

NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

DATE: December 2008 LETTER NO.: 08-CU-25

TO: Federally Insured Credit Unions

SUBJ: Credit Unions Holding Foreclosed Properties as
Foreclosed and Repossessed Assets (FRA)

REF: [Letter to Credit Unions #07-CU-06, Working with
Residential Mortgage Borrowers](#)

Dear Board of Directors:

The purpose of this letter is to provide guidance related to holding foreclosed properties as Foreclosed and Repossessed Assets (FRA).

Due to the current financial market, credit unions hold an increasing number of foreclosed properties. In Letter to Credit Unions 07-CU-06, *Working with Residential Mortgage Borrowers*, credit unions are encouraged to work constructively with residential mortgage borrowers who may be unable to meet their contractual payment obligations. We continue to urge you to work with your borrowers when possible. Prudent workout arrangements can be in the long-term best interest of both credit unions and members.

However, when foreclosures are unavoidable, you must consider all risks associated with holding FRA. FRA should only be held temporarily and not permanently as an income-producing asset.¹

FRA should be actively marketed for sale as evidenced by the fact the credit union has committed to a plan of sale, is seeking a buyer, and expects to collect on the sale within 12 months.

¹The Federal Credit Union Act only authorizes a federal credit union to hold and dispose of real property necessary or incidental to its operations. 12 U.S.C §1757(4). Most state regulators have similar requirements.

Risk Assessment

When determining the appropriate program and time-frame for holding FRA, you should perform a risk assessment and develop policies and procedures establishing overall limits and guidelines for the level of risk your credit union can sustain and still ensure continued safety and soundness. Holding these non-earning assets will cause a decline in profitability due to loss of income from the cost of carrying the asset. These factors must be considered when determining your strategy for managing FRA. In addition to establishing an overall policy regarding FRA, you should also analyze each property on an individual basis. You should document your initial assessment of each property along with the ongoing analysis of subsequent decisions. Your policies and procedures should consider and address the following applicable risks:

- Liquidity – You must determine the level of FRA the credit union can hold and manage before negative implications place undue stress on the credit union’s liquidity position.
- Transaction – The FRA should be appropriately reported on the statement of financial condition, i.e., collateral initially transferred to Foreclosed and Repossessed Assets (FRA) at the fair value of the collateral less costs to sell, the loan deficiency balance, if any, charged-off against the allowance for loan and lease losses. Subsequently, the FRA is reported either as held-for-sale at the lower of cost or fair value through a separate valuation allowance, or held for the credit union’s use and depreciated.²
- Compliance – All applicable consumer regulations and state laws should be considered and addressed.
- Strategic – The implications the chosen strategy places on the credit union’s current and future earnings should be evaluated. The level of FRA the credit union can afford to carry in relation to net worth and liquidity should be determined.

² Para. 30 of FAS 144, *Accounting for the Impairment or Disposal of Long-lived Assets*, provides criteria under which the repossessed and foreclosed assets are to be classified as held for sale. Otherwise, such assets are reclassified as held and used with recognition of depreciation expense. The criteria to consider whether the property is held for sale includes:

- a. Management, having the authority to approve the action, commits to a plan to sell the asset.
- b. The asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets.
- c. An active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated.
- d. The sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale, within one year.
- e. The asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value.
- f. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

- Reputation – The credit union should have a plan in place to determine which properties will be sold immediately and which will be held for a short period of time.

We understand the downturn in the current real estate market has many implications that must be considered when making the decision how long to hold FRA, including the aggressiveness of marketing. You should establish policies and procedures that will protect the financial safety and soundness of your credit union. Examiners will evaluate these policies and procedures as needed to ensure the credit union can safely manage all implications associated with FRA on the statement of financial condition.

Factors to Consider

While marketing to sell a foreclosed property, the following precautions should be taken to protect and potentially enhance the value of the FRA. Maintaining and protecting the FRA from value deterioration is critical to maximizing recovery value. You should be prepared for the typical expenses incurred while holding FRA. These typical expenses include maintenance, real estate taxes, insurance, and other miscellaneous expenses.

If, due to market conditions, you are unable to sell a property and consider leasing or renting the property, you must consider all issues that would arise with this option. The Federal Credit Union Act only authorizes federal credit unions to hold and dispose of real property necessary or incidental to its operations. As such, the Act provides limited authority to hold and dispose of property. Most state regulators have similar requirements. Credit unions are required to market a foreclosed property even though it is renting or leasing it to a tenant. If a credit union chooses to lease property acquired as FRA, they must comply with all financial reporting requirements under generally accepted accounting principles (GAAP).

In regards to financial reporting, credit unions with assets greater than \$10 million must file their Call Reports consistent with GAAP. For a complete understanding of GAAP regarding FRA, credit unions are encouraged to seek the advice of a licensed, certified public accountant in the application of GAAP to their specific facts and circumstances.³ Credit unions should also refer to Call Report instructions for FRA.

Conclusions

The current financial market has forced credit unions to consider the effects of carrying FRA on their statement of financial condition. This letter stresses the

³GAAP requirements addressing FRA are primarily found in Statement of Financial Accounting Standards No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings (FAS 15)*, Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets (FAS 144)*, and Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate (FAS 66)*.

importance of considering all factors and ramifications in these decisions. You should put in place policies and procedures that establish an acceptable level of risk you can properly manage in order to best protect the safety and soundness of your credit union.

If you have any questions or concerns, please contact your regional office.

Sincerely,

/S/

Michael E. Fryzel
Chairman