State of Washington
DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF BANKS
P.O. Box 41200 · Olympia, Washington 98504-1200
Telephone (360) 902-8700 · TDD (360) 664-8126 · FAX (360) 586-5068 · http://www.dfi.wa.gov

Joseph M. Vincent, DFI General Counsel
Ph: 360.902.0516
Email: jmvincent@dfi.wa.gov

July 26, 2005

[redacted]

RE: Houseboat (Floating Home) Lending Program & FFIEC Guidelines Concerning Credit Risk-Ratios

Dear [redacted]:

During the course of the present safety and soundness examination of [redacted] Bank ("Bank"), an issue has arisen as to what credit risk-ratio shall be applied, as per the FFIEC Guidelines for examination, to your portfolio of houseboat loans: The 50% risk-ratio accorded real estate loans, or the 100% ratio accorded consumer loans?

This is a difficult issue and a case of first impression for the Division of Banks, even though the underlying principles that have given rise to the FFIEC Guidelines are well-settled. [redacted]

1.0 Summary Issues and Determination

QUESTION: Are houseboats real estate?

ANSWER: No. See the thorough discussion in Subsection 2.1 of this Interpretive Statement.

QUESTION: Would the Division of Banks' determination be any different if the Bank sought to invoke "federal parity" under RCW 30.04.215(3)?

ANSWER: Not at this time. See thorough discussion at Subsection 2.2 of this Interpretive Statement.

QUESTION: Are there heightened legal and underwriting risks associated with houseboat lending?

ANSWER: Yes. See discussion at Subsection 2.3 of this Interpretive Statement.

QUESTION: Even if the Bank could, through its expertise as a houseboat (floating home) lender, overcome each of the underwriting and legal risks associated with houseboat lending, would the Division of Banks change its position with respect to application of the FFIEC Guidelines?

ANSWER: Not at this time. The FFIEC Guidelines only recognize loans upon real estate as having a lower risk ratio of 50%. That is the uniform standard for examination and classification. Since a houseboat is not real estate, we see no reason, putting aside even our analysis above, to depart from these well-crafted FFIEC Guidelines, which have borne the test of experience.

2.0 Analysis and Discussion

2.1 Houseboats Are "Personal" Property, Not "Real" Property. The common law refers to land (and permanent, *immovable* improvements thereon) as "real" property, rather than "personal" property. *Black's Law Dictionary, Fourth Edition*, p. 1430. "Movable" property (i.e., property which is not permanently affixed to land or real property improvements) is considered "personalty" or "personal" property. *Black's Law Dictionary, Fourth Edition*, p. 1301. Ownership in "real property" must necessarily involve a freehold estate in land. *Restatement of the Law, Property, § 9*.

Accordingly, a houseboat does not meet the definition of "real" property at common law, since it is inherently movable property.[1] Nor has statutory law seen fit to override the common law character of a houseboat as "personal" property, or to ascribe to it the status of a "vehicle" (e.g., a "mobile home," "travel trailer," or "motor home")[2] or a "vessel."

Under the Washington Vessel Registration Act (Chapter 88.02 RCW), a "vessel" is "every watercraft used or capable of being used as a means of transportation on the water, other than a seaplane." RCW 88.02.010(1). A houseboat does not fall within such meaning. Indeed, its legal character, for collateral purposes, is, but for its applicability to Articles 2 and 9 of the Uniform Commercial Code,[3] entirely governed by the common law. State taxing authorities do

[1] While it is technically possible for a houseboat to become permanently affixed to the land, the act of it becoming a real property fixture would be to destroy its character as a houseboat and as personal property. Therefore, a houseboat, in its essence as a houseboat, will always be viewed at common law as "personal" rather than "real" property.

[2] "Mobile home" or "manufactured home" (RCW 46.04.302), "motor home" (RCW 46.04.305), and "travel trailer" (RCW 46.04.623). The process by which a "mobile home" or "manufactured home," as defined under RCW 46.04.302, becomes classified as *real estate*, instead of a personal property "vehicle," involves (1) being permanently affixed to a foundation and (2) "elimination of (vehicle) title" and official re-classification by a County Auditor as *real property*, as required pursuant to Chapter 65.20 RCW.

[3] A "houseboat" is a tangible good subject to sale, lease or other assignment pursuant to Article 2 of the Uniform Commercial Code (Chapter 62A.2 RCW). Security interests (including chattel mortgages) in houseboats are governed by Article 9 of the Uniform Commercial Code (Chapter 62A.9 RCW).

not consider houseboats "real" property for real property assessment or taxation purposes.[4] Moreover, the Washington State Legislature has distanced itself from the characterization of even the *moorage* to which a houseboat is berthed.[5]

State law governing lending by financial institutions upon personal residences has not overridden the common law with respect to the characterization of houseboats as "personal" rather than "real" property. Banks take a security interest in *personal property* (not real estate) when houseboats become collateral for loans they make. See, for example, *Midlantic Nat'l Bank v. Sheldon*, 751 F. Supp. 26 (E.D.N.Y. 1990); *Daniel v. Stevens*, W. Va. 95, 394 S.E.2d 79, 9 A.L.R.5th 1153, 12 U.C.C. Rep. Serv. 2d 854 (1990); *Bankers Trust of South Carolina v. South Carolina Nat'l Bank*, 284 S.C. 238, 325 S.E.2d 81, 40 U.C.C. Rep. Serv. 1302 (1985).

