NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

May 27, 1992

Joseph S. Melchione
Styskal, Wiese & Melchione
550 North Brand Boulevard, Suite 550
Glendale, California 91203

Re: Secondary Principal Residences (Your March 12, 1992, Letter)

Dear Mr. Melchione:

You have asked whether it is permissible for a federal credit union (FCU) to make a long-term mortgage loan under Section 701.21(g) of the NCUA Rules and Regulations (12 CFR 701.21 (g)) to purchase a secondary principal residence. Such a loan is prohibited unless the residence will be the new principal residence of the member or the member's future retirement home.

ANALYSIS

You state that many credit union members have two principal residences. That is, one principal residence during the work week and a second principal residence at all other times. You classify these two residences together as secondary principal residences of the member. You believe long term loans on such secondary principal residences are permitted under the FCU Act and NCUA's Regulations.

A member may obtain a long-term, first mortgage loan from an FCU pursuant to Section 107(5)(A)(i) of the FCU Act (12 U.S.C. 1757(5)(A)(i) and Section 701.21(g) of NCUA's Regulations. Both require that such loans be made on "a one to four family dwelling that is or will be the principal residence of the member-borrower." The legislative history of the long-term mortgage authority emphasizes that the mortgage must be on the principal residence of the borrower. (See Report No. 95-23, February 22, 1977, at p. 8, enclosed.) However, there is nothing in the legislative history that specifically defines the term "principal residence."

FLIA Vol. I, C 4 Real Estate Loans

The information you submitted from Fannie Mae indicates that they define principal residence to be limited to only one residence. Webster's defines principal as the most important, consequential or influential; chief (emphasis added). (See Websters New Collegiate Dictionary, copyright 1976.) This definition makes clear that principal is singular. Hence one can only have one principal residence at a time. You note that Fannie Mae allows for long term mortgages that are secured by a second home as well as by a principal residence. However, they do not take the position that a second home is a principal residence.

The preamble to the 1983 proposed revision to Section 701.21(g) of NCUA's Regulations (48 F.R. 52475, 11/18/83) discusses the term principal residence and states in part that:

> It should also be noted that with respect to the statutory requirement that the dwelling "is or will be" the principal residence of the member, §701.21(f)(2) [now §701.21(g)(2)] of the proposal would not require that the member occupy the dwelling within a certain time after the loan is made . . . The proposed change is designed to provide Federal credit unions the option of financing eventual retirement homes for their members.

An FCU may finance a future retirement home (as a future "principal residence") under the long-term mortgage authority. The time for judging the "principal residence" requirement is when the loan is made. If at that time it is a member's intent to establish a new principal residence, either immediately or some time in the future, an FCU may extend a long-term mortgage loan to the member. Under this analysis, a secondary residence that is not currently the principal residence may qualify if the member plans to eventually retire to that residence.

Although we have interpreted the "is or will be the principal residence" language to allow an FCU to make a second long-term mortgage loan to a member to purchase a future retirement home or to purchase a new principal residence, as noted above, an individual can have only one principal

residence at given time. Thus, a loan to finance a secondary principal residence that does not meet the requirements set forth above is not permitted.

Sincerely,

Hattie M. Ulan

Hattie M. Ulan
Associate General Counsel

Enclosure

GC/MM:sg
SSIC 3501
92-0330

95TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
1st Session } { No. 95-23

DEPOSITORY INSTITUTIONS AMENDMENTS OF 1977

FEBRUARY 22, 1977.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. REUSS, from the Committee on Banking, Finance and Urban Affairs, submitted the following

REPORT

[To accompany H.R. 3365]

[Including cost estimate of the Congressional Budget Office]

The Committee on Banking, Finance and Urban Affairs, to whom was referred the bill (H.R. 3365) to extend the authority for the flexible regulation of interest rates on deposits and accounts in depository institutions, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Page 1, strike out line 8 and all that follows down through line 8 on page 2, and insert in lieu thereof the following:

> SEC. 201. Notwithstanding section 5 of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464), any depository institution which is chartered by the Federal Home Loan Bank Board under section 5 of the Home Owners' Loan Act of 1933 and located in the State of New York may permit withdrawals, overdrafts, or transfers of accounts on negotiable, transferable, or nonnegotiable check, order, or authorization, to such extent and subject to such requirements and conditions as may be applicable under the law of the State of New York to institutions of the same type chartered under the laws of the State of New York.

Page 2, beginning on line 12, strike out "November 1, 1978" and insert in lieu thereof "September 1, 1977"; and on line 14, strike out "October 31, 1978" and insert in lieu thereof "August 31, 1977".

Page 6, line 22, strike out the semicolon and insert in lieu thereof the following:

> : *Provided*, That a credit union which originates a loan for which participation arrangements are made in accordance with this subsection, shall retain an interest of at least 10 per centum of the fact amount of the loan.

