



BULLETIN

Colorado Division of Financial Services

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Colorado
Department
of
Regulatory
Agencies

Issued to: State-Chartered Credit Unions

Subject: Purchased Construction Loans

Date Issued: December 20, 2002

Some state-chartered credit unions are purchasing, in whole or in part, residential construction loans originated by mortgage companies. Also, certain credit unions purchase whole loans from mortgage companies and, in turn, sell participation interests to other credit unions.

It has come to the Division's attention that there have been significant problems with a number of these loans. Credit unions have reported questionable membership eligibility of borrowers, frequent unsupported loan extension requests, poor control over disbursements of construction funds, lack of proper due diligence in reviewing contractor qualifications for projects as evidenced by alleged misappropriations of funds by contractors, suspected appraisal fraud, and failure by lenders to honor permanent take-out commitments.

Such problems have resulted in excessive loan defaults and loan losses for some credit unions as well as litigation against originating mortgage companies.

It appears to the Division that credit unions experiencing problems have relied excessively on the originating mortgage company for proper underwriting and loan administration. Because construction lending is inherently a higher-risk activity, state-chartered credit unions must exercise greater caution in engaging in such activity. If a credit union does not possess the expertise to thoroughly analyze the underwriting of purchased construction loans and closely monitor construction progress, then it should not engage in the activity at all.

Finally, with regard to membership eligibility, state-chartered credit unions are reminded that they have no statutory authority to originate or purchase any whole loan made to a non-member. However, a state-chartered credit union may purchase a participation interest in a loan from another credit union, if said loan is made to a member of the originating credit union.

Should you have any questions regarding the foregoing, please contact your assigned Division examiner or Supervising Examiner Nancy Stevens.