NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

1/6/86

OFFICE OF GENERAL COUNSEL

Thomas M. Hayes, Esquire
Westervelt, Johnson, Nicoll & Keller
1400 First National Bank Building
Peoria, IL 61602

Dear Mr. Hayes:

This is in response to your letter of December 18, 1985, concerning the sale and financing of improved real property acquired by a Federal credit union (FCU) as a result of mortgage foreclosure proceedings or voluntary return by the member.

The FCU may dispose of its collateral property pursuant to its authority to dispose of property (Section 107(4) of the FCU Act, 12 U.S.C. §1757(4)) and the incidental powers clause (Section 107(16) of the FCU Act, 12 U.S.C. 1757(16)). We direct your attention to Section 5110.1.4 of the Accounting Manual for FCU's (enclosed). This Section describes sale of collateral property. An FCU may extend credit to a nonmember in order to dispose of collateral property. Under these limited circumstances, the extensions of credit would not be considered loans for purposes of the FCU Act.

We hope that we have been of assistance. If further questions arise, please contact Hattie Ulan of this Office.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

HMU:cch

Enclosure

Collateral Real Estate Loans

IA file: Vol. I, C, 3 & Vol. I, C, 6.

• Outstanding loan balance when the obligation was cancelled.

If information about the collateral is expected to be of such a volume that it is not readily adaptable for form FCU 102, a card with this information on it can be attached to form FCU 102.

The lower portion of form FCU 102 can be used to record transaction activity pertaining to the asset, as well as the costs that have been posted to Assets Acquired in Liquidation of Loans (Account No. 708).

The beginning balance shown on the form will be the forced sale net realizable value of the asset at the time the loan was cancelled. This value may be obtained from published valuation guides for such items as automobiles, boats, motor homes, and other consumer goods. Thereafter, the worksheet will be recorded with the activity and costs associated with the dissolution of the collateral. Balances should be extended as entries are made on the worksheet. Each entry should be adequately described in the "explanation" column.

By maintaining worksheet records in the manner described above, the credit union will have a working record of all transaction activity, and other pertinent information, relating to the assets the credit union has acquired. The total of the balances shown on these worksheet records must equal the balance of General Ledger Account No. 708 monthly.

5110.1.4 NOTES AND CONTRACTS RECEIVABLE (ACCOUNT NO. 710)

When collateral property is disposed of it is generally favorable if the property is sold for cash. If need be, the credit union may accept a note for all or part of the proceeds of the sale, or it may enter into some other kind of contractual agreement with the purchaser for the payment of the purchase price over a reasonable period of time. The amount due the credit union must be established in Account No. 710, whether the sale is to a member or a nonmember. The details of the note or contract will be described in the General Ledger. If notes or contracts are numerous, subsidiary records must be established for each note or contract to support the General Ledger control account. Interest income on a note or contract receivable will be credited to Miscellaneous Operating Income (Account No. 151).

5110.2 DISPOSITION OF THE PROCEEDS FROM THE LIQUIDATION OF COLLATERAL IN POSSESSION OF THE CREDIT UNION

Following is the order in which the proceeds of the sale of the collateral will be applied. If the credit union is bound to an agreement for application of the proceeds of the collateral, such agreement will take precedence over the order listed below.

If the sale is for cash or under a note or contract, the proceeds will be debited to the appropriate account, and the credits will be applied in the order and to the extent listed below:

(a) To Assets Acquired in Liquidation of Loans (Account No. 708) to the extent that this account has been charged (debited) for costs in connection with the collateral.

(b) To Loans, Collateral in Process of Liquidation (Account No. 707) to the extent of the balance of the loan.

(c) To Allowance for Loan Losses (Account No. 719) to the extent that charge-offs have been made in connection with the loan to which the collateral has been related.

(d) To Interest on Loans (Account No. 111) to the extent of any interest due on the loan.

(e) To Miscellaneous Operating Income (Account No. 151) providing the credit union is to retain such gain. However, if the sale is under a note or contract, any gain on the sale will be deferred by crediting the amount of the gain to Deferred Gain on Liquidation of Loans (Account No. 883). This gain will be amortized and absorbed as income over the remaining term of the note or contract.

As shown above, in the absence of a binding agreement or other requirement, statutory or otherwise, the credit union will apply to Miscellaneous Operating Income, Account No. 151, the excess of the proceeds of the sale of the collateral over the amounts that are applied to other accounts. The board of directors should keep in mind that it is not the function of the credit union to earn income in this manner. Consideration should be given to voluntarily returning the excess to the borrower

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