

— Loans or extensions of credit are made:

  ✓ To borrowers who are related directly or indirectly through common control, including where one borrower is directly or indirectly controlled by another borrower; and

  ✓ Substantial financial interdependence exists between or among the borrowers. Substantial financial interdependence is deemed to exist when 50 percent or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower. Gross receipts and expenditures include gross revenues and expenses, inter-company loans, dividends, capital contributions and similar receipts of payments.

— Separate persons borrow from an association to acquire a business enterprise of which those borrowers will own more than 50 percent of the voting securities or voting interests, in which case a common enterprise is deemed to exist between the borrowers for purposes of combining the loans.

Loans to partnerships are always attributed to the general partners, but the direct benefit test or common enterprise test must be met for partnership loans to be attributed to limited partners. Refer to 12 CFR § 32.5(d) for a discussion of special rules for loans to a corporate group and loans to partnerships, joint ventures and associations.

Debt guaranteed by a person is attributed to the guarantor if the guarantor becomes an obligor under the terms of the guarantee.

Loans

Loans and extensions of credit mean an association's direct or indirect advance of funds to or on behalf of a borrower based on an obligation of the borrower to repay the funds. Loans and extensions of credit include all of the following:

- A contractual commitment to advance funds.
- A maker or endorser's obligation arising from an association's discount of commercial paper.
- An association's purchase of securities subject to a repurchase agreement.
- An association's purchase of third-party paper subject to an agreement that the seller will repurchase the paper upon default or at the end of a stated period.
- An overdraft but not an intra-day overdraft for which payment is received before the close of business.
- Fed Funds sold with a maturity of more than one business day.

Refer to 12 CFR § 32.2(k) for further explanation of these definitions.

Contractual Commitment

The limitation on loans and extensions of credit includes all obligations where the savings association has a contractual commitment to advance funds. This includes the savings association's obligation to:

- Make payment (directly or indirectly) to a third person contingent upon the default of the association's customer in performance of their obligations.
- Guarantee or act as surety for the benefit of a person.
- Advance funds under a standby letter of credit or similar arrangement.
- Advance funds under a qualifying commitment to lend.

A *qualifying* commitment to lend means a legally binding written commitment to lend that, when combined with all other outstanding loans and qualifying commitments, the borrower was within the association's lending limits when entered into, and has not been disqualified. If the association subsequently chooses to grant a loan to the borrower, which when added together with all outstanding loans and commitments exceeds the LTOB limit, then those commitments in excess of the limit become permanently disqualified. The association can advance funds only to the extent that with the advancement of new funds the association remains in compliance with regulatory limitations. Refer to 12 CFR § 32.2(f) for additional details.

> The limitation on loans and extensions of credit includes all obligations where the savings association has a contractual commitment to advance funds.

Savings associations often grant construction or other loan commitments that are scheduled to repay within a certain timeframe. The association may then grant a subsequent loan to the same borrower that, combined with the first, would exceed its LTOB limit, if it were funded prior to the repayment of the first loan. In order to avoid a lending limit violation and as a prudent business practice, savings associations should include in all appropriate loan commitments a clause that releases them from the obligation to fund the commitment if funding would cause an LTOB violation.

Loans to Facilitate Sales

OTS's policy concerning sale financing for any asset is identical to that of the OCC. A purchase money note with no advance of funds is not a "loan" for lending limit purposes. In sales financing, only advances of new funds are "loans" subject to the limits of 12 CFR § 560.93. OTS does not object to sale financings that do not involve an advance of funds or place the lender in a more risky situation, provided the sale is not to the borrower who defaulted on a loan that resulted in the lender owning the asset in question.

Renewals

The lender's renewal of a loan does not constitute a new loan for lending limit purposes provided the lender does not advance new funds to the borrower and does not substitute a new borrower for the original obligor. When the lender renews a nonconforming loan, he or she has an opportunity to bring the loan into conformance with the lending limits. This includes attempting to have the debtor partially repay the nonconforming loan or obtain another institution's nonrecourse participation in the loan to bring it into lending limit compliance. Thus, the lender must make and document best efforts to bring the loan into conformance prior to renewal. If these efforts are unsuccessful, however, the lender may renew, restructure, or modify the nonconforming loan, provided that there is no substitution of borrowers or additional advance of funds.

Upon the expiration of a partially funded loan commitment, the association may renew only the funded portion if this amount exceeds the association's lending limit and only if best efforts were first made to bring it into compliance. The association will then treat this renewed portion as a legal, although nonconforming, term loan. If the borrower subsequently repays a portion of the outstanding balance owed to the lender, the lender may not advance new funds to the borrower until the outstanding balance of the loan is brought within the association's lending limits.

Other Exclusions

The following items do not constitute loans or extensions of credit for LTOB purposes (see 12 CFR § 32.2(k)(2)):

- Additional funds advanced for the benefit of a borrower by a savings association for payment of taxes, insurance, utilities, security, and maintenance and operating expenses necessary to preserve the value of real property securing the loan, consistent with safe and sound banking practices.

- Accrued and discounted interest on an existing loan or extensions of credit.

- Amounts paid against uncollected funds in the normal process of collecting.

- That portion of a loan or extension of credit sold as a participation on a nonrecourse basis, provided that the participation results in a pro rata sharing of credit risk proportionate to the respective interests of the originating and participating lenders.

USE OF SALVAGE POWERS

Traditionally, salvage powers have provided the legal justification for federal savings associations to hold, operate (if necessary), and invest additional funds (when necessary) in property acquired as a result of, or in lieu of, foreclosure prior to resale of that property.

