

# Examination Bulletin: FCA 2006-1

## Subject: Qualified Residential Loans

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### PURPOSE

This bulletin provides clarification and guidance regarding Qualified Residential Loans and related risk-weighting treatment for regulatory capital purposes in accordance with FCA Regulation § 615.5201 ([Notes Link](#)).

### BACKGROUND

In June 2005, FCA issued a final rule addressing various capital issues, including the risk weighting of residential housing loans (70 FR 35336). The previous capital regulations assigned “rural home” loans (as authorized by § 613.3030 ([Notes Link](#))) to the 50 percent risk-weighting category, provided they were secured by a first lien mortgage or deed of trust. However, similar residential loans to bona fide farmers, ranchers, and producers and harvesters of aquatic products (farmers) were risk weighted at 100 percent. The June 2005 revisions to the regulation included a 50 percent risk-weighting provision for all “Qualified Residential Loans” (QRLs) as a means of treating similar residential loans to farmers and nonfarmers in the same manner for regulatory capital purposes. This approach is consistent with that of other financial regulatory agencies.

Since the June 2005 revision, QRL-related questions have been raised by Farm Credit System (FCS) institutions and FCA examiners. The following guidance clarifies the QRL capital risk-weighting provisions.

### EXAMINATION GUIDANCE

In accordance with the definition of QRLs contained in revised § 615.5201([Notes Link](#)), QRLs include two categories of loans: a) “rural home” loans authorized by § 613.3030 ([Notes Link](#)), which by definition are to nonfarmers, and b) single-family residential loans to farmers, which are authorized under §§ 613.3000(b) ([Notes Link](#)) and 613.3005 ([Notes Link](#)). Under § 615.5201 ([Notes Link](#)), all QRLs must meet the following requirements:

- 1) They must be secured by a separate first lien mortgage or deed of trust on residential property alone (not on any adjoining agricultural land or any other nonresidential property);
- 2) They must be approved in accordance with prudent underwriting standards suitable for residential property;
- 3) They must not be past due 90 days or more or carried in nonaccrual status;
- 4) They must be subject to a monthly amortization schedule;
- 5) They must be secured by a mortgage or deed of trust on the residential property that is written and recorded in accordance with all state and local requirements governing its enforceability as a first lien; and

6) They must be secured by residential property with a permanent right-of-way access.

**Separate First Lien Mortgage or Deed of Trust on Residential Property Requirement<sup>1</sup>**

At times, it may be difficult to determine whether a particular loan is secured by a separate first lien mortgage or deed of trust on residential property alone, or whether the secured property also includes agricultural or other nonresidential property. In order to make this determination, examiners should review the institution's controls for identifying QRLs and appropriate application of those controls to the loans at issue. Examiners' review/testing should focus on ensuring that the institution's controls apply appropriate criteria that indicate whether property can be considered residential and whether these criteria are applied properly. Accordingly, when reviewing an institution's controls for identifying QRLs, examiners should use the following guidance:

- A. **Rural home loans** made in accordance with § 613.3030 ([Notes Link](#)) are considered to be loans with a separate first lien mortgage or deed of trust on residential property and qualify as QRLs for capital risk-weighting purposes. By definition, these loans are single-family, moderately priced, owner-occupied, principal residences made to nonfarmers residing in rural areas.
  
- B. **Loans to farmer/aquatic eligible borrowers<sup>2</sup>** are considered to be loans with a separate first lien mortgage or deed of trust on residential property and qualify as QRLs for capital risk-weighting purposes when the following criteria are met:
  - 1. Except for the designation as an farmer/aquatic eligible borrower as defined in § 613.3000(b) ([Notes Link](#)), the loan could have been made as a "rural home" loan under § 613.3030 ([Notes Link](#)) as such the dwelling is a single-family, moderately priced, owner-occupied, principal residence, located in a rural area— all terms as referenced in § 613.3030 ([Notes Link](#));
  - 2. The dwelling itself (including attached components, such as garages, porches, and decks) represents at least 50 percent of the total market value of the entire secured property; and
  - 3. The presence of outbuildings and/or accompanying acreage is incidental to the residential aspects of the property and does not detract from its marketability as residential property.
  
- C. **Other loans to farmer/aquatic eligible borrowers<sup>3</sup>** (not located in a "rural area" **and/or** not "moderately priced" as referenced in § 613.3030(a)(3) & (4) ([Notes Link](#))) require a separate first lien mortgage or deed of trust on the residential property alone (not on any adjoining agricultural land or any other nonresidential property) and qualify as QRLs for capital risk-weighting purposes when the following criteria are met:
  - 1. The dwelling is a single-family, owner-occupied, principal residence;
  - 2. The dwelling itself (including attached components, such as garages, porches, and decks) represents at least 50 percent of the total market value of the residential property;

3. The first lien loan on the subject property does not exceed the maximum loan size for conventional home mortgages for secondary housing market purposes as determined periodically (currently \$417,000); and
4. The property would be appraised and marketed consistent with residential being the highest and best use.

Consistent with risk-based examination principles, FCA examiners should evaluate whether FCS institutions maintain adequate controls and processes to ensure that housing loans comply with applicable requirements and have been categorized appropriately. If FCA examiners discover loans that have been risk-weighted at 50 percent under the QRL provision without meeting the applicable requirements, institutions will be instructed to recategorize these loans and apply the appropriate risk weighting (e.g., 100 percent). Additionally, examiners are encouraged to discuss with FCS management and boards of directors applicable capital needs and optimum capital levels given each institution's unique operating environment, portfolio concentrations, risk exposures, internal controls, and risk-bearing capacity.

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Date

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<sup>1</sup>The guidelines outlined in this bulletin are tools for examining risk weighting issues, but they do not reflect all situations. In cases that are not within the criteria outlined in this bulletin, please contact the FCA's Examination Policy and Development Division at (877) 737-3379 or Office of Regulatory Policy at (703) 883-4414 for an interpretation.

<sup>2</sup>Made in accordance with §§ 613.3000(b) and 613.3005.

<sup>3</sup>Made in accordance with §§ 613.3000(b) and 613.3005.

The following flowchart includes guidelines for identifying qualified residential loans.



QRL Flowchart.pdf