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National Credit Union Administration  
Office of Examination and Insurance

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June 21, 2024

SENT BY FEDERAL EXPRESS AND EMAIL

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Dear XXXX:

On March 27, 2024, you filed a request for reconsideration by the XXXX Regional Director of the material supervisory determination related to the reclassification of residential real estate loans to member business loans (MBLs) and commercial loans, as outlined in the June 30, 2023, and the September 30, 2023, examination reports. Further, you seek the reversal of the requirement to cure the statutory and regulatory violations, outlined in more detail below, resulting from the loan reclassification. On April 22, 2024, Acting Regional Director XXXX rendered a decision, denying the appeal.

On May 17, 2024, you filed a request for review by the Director of the Office of Examination and Insurance (E&I) of the material supervisory determination outlined in the June 30, 2023, and the September 30, 2023, Document of Resolution (DOR) and the April 22, 2024, request for review of the material supervisory determination from Acting Regional Director XXXX.

On May 20, 2024, you provided a certification from your board of directors authorizing the request for review by the Director of E&I. This request, pursuant to 12 C.F.R. § 746.106, allows a credit union to seek my review of a written material supervisory determination by a program office.

As discussed more fully below, I am denying your request. XXXX (XXXX) must reclassify the eleven loans from residential loans to MBL/commercial loans. Further, the credit union is required to work with the region on a plan to cure the statutory and regulatory violations without harm to the member.

Background

XXXX extends credit collateralized by property containing both residential and commercial dwellings, commonly referred to as “mixed use.” A loan collateralized by a property containing both residential and commercial use was identified during the June 30, 2022, examination of XXXX. The identification of this loan resulted in the requirement for the credit union to classify mixed use collateralized loans as MBLs/commercial loans and cure any subsequent statutory or regulatory violations.

Federal Credit Union Act (FCUA) § 1757(5) establishes federal credit unions have the power to make loans, the maturities of which shall not exceed 15 years. There are certain exceptions for

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longer maturity loans. Applicable to this discussion, the FCUA § 1757(5)(A)(i) permits a residential real estate loan on a 1- to 4-family dwelling, including an individual cooperative unit, and which is secured by a first lien upon such dwelling, to have a maturity not exceeding thirty years or such other limits as shall be set by the NCUA Board (except that a loan on an individual cooperative unit shall be adequately secured as defined by the Board), subject to the rules and regulations of the Board. However, as the loans subject of this appeal are MBL/commercial loans and do not meet any exception, these loans are subject to the 15-year maturity limit.

NCUA regulations § 701.21(c)(4) codifies the above referenced section of the FCUA, restating that the maturity of a loan to a member may not exceed 15 years. Lines of credit are not subject to a statutory or regulatory maturity limit. Amortization of line of credit balances and the type and amount of security on any line of credit shall be as determined by contract between the federal credit union and the member/borrower.

NCUA regulations § 723.4(c) establishes the maximum amount of assets, in relation to net worth, allowed in secured, unsecured, and unguaranteed commercial loans and in any given category or type of commercial loan and to any one borrower or group of associated borrowers. The credit union's policy must specify that the aggregate dollar amount of commercial loans to any one borrower or group of associated borrowers may not exceed the greater of 15 percent of the federally insured credit union's net worth or \$100,000, plus an additional 10 percent of the credit union's net worth if the amount that exceeds the credit union's 15 percent general limit is fully secured at all times with a perfected security interest by readily marketable collateral as defined in NCUA regulations § 723.2.

Following the examination, XXXX identified a total of eleven loans collateralized by mixed use properties. XXXX reclassified these loans to MBL/commercial loans on the December 31, 2022, call report. However, no action was taken to cure violations of FCUA § 1757(5) and NCUA regulations § 701.21(c)(4), establishing the maturity limit, or the violations of NCUA regulation § 723.4, establishing the aggregate commercial loan amount to one borrower. The June 30, 2023, and September 30, 2023, DORs reaffirmed the requirement for XXXX to cure any regulatory or statutory violations resulting from the reclassification.

Of the eleven loans, six loan maturities exceed the maturity limit established by FCUA § 1757(5) and NCUA regulations § 701.21(c)(4). Further, a portion of the loans reclassified to MBL/commercial loans result in two loans, as of September 30, 2023, violating NCUA regulations § 723.4(c), which establishes the maximum aggregate dollar amount of commercial loans to any one borrower or group of associated borrowers.

While XXXX did reclassify the eleven loans collateralized by mixed use dwellings and property on their call report, the credit union continues to contend the loans meet the exemption established by NCUA regulations § 723.2. NCUA regulations § 723.2 excludes from its definition of a commercial loan, loans secured by a 1- to 4-family residential property (whether or not it is the borrower's primary residence). Further, NCUA regulations § 723.8 exempts any loan that is fully secured by a lien on a 1- to 4- family dwelling from the statutory MBL limit.

XXXX requested the XXXX Regional Director reconsider the material supervisory determination to reclassify the loans from residential loans to MBL/commercial loans, and to cure the statutory and regulatory violations, as stated in the June 30, 2023, and September 30, 2023, DORs. XXXX requests these loans and future mixed use collateralized loans be exempt

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from the definitions of MBL/commercial loan and to qualify as residential property under the 1-4 family residential exemption in the FCUA and Part 723 of NCUA's regulations.

On April 22, 2024, Acting Regional Director XXXX notified XXXX the request for reconsideration did not rise to the level of a material supervisory determination. Further, that notification re-stated the credit union's requirement to both reclassify the loans from residential loans to MBL/commercial loans and cure the subject loans of the statutory and regulatory violations.

