

Module: Compliance

Section: Borrower Rights - Right of First Refusal

EM-624

Date Published: 06/94

Authority and Purpose

The Farm Credit Act of 1971, as amended by the Agricultural Credit Act of 1987, requires Farm Credit System (System) institutions (except the Banks for Cooperatives) to provide previous owners of other property owned the right of first refusal to purchase or lease the property. FCA Regulation 12 CFR § 614.4522(a)(3) requires the institution, upon acquiring agricultural real estate as a result of loan foreclosure or voluntary conveyance by a borrower, to document in the other property owned file whether the borrower had the financial resources to avoid foreclosure.

Applicability and Exemptions

The right of first refusal does not apply to all other properties owned. First, the other property owned must result from a loan which met the qualifications discussed earlier in the Borrower Rights - Restructuring section of this module. That is, the loan must first meet the statutory and regulatory definition of a loan, it must have been made to a farmer, rancher, or producer or harvester of aquatic products, and it must have been made by a System institution that is a qualified lender.

If the restructuring qualification requirements above have been met, regulatory language applies first refusal rights only to other property owned classified as "agricultural real estate" whose borrowers lacked the financial resources to avoid foreclosure. Although agricultural real estate (as used in the first refusal regulations) is not defined, the following definition (developed from the existing definition of "agricultural land" found at FCA Regulation 12 CFR § 619.9025) will be applied:

Land improved or unimproved, including any buildings constructed on such land, which is devoted to or available for the production of crops and other products such as but not limited to fruits and timber or for the raising of livestock.

A borrower's financial inability to avoid foreclosure specifically addresses situations involving financially capable borrowers who consciously decide against repaying their loans. Such borrowers, when their condition is adequately documented by the lender, would not be protected by first refusal rights. The lender should also have documented the determination of whether the property met the agricultural real estate definition, especially when first refusal rights are not afforded. Situations which appear contrary to borrower rights expectations should be evaluated by examiners, with the expectation that lenders have thoroughly documented the decision process.

Standard real estate lending practices, such as a requirement to include an earnest money deposit with a purchase offer, are allowable and do not diminish a previous owner's first refusal rights as long as the requirement is uniformly and consistently applied to all potential purchasers. **However, any practice that effectively discriminates against a previous owner in the disposition of an other property owned will be considered a violation of the previous owner's borrower rights.**

Sale or Lease by Public Auction, § 614.4522(e)

When selling or leasing other property owned through a public auction, competitive bidding process, or other similar public offering, FCA Regulations require that the institution shall:

- Notify the previous owner, by certified mail, of the availability of the property. The notice must contain the minimum acceptable bid, if any, and any terms or conditions of the sale or lease.

- Accept the offer of the previous owner if the bid is an acceptable bid as stated by the institution and is at least equal to the highest acceptable bid received.
- Not discriminate against the previous owner.

Some lenders have adopted auction policies which allow the previous owner to match the high bid established in the auction process. If the previous owner chooses to match the high bid, the original bidder whose offer was matched is then offered the opportunity to raise the bid, with the previous owner again allowed to match the bid. This process continues until the previous owner or the potential third-party buyer chooses not to continue. This method, though not required, adequately complies with regulatory requirements.

Sale By Other Than Public Auction, § 614.4522(c)

When selling other property owned by other than public auction, the institution shall:

- Notify the previous owner, by certified mail, within 15 days of the decision to sell the property (i.e., the institution has decided to market the property), of the appraised fair market value (established by an accredited appraiser), and of the previous owner's right to purchase the property at the appraised fair market value or to offer to purchase the property at a price less than the appraised value. The notice must inform the previous owner that any offer must be received within 30 days of receipt of the notification.
- Accept, within 15 days, an offer from the previous owner to purchase the property at the appraised value, if the offer is received within the 30-day time limit.
- Notify the previous owner of acceptance or rejection of an offer below the appraised value within 15 days of receipt of the offer. If such an offer is rejected, the institution may not sell the property to anyone else at a price equal to or less than the price offered by the previous owner, without first notifying the previous owner by certified mail and providing an opportunity to purchase the property at such price and under such terms and conditions. The previous owner will be allowed 15 days from receipt of the notification to reply. **For bid comparison purposes, FCA Regulation 12 CFR § 614.4522(c)(4) specifically states that financing by the System institution is not required and any such financing is not considered a "term or condition of the sale."**

