

December 11, 1992

Leroy Lott
Bank Design & Construction Corporation
P.O. Box 220548
El Paso, Texas 79913

Re: Fixed Assets (Your October 30, 1992, Letter)

Dear Mr. Lott:

You have asked a number of questions concerning NCUA's fixed asset regulation. As you know, Section 701.36(c)(1) of the fixed asset regulation (12 C.F.R. 701.36(c)(1)) provides that no federal credit union (FCU) with \$1 million or more in assets, without the prior approval of NCUA, shall invest in fixed assets in an aggregate amount exceeding 5 percent of shares and retained earnings. Your questions and our answers are set forth below.

ANALYSIS

Question # 1 - Is there any difference in NCUA's treatment of a state chartered credit union that is federally insured compared to a similar federally chartered one in regard to Section 701.36?

Federally insured, state chartered credit unions are not required to comply with Section 701.36 as a condition of insurance. However, NCUA may have a legitimate concern regarding the level of fixed assets in a federally insured, state chartered credit union based on safety and soundness issues. Furthermore, a federally insured, state chartered credit union must comply with its state's regulation in this area. Our answers to the remaining questions only apply to FCUs.

Question # 2 - What constitutes the "aggregate" as it applies to Section 701.36 when computing the aggregate of all capital and operating lease agreements? For example, does a lease for 10 years with two, 5-year options require the FCU to add the total of the two 5-year options to arrive at the aggregate?

The aggregate is the amount the FCU would be legally required to pay per its lease agreement. The aggregate in the above example would be (10 years) X (number of payments per year) X (amount of each payment). The two 5 year options are used in the calculation when they are exercised. Therefore, the amount of the stipulated sum per year for the options would have no bearing on the calculation until the options were exercised.

Question # 3 - If the FCU owns another building it is unable to sell, can it lease the building to its sponsor or other independent party, if the FCU retains a presence in the building? What if the FCU does not retain a presence in the building? Would the revenue for the 10 year lease be deducted from the fixed asset account for just the 10 year period or for the full twenty years.

First, it must be determined whether the FCU has more than \$1 million in assets and whether the aggregate of all its investments exceeds 5 percent of shares and retained earnings. See 12 C.F.R. 701.36(c)(1). If the answer to both questions is yes then the FCU must come into compliance with the fixed asset regulation immediately or obtain a waiver from the appropriate NCUA Regional Director. See 12 C.F.R. 701.36(c)(2). It is unclear from your letter whether the second building is being purchased or leased. In either scenario if the FCU can not sell the old building and did not obtain a waiver prior to purchasing or leasing the new building, the FCU could be required to dispose of one of the buildings.

If the FCU is not in violation of the 5 percent fixed asset rule or a waiver was obtained, the old building can be re- tained on the books for four years. Disposition of the property must occur through a private or public sale within 5 years of abandonment unless otherwise approved by the appro- priate NCUA Regional Director. See 12 C.F.R.701.36(d)(2). In the period before disposition the FCU may lease the build- ing regardless of whether they maintain a presence in the building. The term of the lease should be reasonable and may not exceed the 5 year abandonment limitation. See 12 C.F.R. 701.36(d)(2).

The revenue from the building would be accounted for as in- come in accordance with GAAP. Deducting the amount of rev- enue from the fixed asset account would be impermissible.

Question #4 - Assuming that the two leases are legal, can an FCU use both types of lease to achieve their fixed asset ob- jective? Would this approach require approvals in writing?

Using the leases on the new and old building to offset each other to avoid the fixed asset limitation is impermissible. Furthermore, a 10 year lease on the old building would be im- permissible for the reasons discussed above.

Sincerely,

Hattie M. Ulan
Associate General Counsel

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