

RESCINDED

Real Estate Owned and Repossessed Assets Program

This document and any attachments are replaced by Comptroller's Handbook - Other Real Estate Owned

EXAMINATION OBJECTIVES

To determine if the savings association's policies, procedures, practices, internal controls, and accounting treatment regarding real estate owned (REO) and repossessed assets are adequate to maintain safe and sound operations at the following stages:

- Acquisition
- Valuation
- Management and maintenance
- Completion and improvement
- Disposition.

To determine the extent of the savings association's compliance with applicable state and federal regulations and its own policies.

To evaluate the quality of the saving association REO and repossessed assets.

To determine the adequacy of the internal asset review and audit functions in this area.

To determine whether the current or anticipated level of REO and repossessed collateral is consistent with the savings association's business plan and safe and sound banking practices.

To determine the extent of the repossessed assets' effect on operations.

To determine whether the savings association continues to pursue repayment from the borrowers after it sells the collateral.

To determine management's and the board's willingness and ability to initiate corrective action when policies, procedures, practices, and internal controls are deficient.

To summarize findings and to initiate corrective action when deficiencies exist that could affect safety and soundness, or when you note, and bring to their attention, violations of laws or regulations.

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EXAMINATION PROCEDURES

LEVEL I

1. Review scoping materials applicable to this program. If another examiner performed the review of scoping materials, obtain a written or oral summary of the information in the scoping materials relating to this program. Refer to the examiner in charge (EIC) or EIC-designee for instruction, if needed.

Scoping materials might include the following items:

- Prior examination reports.
- Exception sheets and work papers.
- Internal/independent audit reports.
- OTS financial analysis reports.
- Supervisory analysis.
- Correspondence.
- Business plan.
- Minutes of the meetings of the board of directors.
- PERK information.
- Review of market area economic conditions.

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2. Review the preceding report of examination and all REO and other repossessed asset-related exceptions and determine whether management has taken corrective action.
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3. Review the Matters Requiring Board Attention and Corrective Actions from the three or four previous ROEs to ensure that the board and management have taken appropriate corrective action where necessary and persistent problems have not recurred.

4. Determine the adequacy of the savings association's policies and procedures on REO and other repossessed assets by thoroughly reviewing pertinent items such as: policy statements, the internal asset review program, procedures manuals, the savings association's business plan, and board and committee minutes.

5. Conduct interviews with management and ascertain compliance with policies and procedures. Determine whether management reviews policies and procedures periodically and communicates changes to the appropriate savings association personnel.

6. Determine if the savings association's procedures, controls, and objectives in this area are safe and sound and in compliance with applicable laws and regulations.

7. Ascertain the major causes of repossessions and foreclosures (for example, inadequate credit or collection policies, loan concentrations, unsound construction lending procedures, poor appraisal policies or inadequate appraisal reports, depressed economic conditions, reacquisitions). Determine if management is aware of the underlying causes. Determine if they improve or correct policies and procedures when necessary.

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8. Determine if the savings association has adequate staff to manage its current and projected levels of REO. Ascertain if management informs the employees responsible for managing these assets of relevant policies and procedures.

9. Determine if management has realistic plans for disposing of the REO and other repossessed assets portfolios. Determine whether management has considered the need for professional consulting or management firms to manage its more sophisticated acquisition, development, or construction type projects. If management is opting to retain the property, the analysis and documentation justifying such a decision should be on file.

10. Determine whether the savings association's real estate workgroup personnel have sufficient expertise to effectively manage the savings association's REO. Additionally, consider whether the savings association uses REO workout consultants or other third-party professionals to assist in this area, and whether the savings association's management adequately scrutinized these arrangements.

11. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

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LEVEL II

12. Obtain a detailed listing of the assets and reconcile to the general ledger balances. Determine if the savings association correctly reports REO and other repossessed asset balances on the Thrift Financial Reports (TFR). Request that the savings association make corrections to the TFR(s) or correct reporting on the next TFR, if you determine that they incorrectly report REO and other repossessed asset balances.
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13. Determine whether the savings association establishes any specific loss reserves and made charge-offs where warranted. In establishing valuation allowances, determine if management reviews the following considerations:
- Vandalism to the property.
 - Anticipated demolition or razing.
 - Additional construction costs to complete, restore, or improve.
 - Obsolescence.
 - Compliance with zoning requirements.
 - Failure to sell at asking prices.
 - The costs of managing and maintaining REO.
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14. Prepare the proposed asset classification write-ups (if warranted) and determine management's concurrence. Leave a list of all proposed REO and repossessed asset classifications with management.
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15. Review a list of all loans to facilitate the sale of REO or significant other repossessed assets.
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16. Determine if the terms of sale are realistic and that the savings association structured the loan to a creditworthy borrower such that reacquisition is unlikely. Determine if the savings association overstates sales and prices to defer losses. Analyze the effective cost of below-market financing and whether the savings association recorded the proper profit or loss.
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17. On a selected sample of asset files, check source documents (receipts, invoices, etc.) against general ledger entries. Ensure the association made accurate accounting entries to capitalize certain REO costs. Appropriate capitalization limited to fair value might include the following items:
- Unpaid loan balances, excluding accrued uncollected interest.
 - Taxes and assessments advanced and due, or those accrued up to the time of acquisition.
 - Insurance premiums advanced.
 - All other unpaid advances due at the time of acquisition.
 - Improvements or enhancements that add to value.
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18. Determine whether the savings association capitalizes expenses of REO operations in an attempt to defer operating losses. Request that the savings association correct the entries where necessary.
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19. From a selected sample, determine whether the savings association holds a valid title for REO and other repossessed assets.

20. Determine that the savings association paid any taxes due on REO parcels as required by local law.

21. Determine if the savings association obtained adequate hazard and public liability insurance for REO selected for review.

22. Review a selected sample of REO acquisition appraisal reports for conformance with the savings association's appraisal policies and determine whether the savings association obtained the appraisals promptly upon foreclosure. Ensure that the savings association obtains annual reappraisals when appropriate and in conformance with the savings association's appraisal policies. Calculate fair values when necessary.

23. Reconcile foreclosed and repossessed property totals for this examination to totals from the previous examination using the following documents:

- Current listing of foreclosed and repossessed assets.
 - Summaries of assets sold.
 - Attorneys' letters.
 - Minutes of the board of directors and applicable committees.
 - Work papers from the previous examination.
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24. Review the sales of all foreclosed and repossessed property since the previous examination. (A sampling is acceptable if there a large number of transactions.) Determine if management is pursuing personal liability judgments against borrowers, if allowed by law. Obtain management's response if it is not.
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25. Prepare a summary income statement dealing only with REO operations to determine the carrying cost of the REO portfolio. The statement should cover the period since the previous examination and be comparable with similar analyses performed during prior examinations. Where significant, determine net operating income (NOI) (or net operating loss (NOL)) from REO operations. Note that the savings association must consider the cost of funds attributable to the average monthly balance of REO. Use the actual composite cost of money for the period being reviewed. That means apply the weighted average rate payable on deposits and borrowings to the balance of the REO account. Determine whether the savings association modified objectives, policies, and procedures for REO operations (acquisition, management, and disposition) based on the levels of income or loss reported.
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26. Ascertain the effectiveness of management's efforts to prudently dispose of REO and other repossessed assets by determining if the savings association performs the following procedures:
- Sets reasonable sales (asking) prices compared with appraised value.
 - Lists and advertises properties with brokers.
 - Maintains reasonable selling expenses.
 - Maintains sales volume commensurate with market conditions.
 - Documents whether and why it holds properties off the market.
 - Analyzes the overall cost of previously sold REO now brought back into the portfolio, noting the increased cost, if any, to reclaim the property and restore it to its previous condition.

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- Modifies disposition objectives (as stated in the business plan) and policies based on sales experience and market characteristics.
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27. Ensure that your review meets the Objectives of this Handbook Section. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

LEVEL III

28. Consider the following and determine the need for property inspections:

- Comparisons of book values and appraised values.
- A review of the asset files.
- Interviews with management.

Inspect appropriate properties to determine the following:

- Marketability.
 - Reasonableness of appraised values.
 - Quality of property maintenance.
 - Whether OTS should require independent appraisals.
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29. In the event the independent auditor's work papers are not available, you should take the following actions:

- Test check accounting entries for any property disposed of since the previous examination.
- Review bids on sold assets for propriety.

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- Review transactions with insiders or affiliates.
 - Ensure that the savings association properly recognized gains and losses on sales.
 - Review sales made on the basis of loan terms that were unreasonably favorable to the purchaser or borrower.
 - Determine whether the savings association gave excessive commissions, fees, or other preferential treatment to dealers, brokers, or attorneys involved in handling foreclosures or repossessions.
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EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

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