### Discussion

The Director of E&I has jurisdiction to review the Regional Director's decision, as your request for review was timely and I have determined that the issues presented are material supervisory determinations. NCUA regulations § 746.103 defines a material supervisory determination as, "...a written decision by a program office (unless ineligible for an appeal) that may significantly affect the capital, earnings, operating flexibility, or that may otherwise affect the nature or level of supervisory oversight of an insured credit union."

NCUA regulations § 746.103 broadly defines "Material Supervisory Determination." After review, I have determined that the requirement to reclassify the eleven loans from residential to MBL/commercial loans and resulting requirement to cure these loans of any statutory or regulatory violations, meets the definition of a material supervisory determination. The reclassification of approximately \$4 million in loans, or 10 percent of the loan portfolio, from residential loans to commercial loans, and subsequent cure of regulatory violations could have a significant impact on the capital, earnings, and operating flexibility of the credit union.

The eleven loans identified by the credit union, and NCUA examination staff, subject to reclassification from residential loans to commercial loans, are securitized by properties containing dwellings of both commercial and residential elements. As noted above, the definitions of residential property, 1- to 4- family residential property, and commercial loan do not explicitly address mixed use properties or dwellings. As such, my review focused on characteristics of the subject loans and associated collateral to determine if these loans are MBLs/commercial loans and, if so, do any exemptions apply that would cause these loans to not be included in the definition of an MBL/commercial loan.

The eleven loans subject to reclassification meet the definition of a commercial loan as defined by NCUA regulations § 723.2 and the MBL term as defined in FCUA 1757a. Specifically, eleven loans meet the definition of loans for commercial, industrial, agricultural, or professional purposes, but not for personal expenditure purposes. FCUA 1757a defines the term MBL as any loan, line of credit, or letter of credit, the proceeds of which will be used for a commercial, corporate, or other business investment property or venture, or agricultural purpose. The

the eleven loans are used for commercial, corporate, or other business investment properties. Further, these loans do not meet the exception from classification as MBLs for 1-4 family residential dwellings in the FCUA. The FCUA exception from the MBL definition is for a loan that is fully secured by a lien on a 1- to 4-family dwelling. The eleven loans are secured by a lien on dwellings containing commercial units.

As discussed in more detail below, the subject loans do not meet the exception for 1-4 family residential properties in NCUA regulations § 723.2. As noted in the definition of residential property in that section of the NCUA's regulations, residential property is a house, condominium unit, cooperative unit, manufactured home (whether completed or under construction), or unimproved land zoned for 1- to 4- family residential use. The properties securing these loans are not limited to a house, condominium unit, cooperative unit, manufactured home, or unimproved land zoned for 1- to 4- family residential use.

A review of the appraisals associated with the eleven loans indicated the dwellings collateralizing the loans contained commercial elements. Specifically, the dwellings are a combination of residential apartments and various commercial properties including groceries, tattoo parlors, restaurants, and other non-residential units.

The appraisal reports for five of the dwellings specify the building is zoned as S1, S2, or S9, indicative of commercial use, one dwelling is classified as G9 permitting a garage or gas station, and the remaining dwellings are identified being on property with a "commercial overlay." It is further noted, one of the above-mentioned properties is zoned as M-1 per the appraisal, thus not reflecting residential zoning at all.

The commercial loan definition means any loan, line of credit, or letter of credit... for commercial, industrial, agricultural, or professional purposes. The extension of credit for mixed use properties contains a commercial aspect of the properties, in addition to the residential portion, therefore meeting the commercial definition. There is no section in the commercial lending regulation that exempts a loan when the proceeds of which are partially for a residential purpose and also for a commercial purpose.

XXXX, XXXX, differentiates between property and dwelling when assigning zoning codes. However, as the FCUA notes, the exclusion of residential 1- to 4- family properties is based on the dwelling. My review of appraisals reviewed the zoning of the dwelling as an indicator of collateral purpose. As a federally chartered credit union, we rely upon the definition of commercial or residential loans as established by the NCUA. While I appreciate the submission of definitions of residential lending from the U.S. Department of Housing and Urban Development, XXXX, and the Consumer Financial Protection Bureau in support of your classification of these loans as commercial loans, your credit union is bound to comply with the FCUA and NCUA regulations, and this agency's interpretation thereof.

As such, I find that the subject loans are MBL/commercial loans and do not meet any exemption from such classification. As a result, I find the region correctly identified these loans violate FCUA § 1757(5) and NCUA regulations § 723.4. This includes both the FCUA maturity limits and the NCUA's commercial loan concentration limit to one borrower or group of associated borrowers.

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For those loans exceeding the 15-year maturity limit, the credit union is required to develop and implement a plan to bring them into regulatory and statutory compliance. The credit union also needs to ensure no commercial loans exceed the maximum aggregate dollar amount to any one borrower or group of associated borrowers as required under NCUA regulations § 723.4(c). The means in which this is done is the decision of the credit union.

Decision

**For the reasons noted above, I am denying your request to classify the subject loans as residential loans and further require you to work with the region on a plan to cure the statutory and regulatory violations of said loans without harm to the member.**

Pursuant to NCUA's regulations, 12 C.F.R. § 746.107, you may appeal this decision to the Supervisory Review Committee within 30 calendar days of receipt of this letter. Such an appeal must follow the requirements of the regulation and must be filed in writing with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314- 3428. Please refer to NCUA regulations § 746.107 for additional information regarding the required contents of an appeal.

Sincerely,

Kelly Lay  
Director

cc: Board Chairperson XXXX (XXXX)  
XXXX, CEO (XXXX)

bcc: Regional Director XXXX  
ARDP XXXX  
SE XXX  
Ex XXX  
Eastern Region DOS Mail  
Board Secretary XXXX  
DD XXXX  
DRM Director XXX  
Acting AD XXXX  
All Risk Officers