Nor has federal law heretofore preempted state law with respect to the characterization of houseboats as "personal" property. For example, under the Real Estate Settlement Procedures Act (12 USC § 2601 et seq.), a "'federally related mortgage loan' [is] any loan (other than temporary financing such as a construction loan) which . . . is secured by a first or subordinate lien on residential real property (including individual units of condominiums and cooperatives) designed principally for the occupancy of from one to four families . . . ." 12 USC § 2602(1).

Now it is true that the Internal Revenue Code and Federal Tax Regulations permit a houseboat the status of a "qualified home" for purposes of the mortgage interest deduction.[6] However, for our purposes here, federal taxation policy is distinct from and has nothing to do with FFIEC Guidelines for federal and state banking examiners concerning the risk ratio to be attributed to a loan on a houseboat (100%, as with consumer loans), as opposed to a residential mortgage loan on real estate (50%). Nor do such taxing policies alter in any way the governing common law characterization of a houseboat as "personal" rather than "real" property.

2.2 The Powers of a National Bank Do Not Change the Classification of a Houseboat as "Personal" Property. On January 7, 2004,[7] the Office of the Comptroller of the Currency ("OCC"), the federal banking regulator having jurisdiction over national banks, issued two momentous final rules: One pre-empting state officials from having visitorial power over operating subsidiaries of national banks, and the other, more ominous final rule that presumes to pre-empt national banks and their operating subsidiaries from certain state real estate laws that

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[4] *Brighton v. Noble*, Washington Board of Tax Appeals, 2002 Wash. Tax LEXIS 148 (2002). In a tax appeal involving assessed value of a *moorage* site, the Washington Board of Tax Appeals stated that "[t]he houseboat located at this moorage site is valued separately as personal property, and is not a part of these appeals."

[5] The Horizontal Property Regimes Act (Washington Condominium Act), Chapter 64.32 RCW, does not apply to houseboat moorage unless adopted by local ordinance. Pursuant to Session Law 1981, Chapter 304, Section 35: "The provisions of section 34(1) [RCW 64.32.010(1)] [of the Condominium Act, which define a condominium "apartment"] shall not apply to moorages for houseboats without the approval of the local municipality."

[6] According to IRS Publication 936, "[f]or [one] to take a home mortgage interest deduction, [one's] debt must be secured by a qualified home. This means [one's] main home or [one's] second home. A home includes a house, condominium, cooperative, mobile home, house trailer, boat, or similar property that has sleeping, cooking, and toilet facilities." This expansive definition of "qualified home" includes other categories of collateral (e.g., certain mobile homes and all house trailers and boats) that are always considered collateral for *consumer* loans.

[7] Published at 69 FR 1904, 1916 on January 13, 2004; codified at 12 CFR 7.4000 et seq.

would have more than an "incidental effect" on uniform national bank policy, as determined by the OCC.

At present, of course, the OCC ascribes for its national bank stakeholders to the afore-stated FFIEC Guidelines concerning the disparity in credit risk-ratios between real estate loans (100%) and consumer loans (50%). It is conceivable that the OCC could, in the future, agree by rule or bulletin to depart from the present FFIEC Guidelines and treat houseboat loans the same as real estate loans for risk-ratio purposes. In doing so, the OCC could also invoke the provisions of 12 CFR 7.4000 et seq. ("Preemption Rule") to say that state statutory and common law regarding houseboats does not apply to national banks and their operating subsidiaries.

The Division of Banks is on record as vigorously opposing the Preemption Rule; and the Division of Banks will likely continue to oppose it. However, the Division of Banks has an increased concern that its stakeholders may feel the desire to invoke "federal parity" with the powers of a national bank pursuant to the provisions of RCW 30.04.215(3).

Under the terms of RCWW 30.04.215(3), a state-chartered commercial bank under Title 30 RCW may exercise the powers a federally chartered bank (including a national bank) had as of July 27, 2003. The Preemption Rule was not made effective until January 7, 2004. Therefore, pursuant to RCW 30.04.215(3), if a state-chartered commercial bank wanted to invoke the Preemption Rule for purposes of overriding state law and regulation governing its classification of houseboats as collateral, it would have to apply to the Director of the Division of Banks for a determination that the exercise of the Preemption Rule would (1) serve the convenience and advantage of depositors, borrowers, or the general public, and (2) maintain the fairness of competition and parity between state-chartered banks or trust companies and federally chartered banks.

Based, however, on our perception of heightened risk associated with houseboat loans (see below), and assuming that the OCC would even alter their classification standards with respect to houseboat loans (which it has not), the Division of Banks cannot perceive at this time any reasonable basis for adopting classification standards any different than that presently in effect under the FFIEC Guidelines, with or without the invoking of "federal parity" pursuant to the Preemption Rule.

