NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

GC/SRB:sg

June 25, 1987

Office of General Counsel

Harold M. Carter, Jr., Esq.
Harris, Beach, Wilcox, Rubin and Levey
130 East Main Street
Rochester, NY 14604

Dear Mr. Carter:

This is in reply to your May 5, 1987, letter and pursuant to your conversations with this Office concerning the proposed transaction between First Heritage Federal Credit Union and Peter L. Morse & Associates ("PMA"). After reviewing your legal analysis of the transaction, I now have several additional comments and concerns.

It is clear that, pursuant to Section 107(4) of the FCU Act (12 U.S.C. §1757(4)), an FCU has the authority to hold and dispose of property necessary or incidental to its operations. However, as you recognize, this authority is regulated pursuant to Section 701.36 of the NCUA Rules and Regulations (12 C.F.R. §701.36) with respect to fixed assets owned by an FCU.

You assert that the Credit Union purchased 2.5 acres of undeveloped land in 1980 for future expansion needs. Its need for the acreage has since been determined to be limited to only about .25 acres. We agree that the remaining 2.25 acres would come within the definition of "abandoned premises" as stated in Section 701.36(b)(5), in that it is ". . . property originally acquired for future expansion for which such use is no longer contemplated." You state that the Credit Union had attempted to sell the property during the prior 24 months, without success, before receiving the proposal from PMA.

As we have discussed, one of the principal concerns of this Office is how to properly characterize the proposed transaction. We have reviewed the general law relating to exchange of property (you have referred to it as a swap) to determine whether or not the proposal could properly be considered a swap. It appears that in many instances the ownership (title) of the properties to be exchanged is

transferred simultaneously. However, in the proposal presented, the Credit Union would be transferring title to the entire property to PMA in exchange for the contractual commitment to receive back, in the future, title to a portion of the land and to a structure that will have been built by PMA on that land. Based upon our general review of the law of exchanges of property, the fact that the properties are not transferred simultaneously would not cause the transaction to necessarily be viewed as something other than a swap. In any event, the proposed transfer of property would be authorized by Section 107(4) of the Act.

Under the proposal, the Credit Union will receive title to approximately 1500 square feet of space constructed for use as a Credit Union office, plus a three lane drive-up facility. Further, the Credit Union will receive 15% of any net pre-tax operating profits from the site for an unspecified period of time. Although the Credit Union will receive a portion of the profits, the agreement provides that the FCU "shall have no liability for any losses arising from the operations of the site." See paragraph 1.(e) of the Proposal forwarded under cover of your March 17, 1987, letter. Pursuant to paragraph 1.(a) of the Proposal, PMA will agree to construct the entire project "in accordance with plans and specifications approved by the Credit Union . . . ." (Emphasis added.) Further, the Credit Union is empowered to "exclude types of tenants from the plaza which might adversely affect its business to the extent permitted by law." See paragraph 1.(g) of the Proposal.

In addition to the exchange of property, the Credit Union will loan Peter Morse at least $150,000. The entire parcel of land, as well as the $150,000, will be used to secure a loan to be made by a commercial bank to finance the construction of the project. The Credit Union will receive a subordinated lien against the real estate to secure PMA's construction and reconveyance obligations, as well as Peter Morse's loan.

The partial outline of the Proposal provided above presents certain potential legal and safety and soundness issues.

First, the control vested in the Credit Union to approve the plan for the project, its authority to exclude prospective tenants, and its sharing in the profits of the site (after it is developed), may cause the transaction to be viewed as a joint venture. If the Credit Union is determined to be a party to the joint venture, it could have exposure beyond its potential loss of the land and loan to Peter Morse. Since the determination as to whether the proposed transaction will create a joint venture is a matter of state law, we must defer to you to render such an opinion for the Credit Union. Additionally, if the transaction is a joint venture, it would likely be viewed by this Office as an impermissible FCU investment or activity.

Second, the fact that the Credit Union is in a subordinated position to the commercial lender with respect to the real estate may leave the FCU exposed to a loss equal to the value of the property plus the $150,000 (or larger) loan to Morse. You mention that PMA will secure a performance bond. As you know, receiving payment on a performance bond is often a difficult task. More often than not, litigation ensues. However, even if there is no difficulty in receiving payment, the performance bond may not be sufficient to repay the Credit Union since it would cover, as stated in your letter "completion of all construction obligations." Depending upon the circumstances, the completion of the project might only provide enough equity to repay the commercial lender. To evaluate the Credit Union's exposure to loss the Regional Office would need more specific information concerning the operation of the performance bond and how it would effectively protect the Credit Union.

You note in your letter that some additional protection is afforded the Credit Union in that the agreement will provide that the .25 acres (you refer to it as the "non-abandoned property") "will be reconveyed to the Credit Union upon the earlier of either completion of construction or nine months after signing the agreement. Thus, if PMA does not complete construction of the Credit Union building within nine months, the land will be reconveyed automatically to the Credit Union and the Credit Union can look to the performance bonds in order to have sufficient funds to complete construction." (Emphasis added.) It is unclear to us how, if title is transferred to PMA, upon the operative event (end of nine months) the land can be reconveyed automatically. This point needs to be clarified.

Lastly, we agree that IRPS 81-7 would not be applicable in this instance. Further, we agree that, effective July 1, the member business loan rule would be applicable to the $150,000 loan to Mr. Morse. Also, if PMA has no legally recognizable identity independent of Peter Morse as an individual, then the Article XII, Section 1 bylaw limitation for nonnatural persons would not apply.

Since the issues raised herein are essentially safety and soundness issues, you should address any further communication to

our Regional Office in Boston. They will also review your latest submission and provide you with any additional concerns and comments that they might have.

If there are further legal issues that need my input, please let me know.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

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cc: RD, Region I (Boston)