

commenter noted that lowering the equity requirement reduces the additional burden on credit unions to secure a waiver from the 35% equity interest requirement.

Eight commenters recommended an even lower percentage for the mandatory equity requirement to be competitive with the market. One stated the requirement should be set at 20% and another suggested that the rule permit waivers to 20%. One commenter asked that the rule allow for a lower percentage when a government agency has provided a guarantee or advance commitment on the loan. Another stated that the proposal was a step in the right direction but would prefer if the minimum equity requirement was lowered to 10% if principals give their personal liability and guarantee. A few commenters raised concerns about the equity requirement in relation to the current rule's definition of LTV. They suggested that the agency adopt the FFIEC Interagency Guidelines for Real Estate Lending that establish supervisory limits on LTV ratios on construction and development MBLs. 12 CFR part 34, subpart D, appendix A.

The final rule retains the equity requirement as proposed. The Board continues to regard the borrower equity interest in construction and development projects and the MBL rule's LTV section, § 723.6, as important tools for safe and sound business lending, just as it did when the Board first adopted these requirements in 1991. "Collateral requirements are imposed as a hedge against the potential for borrower default. Additionally, LTV ratios implicitly produce powerful incentives to encourage borrowers to repay, *e.g.*, to protect the borrower's equity interest in the property. These incentives do not exist with high LTV ratios, where the borrower has little, if any, equity at risk. Accordingly it is critical that sufficient equity be available to protect the lender's interest." 56 FR 48421, 48423, Sep. 25, 1991. The Board also continues to view construction and development loans as containing the largest overall risks to business lending. *See id.* at 48424. It believes, therefore, that the requirement for a borrower to have a 25% equity interest in a construction or land development project is appropriate. A credit union, however, may apply for a waiver of this requirement. 12 CFR 723.10.

The FFIEC Interagency Guidelines for Real Estate may provide more flexibility for other financial institutions because, for example, the Guidelines do not require any equity interest but establish LTV limits for certain transactions.

Some of the relevant FFIEC supervisory limits are set as follows: 65% LTV for raw land; 75% LTV for land development; and 80% LTV for commercial construction loans. 12 CFR part 34, subpart D, appendix A. As noted above, however, comments directed at the rule's LTV definition are not relevant to this current rulemaking because the Board did not seek public comment on any changes to that definition. These comments, as well as the suggestion to review the FFIEC Interagency Guidelines for Real Estate Lending, remain under consideration and may be addressed by future rulemaking.

Finally, commenters asked for clarification about the borrower's equity requirement and whether it is based on the cost amount of the project or the appraised value of the project upon completion. In NCUA legal opinion 01-0422, dated June 7, 2001, the Office of the General Counsel stated that a borrower's equity interest in a project may include down-payment money and the value of land owned by the borrower on which the project is to be built, less any liens. The legal opinion letter also states that, because construction and development projects are typically very speculative in nature, appraisals that attempt to determine the future market value of the completed project tend to be unreliable. Accordingly, NCUA believes it is more prudent to use the market value of the project at the time the loan is made to determine the value of the financed project. This includes the appraised value of land owned by the borrower on which the project is to be built, less any liens, plus the cost to build the project. To adopt the agency's position and clarify this issue for commenters, the final rule states that credit unions must use the current market value of the project in determining its value.

Section 723.3 reduces the regulatory burden for members engaged in the business of constructing single-family residential properties. First, in the case of a loan to finance the construction of a single-family residence where a contract already exists between the builder, who is a member-borrower, and a prospective homeowner, the final rule provides that such a loan is not subject to the aggregate 15% of net worth limit of § 723.3(a) or the 25% equity interest requirement. These loans need only comply with the LTV requirements of § 723.7. Second, the final rule grants this same relief from the aggregate net worth limit and the equity interest requirement for one construction or development loan per member-borrower or group of associated member-

borrowers for a single-family residence, irrespective of the existence of a contract with a prospective homeowner.

When making construction and development loans that are exempt from the equity requirements in § 723.3 but subject to the LTV requirements of § 723.7, credit unions must use the market value of the project at the time the loan is made, as discussed above, when determining the appropriate LTV limits.

Eleven commenters supported the exemptions for the financing of single-family residential properties. Several of these commenters stated that the Federal Credit Union Act charges credit unions to extend credit for provident purposes. They found the exclusions for the construction of single family residences enable credit unions to assist their members in achieving home ownership because increased credit union construction financing will enhance the marketplace for readily saleable homes in every community. In short, they stated this regulation opens a door for credit unions to increase the types of service they can offer to their communities.

Two commenters asked for clarification on these provisions because they were unclear as to the number of loans a member homebuilder may have with the credit union under these exclusions. The final rule allows the homebuilder to have as many loans as it has sales contracts with future homeowners, plus one loan for a home for which the homebuilder does not yet have a sales contract, subject to the loans to one borrower limit in § 723.8. When the credit union applies the rule's exceptions to its first speculative-type loan made to a homebuilder, that loan remains exempt from the 25% equity requirements and excluded from the 15% net worth limit of § 723.3 until the builder pays off the loan. Once it is fully paid, the credit union may exclude a new speculative loan made to the builder from the 15% net worth limitation and subject the loan to the LTV requirements of § 723.7. This is contrasted with an outstanding speculative loan to the builder. The credit union cannot exclude an outstanding speculative loan it made during the time the builder was repaying the first exempt loan because any additional speculative loans to the builder during that time must have been made under all of the conditions of § 723.3.

Three commenters noted that the proposed § 723.3(b) excluded certain construction loans if the prospective homeowner contracted to purchase and reside in the property, but that typically