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with maturities not exceeding ten years. Your Committee removes the distinction between secured and unsecured loans and empowers the board of directors of federal credit unions to establish their own loan maturity and collateral requirements.

This increased lending authority is based upon a lending principle that has become widely accepted by all financial institutions. For example, the laws pertaining to national banks contain no maximum term for secured or unsecured loans. The Financial Institutions Act of 1975, as approved by the Senate in the 94th Congress, permitted consumer loans for federally chartered savings and loans with no maturity limit. State chartered credit unions in 39 states and Puerto Rico are not encumbered by loan maturity limitations. Your Committee believes the creditworthiness of the borrower in an unsecured loan is the determining factor in repayment ability and the individual boards of directors of the credit unions can best determine the terms for such loans.

Section 404 of Title IV removes the $2,500 maximum amount for unsecured loans but retains the provision that no one loan or aggregate of loans to any member not exceed 10 per centum of the credit union's unimpaired capital and surplus. Removal of the ceiling would provide each credit union the flexibility needed to meet the members' needs in accordance with the applicant's creditworthiness and the credit union's soundness rather than arbitrary loan ceilings. By removing the $2,500 limit on unsecured loans, which has been the law since 1968, your Committee recognizes that the disparity in income levels among credit union members or credit unions makes a universal loan limit unrealistic and failure to do so will continue to provide difficulty in administration to those credit unions whose members qualify for amounts far in excess of such loan limits. However, such a removal of the unsecured loan limits is in no way intended to provide an incentive for credit unions to abandon their tradition of providing for the small borrowers and, therefore, your Committee will require the National Credit Union Administration to report annually on the unsecured loan limits adopted as a result of this amendment. Such reports will be by region, or other meaningful geographic breakdown, and shall include such information as deemed necessary by the National Credit Union Administration.

A most important grant of authority contained in Section 402 is the provision permitting federal credit unions to make real estate loans with maturities up to 30 years. At the present time, the ten year maturity limit on secured loans effectively precludes federal credit unions from making conventional mortgage loans. Your Committee is satisfied that credit unions do have considerable experience in the mortgage lending field (approximately 26 state laws permit state chartered credit unions to make long term real estate loans). This experience and ability to provide the needed capital to housing markets should not be overlooked.

In keeping with traditional credit union philosophy and the present needs for home mortgages, your Committee has included the following restrictions to credit union mortgage lending authority: one, such loans must be secured by a first lien; two, the loan must be for a one-to-four family dwelling; three, such dwelling must be the principal

residence of the borrower; and four, the sales price of such dwelling must not exceed 150 per centum of the median sales price of residential real property situated in the geographic area in which the property is located.

Your Committee anticipates that the board of directors of each credit union will determine the geographic area most appropriate to serve the greatest amount of members within its principal field of membership. In the selection of the geographic area by the board of directors of each credit union, such selection should not seek out high priced or depressed areas as the basis for determining 150 per centum of the median sales price of residential real property situated in the geographic area in which the property is located. The regional office of the National Credit Union Administration shall be the ultimate arbitrator in case of any uncertainty or dispute pertaining to the determination of "geographic area" in the making of real estate loans.

Your Committee recognizes that without such limitations as stated above, it could be possible for large sums of money to be tied up in luxury homes, vacation homes, or other nonessential real estate investments, thereby eliminating available funds to persons of greater need and more modest means. Your Committee intends that it be within the discretion of the National Credit Union Administration to impose maximums on the percentage of a credit union's portfolio that may be allocated for such long-term obligations, and to determine, among other things, whether this percentage should vary according to asset size of the credit union.

Other long-term lending authorizations contained in Section 402 allow federal credit unions to make loans with maturity dates not exceeding 15 years for the purchase of mobile homes to be used by the credit union member as a residence, or for the repair, alteration or improvement of a residential dwelling which is the residence of a credit union member. Section 402 would also permit federal credit unions to make federally guaranteed or insured loans, such as the VA-guaranteed mobile home loans, with maturities as specified in those statutes. Such loans generally carry minimal risk, and under present National Credit Union Administration policy, are excluded from the risk asset category. Moreover, guarantees and insurance are used by government agencies to encourage lending for certain social or economic objectives. Your Committee agrees that federal credit unions should not be precluded from participating in federally guaranteed or insured loans.

In Section 402 the officials' borrowing limit on unsecured loans is increased from $2,500 plus pledged shares of $5,000 plus pledged shares. The same officials (directors, supervisory and credit committee members) would also be permitted to guarantee or endorse up to the same amounts. Your Committee is sensitive to any grant of authority which appears to make it easier for "insiders" to take advantage of funds entrusted to their care. Such increased borrowing authority for officials of federal credit unions is recommended based upon the following facts: one, the National Credit Union Administration recommends such an increase; two, included in the increase to $5,000 plus pledged shares of the aggregate officer borrowing limit are all loans made, guranteed or endorsed by an official of the credit union and such