

Bank:

Date of Exam:

Charter #:

Prepared By:

#19– OTHER REAL ESTATE OWNED (Risk Focused)

ASSIGNMENT OVERVIEW

Other real estate owned (“OREO”) are real properties (including mineral interests) that a bank has acquired which do not constitute its bank facilities. Generally, property in the OREO account includes: (1) real estate acquired through foreclosure to protect the bank’s interest in debts previously contracted; (2) future expansion properties which have been held more than three years, or which are no longer intended for that use; (3) employees’ residences acquired to facilitate a change of duty assignment; and (4) real estate acquired with the prior written approval of the Commissioner. Ownership by the bank for reasons other than these may be considered speculation in real estate, which is an unsound practice. OREO is normally a nonearning asset and its value is subject to wide fluctuations which directly effect a bank’s financial condition through market value adjustments. Consequently, banks should make diligent efforts to dispose of each parcel of OREO and maintain documentation adequate to reflect those efforts. See [Section 3.6](#), “Other Real Estate” in the FDIC Examination Manual for more detailed guidance. Also refer to the related DOB Reference Material file which identifies useful regulations, guidance, and other issuances by various regulatory authorities.

INSTRUCTIONS

Examiners must follow the requirements in the Examiner Bulletin addressing Guidelines for Procedures and Work Paper Documentation for Commercial Examinations.

All examiners performing these procedures must be listed above in the “Prepared By” section. All of the CORE ANALYSIS PHASE should be completed. Comments and findings for each step should be made in the comment box below each question. Reference to work paper documentation should also be included here. Documentation is to be sufficient to allow an audit trail of the examiner’s thought process and all significant findings.

Based on any weaknesses or risks noted in the CORE ANALYSIS PHASE or as directed by the EIC, the applicable Supplemental Assessment Phase (SAP) should also be performed. Responses should be entered in the SAP. Summarize your conclusions in the corresponding CORE ANALYSIS comment section.

Information on the Summary of Findings page must tie back to the findings noted within the procedure. The SEIC/EIC will determine which information in the Summary of Findings will be included in the Report of Examination.

The EIC/AEIC should review this procedure when complete. Acknowledgement that this procedure has been reviewed by the EIC/AEIC will be noted on the SCOPE FORM.

EXAMINERS ARE RESPONSIBLE FOR EXERCISING SOUND JUDGMENT AND UTILIZING REASONABLE INVESTIGATIVE AND ANALYTICAL SKILLS TO ARRIVE AT AN ACCURATE ASSESSMENT OF THE RISK PROFILE OF THIS SEGMENT OF THE INSTITUTION’S OPERATIONS. PERFORMING ALTERNATE PROCEDURES NOT LISTED WITH THESE GUIDELINES MAY BE NECESSARY TO COMPLETE THIS RISK ANALYSIS.

CORE ANALYSIS PHASE

#19 Other Real Estate Owned

1. Prior Criticism

1. Determine whether deficiencies noted in the last examination and most recent internal/external audit have been addressed and/or corrected by management. Detail how deficiencies were corrected. *Include copy of exam and/or audit exceptions and management response in work papers, or summarize exceptions/criticisms below or indicate the page number in the last examination report where deficiencies are noted, if applicable.*

Comment:

2. Balance and Reconcile

2. Balance and reconcile OREO accounts to the general ledger, and verify that the accounts are accurately reported in Call Report Schedules RC and RC-M. Note any deficiencies. *Include transcripts and reconciliation in 19-C of work papers.*

Comment:

3. Previously Existing OREO

3a. If OREO parcels were present at the last examination, Verify compliance with Title 7 Texas Administrative Code (TAC) §12.91 (d), (f), (g) and (h), Texas Finance Code (TFC) Sections 34.003 and 33.109. Refer to [Appendix](#) for further guidance on previously existing OREO properties and work paper requirements. *Comment on compliance with TAC and TFC.*

Comment:

4. Acquisitions & Dispositions

4a. For OREO [acquisitions](#) and/or [dispositions](#) since the last examination complete each respective section in the [SAP](#). Refer to [FIL-62-2008](#) and *Supervisory Memorandum 1008* for additional guidance. *Confer with examiner performing the Premises & Equipment procedure to verify that any future expansion property does not need to be moved to OREO under §34.002 of the Texas Finance Code.*

Comment:

5. All OREO Properties

5a. Analyze OREO income and expenses to determine that no expenses are taken against the ALLL, and are appropriate under 7 TAC 12.91(e). Refer to [Appendix](#).

Comment:

5b. Ensure that no one individual has total control over the acquisition, booking, and disposition of

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OREO. *Comment on any significant deficiencies.*

Comment:

5c. Conduct formal discussions with senior management on any properties considered for classification and determine correct classification. *See Supervisory Memorandum 1008 for suggested classification treatment.*

Comment:

6. Mineral Interests

6a. If the bank holds any nonparticipating mineral or royalty interests as allowed by TFC §34.004, determine if a written request was submitted to the Commissioner and upon approval by the Commissioner, an application was submitted to the FDIC to hold the reclassified property, in compliance with 12 CFR §362.3(b)(2)(i). *Comment on compliance with TFC.*

Comment:

6b. If the bank has transferred the nonparticipating royalty interest to an affiliate, as allowed by 7 TAC §12.91(h)(4), determine compliance with 12 CFR §362.4(b)(5)(i).

Comment:

7. Final Analysis

7a. Prepare applicable OREO pages for the report of examination and write-ups (violations) as directed by the EIC.

Other Real Estate page -Include page if ORE assets are more than 25% of Tier 1 Capital and ALLL. List in acquired date order. Include write-ups if individual parcel is 10% or more of Tier 1 Capital.

