DCU BULLETIN

Division of Credit Unions

Washington State Department of Financial Institutions

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Indirect Manufactured Home Lending

Due to weak loan demand, many credit unions are looking toward increasing total loans by offering new lending programs. One such program is manufactured home lending using an indirect relationship. The guidance provided in this Bulletin pertains directly to indirect manufactured home lending and much of the guidance is applicable to other vendor provided products/platforms.

Prior to entering into any new indirect lending relationship, it is important that the credit union perform in-depth due diligence on the vendor, and perform a complete analysis of the risks and rewards of the new lending program. NCUA Letter to Credit Unions 10-CU-15 titled "Indirect Lending and Appropriate Due Diligence" provides general guidance on indirect lending and NCUA Letter 07-CU-13 titled "Evaluating Third Party Relationships" provides guidance on how to implement an effective ongoing vendor due diligence program. Additionally, it is important to fully understand the indirect lending platform, because effective use of the platform will help reduce credit risk and help ensure the program is well managed and monitored. Examiners will use the "Internal Lending Controls" exam questionnaire, available on NCUA's website at http://www.ncua.gov/DataApps/Pages/AIRES.aspx .

Prior to starting an indirect manufacturing home lending relationship, Division of Credit Unions (DCU) examiners will expect that credit union management, including the board of directors, fully understands the risks and rewards of the program. In addition, the examiners will check that satisfactory policies and procedures are in place to guide staff and management to properly implement the program. Specifically, DCU examiners will expect to see the following conditions before a credit union embarks on an indirect manufactured home lending program:

1. The credit union has the necessary experience and knowledge on staff, preferably a manager, to successfully implement and manage an indirect manufactured home lending program.
2. The credit union performed comprehensive due diligence on the indirect manufactured home loan product and provider, and fully understands the strengths and weaknesses of each of them. Additionally, the credit union should document in writing what actions it will take to minimize the program's weaknesses and risks in order to reduce potential losses. The due diligence process should also include an attorney's legal opinion on its review of all the contracts and loan documents to be used in implementing the program, including ensuring consumer protection compliance.
3. After analyzing the strengths and weaknesses of the indirect manufactured home program, the credit union should determine appropriate limits to place on the program. For example, the limits should include:
    a. Total dollar limits on the program (i.e. set the limit in relationship to net worth, total loans, etc.);
    b. Maximum growth limits;
    c. Volume of indirect loans originated in a given month or period (at least until a program is seasoned);
    d. Limitation of the amount of units/loans on leased land (parks and / or resorts) versus borrower owned real estate;
    e. Size of homes to be eligible in your program: credit union should specify in policy whether it will finance the 300 square foot vacation park cabins (also used as fishing or hunting cabins), as well as single wide, double wide, and triple wide homes;
    f. Minimum credit score limits;
    g. Minimum debt-to-income ratio limits;
    h. Maximum loan-to-value ratio limits[1];
    i. Maximum exposure to any one geographic location limit (either state or manufactured home park facility); and
    j. Reporting requirements to senior management and the board of directors.

   The credit union has to fully demonstrate that they understand the product, lien perfection, and risk levels. They also need to demonstrate understanding of the impact to the balance sheet as most of these loans, especially if they are financed beyond 15 year

[1] Loan-to-value calculation standards are expected to be different for homes on leased land versus borrower owned real estate. For example, freight, delivery, and set up charges; site improvements; utility connections; skirting and anchoring may be allowed to be included in the valuation when valuing a home on borrower owned real estate and omitted when the home is on leased land. The policy should address how the loan-to-value ratio is to be calculated.

terms. The limits must be appropriate for the credit union's overall risk profile and its level of net worth. Higher risk profile and lower net worth ratio credit unions should establish lower limits.

4. The credit union should develop strong policy requirements and procedural guidance to ensure it sufficiently controls the risks associated with the program and that the program is satisfactorily managed and monitored. The policy should document the established policy limits the board of directors approved, including any other credit criteria disqualifiers that will be used.
5. The credit union should create an implementation timeline for the program, including setting appropriate growth goals for the program.
6. The Allowance for Loan and Lease Losses must adequately include an estimate for probable, incurred losses inherent in the indirect manufactured home loan program. If the third party service provider is responsible for collections, the credit union must still oversee the collections to ensure that they are completed to the credit union's expectations and standards.
7. The credit union should documentation its knowledge and understanding of the program's cash reserves for credit losses, if applicable. Typically, the cash reserve is established for the benefit of the credit union and is deposited by the third party service provider. The function of the reserve is to offset credit losses in the credit union's purchased manufactured home loan portfolio. Specifically, the documentation should address the following: (1) How the cash reserve works; (2) How it will be accessed in event of default; (3) Who is responsible for collections, foreclosure, disposing of owned real manufactured homes after foreclosure, etc.; (4) When the cash reserve will be credited to cover a loss or potential loss; (5) when does the cash reserve revert back to the third party service provider, and (6) Who controls the cash reserve.
8. The credit union should verify the borrower will meet membership eligibility and requirements prior to granting an indirect loan.
9. The credit union should have documentation supporting how each loan will be priced, and that the program's impact on the credit union's balance sheet and interest rate risk were analyzed and are appropriate for the credit union's risk structure.
10. Management must monitor this program much like other indirect lending arrangements. The examiners will expect reports generated that track each dealer regarding:
    a. Applications submitted, approved, conditioned, and denied;
    b. Total loans outstanding;
    c. Delinquency;
    d. First payment defaults;
    e. Repossessions;

f. Charge-offs;
g. Average loan to value;
h. Average loan term; and
i. Average credit score.

It is expected that the board of directors will be provided information pertaining to the program (loans processed, approved, rejected, booked, delinquency, repossessions, etc.) on a periodic basis.

Summary

DCU requests that Washington State chartered credit unions who are actively contemplating an indirect manufactured home lending relationship contact their assigned DCU caseload examiner regarding their interest in doing so. Prior to implementing the program DCU representatives would like to meet with credit union representatives to discuss the credit union's program and plans.

Any questions about this Bulletin should be directed to Doug Lacy-Roberts at Doug.Lacy-Roberts@dfi.wa.gov or (360) 902-8753.