Lease By Other Than Public Auction, § 614.4522(d)

When leasing other property owned by other means, the institution shall:

- Notify the previous owner, by certified mail, within 15 days of the decision to lease the property, of the appraised rental value (established by an accredited appraiser), and of the previous owner's right to lease the property at the appraised rental value or to offer to lease the property at a price less than the appraised rental value. The notice shall inform the previous owner that any offer must be received within 15 days of receipt of the notification.
- Accept, within 15 days of receipt, an offer from the previous owner to lease at the appraised rental value, if the offer is received within the 15-day limit, unless the institution determines that the previous owner does not have the resources available to conduct a successful farming or ranching operation or cannot meet all of the payments, terms, and conditions of the lease.
- Consider an offer at less than appraised rental value from the previous owner, if it is received within the 15-day limit.
- Notify the previous owner of acceptance or rejection of an offer below the appraised rental value within 15 days of receipt of the offer. If such an offer is rejected, the institution may not lease the property to anyone else at a rate equal to less than that offered by the previous owner, or on different

terms or conditions than those that were extended to the previous owner, without first notifying the previous owner by certified mail and providing an opportunity to lease the property at such rate or under such terms and conditions. The previous owner will be allowed 15 days from receipt of the notification in which to agree to lease the property at such rate or under such terms and conditions.

Each certified mail requirement included in notification regulations shall be fully satisfied by mailing one certified mail notice to the last known address of the former borrower (FCA Regulation 12 CFR § 614.4522(f)). Additionally, the first refusal rights provided in these regulations do not diminish any right of first refusal provided under the laws of the State in which the property is located (FCA Regulation 12 CFR § 614.4522(g)).

A previous owner who does not submit an offer in accordance with the time frames as defined above is considered to have been afforded his right of first refusal. The lender is not obligated to consider offers received from such former owners at a later date. However, the lender is also not prevented from considering or accepting any such offers.

As noted in the Borrower Rights - Restructuring section of this module, lenders may not require waivers of first refusal rights as part of a restructuring agreement.

Examination Objectives

Determine whether adequate policies, procedures, and internal controls have been established to provide reasonable assurance of compliance with the requirements of right of first refusal regulations.

Obtain corrective action when violations are identified or deficiencies in policies, procedures, or internal controls are noted.

Examination Procedures

The following procedures are provided to facilitate an evaluation of the right of first refusal. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures as needed based on the particular circumstances of the institution.

1. Coordinate compliance examination activities with other members of the examination team and the examiner-in-charge (EIC). Emphasis should be on identifying violations of law and regulation in other areas (e.g., eligibility, scope of financing, lending limits, etc.); integrating those findings with the examination of consumer protection, borrower rights, and financial reporting; and concluding on management's compliance with laws and regulations.
2. Review and evaluate the adequacy of policies, procedures, and internal controls that are in place to ensure compliance with right of first refusal regulations.
3. Review a sample of other properties owned (both on hand and sold since the previous examination) and determine whether proper notices were given when selling or leasing the properties, and whether offers from previous owners were properly considered.
4. Complete workpapers FCA 6060 and FCA 6085, if necessary, in conjunction with the evaluation of compliance with the requirements of this regulation.
5. Utilize discussions with institution managers as needed to gather information and discuss procedures and practices followed by institution personnel to ensure compliance with laws and regulations.
6. Conclude whether the institution is adequately complying with right of first refusal regulations. If not, ascertain whether the conclusion of noncompliance is supported by adequate documentation of the specific noncompliance.
7. Consider the possibility of issuing a borrower rights directive or imposing civil money penalties if

significant, repeated, and uncorrected violations are surfaced.

8. Discuss tentative conclusions and examination findings with the examiner(s) responsible for evaluating management.
9. Discuss items of concern, scope of work performed, and conclusions with the EIC and with the appropriate institution manager. Obtain a response regarding the cause(s) of deficiencies or weaknesses and anticipated corrective actions.
10. Organize and compile, if necessary, violations of law and regulation into an appendix for the Report of Examination.
11. Prepare a leadsheet or other summary document to provide workpaper support for the work performed and the conclusions reached.