It has long been the position of the OTS and its predecessor that a federal savings association has inherent or implied authority to take whatever steps may be necessary to salvage an investment, provided that the steps taken:

- Are an integral part of a reasonable and *bona fide* salvage plan; and
- Do not contravene a specific legal prohibition. (The OTS does not consider the LTOB limitation to be a specific legal prohibition within the meaning of the salvage powers doctrine.)

Accordingly, a savings association may use its salvage powers to exceed the LTOB limitation provided it is able to demonstrate that it is making excess investment pursuant to a reasonable and *bona fide* salvage plan. Excess investments that are not made pursuant to such a plan are illegal and could trigger enforcement action by the OTS. The board of directors should expressly approve the salvage plan. State-chartered savings associations have similar authority under state law.

> A federal savings association that intends to make a salvage powers investment in excess of its LTOB limitation must first contact its OTS regional office to ensure that the Regional Director does not object to the association's judgment that the proposed salvage plan is necessary and appropriate.

A federal savings association that intends to make a salvage powers investment in excess of its LTOB limitation must first contact its OTS regional office to ensure that the Regional Director does not object to the association's judgment that the proposed salvage plan is necessary and appropriate. (An association need not contact its regional director before making reasonable delinquent tax or insurance payments necessary to protect the association's security interest in the property. However, it should still document that such action is necessary and appropriate.)

Regional Directors will take into consideration the risks posed by proposed salvage plans, an association's past history of salvage operations, the financial condition of the association and its ability to undertake the risks attendant to salvage operations. The level of scrutiny given to a salvage plan will also vary depending on the foreclosue status of the asset being salvaged.

Assets Acquired as a Result of, or in Lieu of, Foreclosure

Once an asset has been acquired as a result of, or in lieu of, foreclosure, the LTOB limitation no longer applies directly to subsequent investments in that asset. In such situations, however, OTS uses the LTOB limitation as a prudential standard to identify significant salvage operations that may require special scrutiny to ensure that they are being prudently conducted. This includes salvage operations on foreclosed assets held in the insured institution and those held in subsidiaries. (For purposes of measuring whether an association has exceeded its LTOB limit, OTS will aggregate all of a federal savings association's investments in the property in question regardless of whether those investments occurred before or after foreclosure.)

The OTS recognizes that the payment of normal operating expenses (such as taxes and insurance or expenses to prevent deterioration of the investment) may be prudent steps necessary to minimize the

potential for loss pending the disposition of repossessed assets. Some capital expenditures, such as those necessary to put collateral property in final form for occupancy or sale, may also be prudent. However, the burden of demonstrating that capital expenditures are reasonable is greater than for operating expenditures, since capital expenditures are likely to be much more substantial.

When reviewing a proposed budget plan, regional staff will consider whether the plan meets the following criteria:

- Is necessary to enable the association to salvage its existing investment.
- Is necessary to protect the value of the foreclosed property (e.g., the additional investments will result in a more marketable property).
- Is in the best interest of the association.
- Will reduce the risks associated with the foreclosed property.

Loans in the Process of Foreclosure

A loan will be deemed to be in the process of foreclosure if a federal savings association has begun the process necessary to foreclose or to take a deed in lieu of foreclosure and is actively pursuing that process, but has not yet acquired title to the property securing the loan.

Any advance of funds, even those to protect the value of the collateral are considered loans to the borrower and subject to the LTOB lending limits. Thus, a federal savings association may not invest in such properties any amounts that would exceed the LTOB limits until it has acquired title to the property. Any valid exceptions, such as when funds need to be immediately disbursed to maintain hazard insurance to protect the association's interest in the property, for example, must be approved by the OTS Regional Office. To obtain such approval, the association must demonstrate that the need for and timing of its proposed investment (i.e., before foreclosure) are reasonably necessary.

REFERENCES

United States Code (12 USC)

Chapter 2: National Banks

§ 84	Lending Limits

Chapter 3: Federal Reserve System

§ 371c	Banking Affiliates
§ 371c-1	Restrictions on Transactions with Affiliates

§ 375b	Loans to Insiders

Home Owners' Loan Act

§ 1464 (c)	Investment Authority
§ 1464(u)	Limits on Loans to One Borrower
§ 1467a	Holding Companies
§ 1467a(m)	Qualified Thrift Lender Test
§ 1468	Transactions with Affiliates and Loans to Insiders

Federal Deposit Insurance Act

§ 1813	Definitions
§ 1831e	Activities of Thrifts

Code of Federal Regulations (12 CFR)

Chapter I: Comptroller of the Currency
Part 3: Minimum Capital (for National Banks)

§ 3.3	Transitional Rule (Intangible Assets)
§ 3.100	Capital and Surplus
§ 3.100	Components of Capital, Appendix A

Part 32: Lending Limits (for National Banks)

§ 32.2	Definitions
§ 32.3	Lending Limits
§ 32.4	Calculation
§ 32.5	Combination Rules
§ 32.6	Nonconforming Loans
§ 32.7	Special Lending Limits for 1-4 Family Residential Loans, Small Business Loans, and Small Farm Loans
§ 32.102	Federal Funds Sold

§ 32.108	Interest and Discount

Chapter III: Federal Deposit Insurance Corporation
Subchapter A: Procedure and Rules of Practice

§ 303.13	Applications by Thrifts

Chapter V: Office of Thrift Supervision

Part 541	Definitions
Part 560	Lending and Investment
§ 560.30	General Lending and Investment Powers
§ 560.93	Lending Limitations
§ 560.101	Real Estate Lending Standards
§ 561.19	Financial Institution
§ 563.41	Transactions with Affiliates
Part 567	Capital Requirements

OTS Bulletins

TB 84	Interagency Statement on the Purchase and Risk Management of Life Insurance