While we respect your houseboat (floating home) lending program, the Division of Banks stands, until a change of circumstances and further notice, in favor of retaining the classification of a houseboat as "personal" property, and the classification of a loan secured by a houseboat as a consumer loan and *not* a real estate loan.

2.3 Heightened Legal and Underwriting Risk Associated with Houseboat Loans. The position of the Division of Banks in this matter, as stated above, is also supported by our perception, reflected in our experience and in relevant case law, that there is, notwithstanding the best efforts of the Bank, heightened legal and underwriting risk associated with houseboat lending.

The biggest risk associated with houseboats is the danger that its owners may lose their moorage. Efforts have been made in the past to provide houseboat owners with governmental protections from the risk of eviction from their moorages. However, in *Granat v. Keasler*, 99 Wn.2d 564, 663 P.2d 830, cert. denied, 464 U.S. 1018, 104 S. Ct. 549, 78 L. Ed. 2d 723 (1983), a section of Seattle houseboat ordinance, which prohibited moorage owner from evicting a floating home tenant without locating another lawful moorage site within the city, was held unconstitutional for depriving moorage landlords of property without just compensation. One year after the *Granat* case was decided, the Washington Supreme Court decided *Kennedy v. City of Seattle*, 94 Wn.2d 376, 617 P.2d 713 (1984), in which the provisions of a Seattle ordinance relating to floating home moorage were also held to be unconstitutional because they deprived a moorage owner of any personal use of the moorage and in effect gave the houseboat owner a perpetual right to use the moorage. Indeed, with great lament, the *Granat* case was recently cited in *Manufactured Housing Communities of Washington v. State of Washingto*n, 142 Wn.2d 347, 13 P.3d 183 (2000), which held that Chapter 59.23 RCW − a mobile home parks-resident ownership, which gave qualified tenants a right of first refusal to purchase a mobile home park − amounted to an unconstitutional "taking," notwithstanding the Washington Supreme Court's acknowledgement of the devastating effects of mobile home owners being dispossessed of the leased "pads" upon which their homes are situated, with often no other available space capable of being leased.

There are, of course other risks inherent in the character of houseboat moorage, aside from the danger of dispossession by a landlord. For example, in *West v. Smith*, 95 Idaho 550, 556, 511 P.2d 1326, 1332 (1973), owners purchased a houseboat that was moored to pilings driven into a navigable lakebed. The houseboat was connected to the shore by a catwalk that terminated onto a public road that was acquired by prescription (i.e., the doctrine of adverse possession). The houseboat was located off the shoreline of property that the sellers had contracted to sell the buyers. The sellers and the buyers claimed undue interference with their littoral rights, and brought suit. On appeal, the Idaho Supreme Court held that the owners were not entitled to maintain the houseboat and catwalk by reason of their membership in the navigating public, because it would justify the building of similar catwalks along public roadways by others. The court did hold that the owners acquired a private prescriptive right to maintain their houseboat because there was substantial evidence that the owners' mooring was open, notorious, continuous, uninterrupted, and with the sellers' knowledge, for a period in excess of Idaho law respecting adverse possession. However, the Idaho Supreme Court also concluded that since the easement was obtained by prescription (adverse possession), it was an easement in gross and not an appurtenant easement that would have been available to an adjoining landowner, which the houseboat owners were not. Therefore, while they would have an easement to use the road as long as they remained in use, the easement was not assignable to a future owner of the houseboat, since a right gained by prescription is limited to the right as exercised during the prescriptive period.

One way to overcome the precarious nature of a houseboat owner's rights in moorage is to create a moorage condominium. However, as noted in Footnote 5 above, the 1981 Washington State Legislature specifically excluded moorage from Washington's condominium law unless otherwise permitted by local ordinance. Moreover, there are very few moorage condominiums.

Notwithstanding the legal and underwriting risks set forth above, there are potential risks associated with casualty insurance, title insurance, proper securitization and documentation, loan assignment, and guaranteeing possession of a houseboat incident to a chattel foreclosure. Each of these is worthy of an independent discussion, even though we believe it is unnecessary to do so here.

The Bank may, indeed, have a legal methodology or program for minimizing each of the heightened risks set forth above as well as those that may have gone unmentioned. However, this does not belie the fact that the FFIEC Guidelines only recognize loans upon *real estate* as having a lower risk ratio of 50%. That is the uniform standard for examination and classification. Since a houseboat is *not* real estate, we see no reason, putting aside even our analysis above, to depart from the FFIEC Guidelines.

3.0 Concluding Remarks

The statutory standards for making this determination are uniformly applicable for any Washington State-chartered commercial bank, similarly situated. However, persons other than Bank are advised that each institution's relevant facts and circumstances may be different; and such relevant facts, as applied to the governing law, may result in the Director of the Division of Banks reaching a conclusion different than the one set forth above.

Should you have any questions, please do not hesitate to call upon the Division of Banks at either (360) 902-8704.

Sincerely,

WASHINGTON STATE DEPARTMENT OF
FINANCIAL INSTITUTIONS

By: Joseph M. Vincent

Joseph M. Vincent
DFI General Counsel

For Division of Banks