

**INTERPRETIVE LETTER 94-018 (SEPTEMBER 2, 1994)**

**Higher lending limit under Section 32(3) for qualified real estate loans is not available for the purchase of a participation if both appraisals are not obtained at the time the loan is made or refinanced.**

Your letter to \* of this Agency has been referred to me for response. In your letter you asked whether the \* ("Bank"), \*, Illinois, would be able to increase the size of its participation in a loan secured by real estate if Bank obtained a second appraisal which appraised the real estate at a value at least twice the principal amount of the loan. For the reasons explained below, procuring an additional appraisal alone will not permit Bank to increase the size of its participation under Section 32(3) of the Illinois Banking Act ("Act"), 205 ILCS 5/32(3) (1992), since the participation will not satisfy all the criteria of that section. However, because of a recent legislative change in the calculation of state banks' lending limits, Bank may be able to pursue alternative transactions that will accommodate the needs of the borrower in question.

You stated in your letter that Bank has participated in a loan with \* ("Affiliate Bank"), \*, Illinois, by purchasing from Affiliate Bank \$\* of a \$\* loan. Bank is an affiliate of Affiliate Bank as they are both entirely owned by \* Bancorp, Inc. The loan is secured by \* [real estate] the value of which, as ascertained by one appraiser, was \$\*.

As stated in Section 32 of the Act, the liability of any one person to a bank for money borrowed may not to exceed 20% of the bank's unimpaired capital and unimpaired surplus. Credit extended pursuant to Section 32(3), however, is not considered as money borrowed. Consequently, a state bank may make loans or purchase evidences of indebtedness with respect to a borrower of up to 50% of the bank's unimpaired capital and unimpaired surplus (or 25% of deposits) if the credit extension satisfies all of the criteria of Section 32(3), assuming that the borrower has no additional liabilities to the bank.

To obtain the higher lending limit of 50% under Section 32(3), the credit extension must satisfy the following conditions:

- 1) It must be secured by a mortgage or a deed of trust;
- 2) The mortgage or deed of trust must be shown to be a first lien on the real estate collateral;
- 3) The real estate must be productive; and
- 4) The appraised value of the real estate, as ascertained by the oath of two qualified appraisers, must be at least double the amount of the principal of the money loaned or the

purchase of evidence of indebtedness at the time of the loan or the purchase of evidence of indebtedness.

Bank's participation, as of the date of your inquiry, did not satisfy all of the criteria of Section 32(3) of the Act because the real estate securing the loan had not been appraised by two qualified appraisers before Bank purchased its participation from Affiliate Bank. Section 32(3) will permit Bank to use Affiliate Bank's appraisal only if a second appraisal, also indicating that the value of the real estate is at least twice the amount of the loan, is obtained at the time the loan is originated or at the time of any subsequent refinancing. Consequently, Section 32(3) would not permit Bank to increase the size of its participation up to an amount equal to 50% of Bank's unimpaired capital and unimpaired surplus.

Public Act 88-546, effective June 29, 1994, has defined the term "unimpaired capital and unimpaired surplus" for lending limit purposes to include Tier 1 Capital and Tier 2 Capital as defined by federal regulation. A copy of Public Act 88-546 is enclosed for your information. This Agency has also promulgated an emergency rule to add the portion of the allowance for loan and lease losses ("ALLL") not already included in Tier 1 Capital and Tier 2 Capital as part of unimpaired capital and unimpaired surplus (copy enclosed). Given this revised method of calculating unimpaired capital and unimpaired surplus, it is our understanding that Bank's basic lending limit under Section 32 of the Act has increased from \$\* to approximately \$\*. Of course, Bank must calculate its own Tier 1 and Tier 2 capital (plus the additional ALLL permitted by the emergency rule) to precisely determine its new statutory lending limit. Therefore, Bank may now lend (or purchase participations) up to approximately \$\* to a single borrower without violating the lending limit and without having to use the qualified real estate provisions of Section 32(3).

We also understand from our telephone conversation of \*, that Bank intends to originate the loan directly to the borrower in question. Bank plans to qualify for the lending limit exception in Section 32(3) by procuring two appraisals at the time that the loan is originated which state that the value of the real estate on which Bank would hold a first mortgage is at least twice the amount of the loan. If Bank originates such a loan consistent with the criteria in Section 32(3), we conclude that Bank could extend credit to the borrower up to 50% of the Bank's unimpaired capital and unimpaired surplus as calculated pursuant to P.A. 88-546 and the emergency rule.