



State of Washington

DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF CREDIT UNIONS

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January 30, 2007

TO: Division of Credit Union Examiners

FROM: Linda Jekel, Director of Credit Unions

DCU Interpretive Letter I-07-02

RE: Clarifying What Constitutes a MBL Construction Loan under Chapter 208-460 WAC

WAC 208-460-170 defines “development or construction loan” as a financial arrangement for acquiring real property or rights to real property, including land and structures, with the intent to develop or improve it for:

- a. Residential housing for sale;
- b. Income property;
- c. Commercial use;
- d. Industrial use; or
- e. Similar uses.

When a member borrows funds to build a commercial property, such as a rental house on property she owns free and clear, the loan is considered a member business loan (MBL) and a construction loan. The credit union must comply with WAC 208-460-030, along with other applicable requirements for MBLs in Chapter 208-460 WAC.

In addition, a MBL is a construction or development loan, under the following criteria:

- The use of the property will not change and the construction portion of the loan funds are at least 50% of the appraised fair market value before construction/development, or
- The loan proceeds are being used to convert the use of the property.

Examiners have asked for examples to illustrate these distinctions. The following examples have some mix of loan funds used for renovation, construction, or development. The examples are used to clarify as to whether these MBLs should also be classified as a construction loan.

Example 1: An auto dealership would like to make an addition to its existing business facility. An expansion to the existing building will cost an estimated \$300,000 and not change the use of the business facility. The fair market value before beginning the expansion

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is appraised at \$1 million. The question is whether the \$300,000 loan to build the add-on building with the refinancing of the existing permanent loan constitutes a construction loan under Chapter 208-460 WAC?

Answer: No, because the use of the property remains the same as an auto dealership and the construction portion of \$300,000 is less than 50% of the appraised fair market value before beginning the expansion. However, the loan would still be considered a MBL because the loan is for commercial purposes and meets the MBL definition in WAC 208-460-010(1). The credit union must comply with other applicable requirements for MBL, including but not limited to loans-to-one borrower (WAC 208-460-070) and aggregate MBL limit (WAC 208-460-130).

If loan amount for the renovation was at least 50% of the fair market value before beginning construction, then the loan would need to be classified as a MBL construction loan.

Example 2: The member purchases twelve duplexes as rentals with the idea of converting these twelve units to condominiums in the future. The credit union does not know when the conversion will occur. Should the loan granted to purchase these twelve units be considered a MBL construction loan?

Answer: No, because the purpose of this loan is to fund the purchase of the twelve duplex units, not to fund the conversion of the units to condominiums. The future conversion of these twelve units may or may not happen and does not impact the ability of these units to generate rental income as they currently are. If the credit union funds a loan to convert these twelve duplex units to condominiums, then this loan would be considered a construction loan. The reason is the use of the business has changed and the change of use causes this loan to be classified as a construction loan. However, the purchase loan would still be considered a MBL because the loan is for commercial purposes and meets the definition of a MBL in WAC 208-460-010(1). The credit union must comply with other applicable requirements for MBL.

Closing

If you have additional questions about whether a MBL loan is also classified as construction and development loan, please contact the Director of Credit Unions, Linda Jekel, at (360) 902-8778 or Program Manager, Mike Delimont at (360) 902-8753 with details about the MBL transaction.