Analysis of Other Real Estate Subject to Adverse Classification page - Include if classifications are more than 50% of Tier 1 Capital + ALLL and OREO equals or exceeds 25% of Tier 1 Capital + ALLL

7b. Complete the Summary of Findings.

SUMMARY OF FINDINGS

#19 – OTHER REAL ESTATE OWNED

Describe all strengths evident from the evaluation.

Describe all weaknesses evident from evaluation, including violations of law/regulation/rules; noncompliance with Departmental policies/guidelines; internal policy deficiencies/noncompliance; internal control weaknesses; MIS problems; and deficiencies in management supervision.

Determine why weaknesses exist and comment on management’s response and plan of action. Identify bank personnel making the response.

SUMMARY RATING ASSIGNED: Choose an item.

Provide copy of this page to EIC/AEIC. Receipt and review of this form by the EIC/AEIC will be evidenced by his/her initials in the appropriate column for this procedure on the SCOPE FORM.

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SUPPLEMENTAL ASSESSMENT PHASE

SAP

Document findings within the SAP. Summarize conclusions in the CORE ANALYSIS.

Acquisitions & Dispositions (Q4a)

ACQUISITIONS

Review a sample of new OREO since the last examination and determine the following:

1. Did the method of acquisition comply with Section 34.003 of the Texas Finance Code? (If not, notify the EIC of the apparent violation.)
2. Was legal title to the property obtained when the asset was booked as OREO?
In the event there are any senior lien holders, has the bank recorded a liability in the amount of the lien (principal and accrued interest) in accordance with FASB 144 –*Accounting for the Impairment or Disposal of Long-Lived Assets* (superseded SOP 92-3 – *Accounting for Foreclosed Assets*) See FASB ASC Topic 360 – *Property, Plant, and Equipment*. (The carrying amount of the asset should be increased by the amount of the lien, not to exceed market value less estimated costs of sale.)
3. Do any senior liens materially affect the bank’s collateral position?
4. Have all senior liens been properly reported on the call report under schedule RC, item 16 “Other borrowed money”?
5. Was the property booked in accordance with DOB Supervisory Memorandum 1008 and GAAP? Failure to follow regulatory accounting guidelines may result in a violation of Section 34.003 of the Texas Finance Code.
6. Have the requirements of 7 TAC 12.91 (d) regarding appraisal/evaluation requirements been complied with?
7. Were only direct costs of acquisition (i.e. payment of existing first lien when the bank holds the second lien position, payments of delinquent property taxes to clear tax liens, and payments to contractors and subcontractors to clear mechanic’s liens) capitalized at the acquisition of the property?
8. If the bank has acquired any alternate or additional real estate to avoid or minimize loss potential on existing OREO was prior approval from the Commissioner of Banking obtained and the additional real estate accounted for as OREO?
9. Has the bank evaluated the potential environmental hazard of the property, which may give rise to a liability for the bank? (See FDIC [FIL-98-2006](#) which gives guidelines for the

SAP

treatment of OREO with potential environmental hazards).

Refer to [FIL-62-2008](#) for additional guidance.

Comment:

DISPOSITIONS

Review a sample of OREO sales since the last examination to determine the following:

1. Did all sales to insiders, if any, receive prior approval of a disinterested majority of the Board as required by Section 33.109 of the Texas Finance Code?
2. Was the sale price comparable to the most recent valuation obtained by the bank? If not, explain the reasons for the difference.
3. If the bank financed the sale, was it properly accounted for under FAS 66 (FASB ASC Topic 360 –*Property, Plant, and Equipment*)? Until a sale occurs under one of the five prescribed methods, the property should continue to be accounted for as OREO.

Refer to [FIL-62-2008](#) for additional guidance.

Comment:

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APPENDIX

PREVIOUSLY EXISTING PROPERTIES

Compliance with Texas Finance Code and Texas Administrative Code

When reviewing a sample of OREO acquired prior to the last examination, consider the following:

1. Has an extension been approved by the Commissioner for any properties which the bank has held in excess of the five year holding period under Section 34.003 of the Texas Finance Code? Otherwise, a violation should be cited. *Include copy in work papers.*
2. Does the bank have title to any OREO which has been completely written off? If so, verify compliance with the holding period in TFC Section 34.003, as these properties are not exempt.
3. Is the bank making a good faith effort to dispose of each parcel of OREO as per 7 TAC 12.91(g) and Supervisory Memorandum 1008, with documentation in each file including the following:
 - Listing agreements executed with real estate agents/brokers detailing the asking price and terms of sale. If a property is not listed, has the bank kept adequate documentation showing their disposal efforts?
 - Documented reasonableness of the asking price relative to the appraised fair value.
 - Records of all inquiries and offers.
 - Records of decisions made on all verbal or written offers received.
 - Advertising media employed, e.g., signs, publications, and broadcast media.

If marketing efforts are less than satisfactory, consider citing an apparent violation of 7 TAC 12.91 (g) and write a comment for the report.

4. Has the bank substantiated the carrying value of each property by obtaining an annual evaluation? To clarify, annual evaluation means 12 months from the date of the last appraisal or evaluation. Refer to TAC 12.91(a) for definitions of evaluation and appraisal. Refer to [Interagency Appraisal and Evaluation Guidelines](#) Issued December 2010.
5. Is a comprehensive, full appraisal obtained at least once every three years? If the book value of the property is over \$250,000, the appraisal must be by a state certified or licensed appraiser as per [12 CFR 323](#) (or [12 CFR 225.63](#), Regulation Y - Subpart G, for Fed member banks).

6. When the book value exceeds the appraised value, has the difference been taken into a reserve if it is determined to be a temporary decline in market value? Any write-down below market value beyond estimated selling costs should be reviewed for propriety (See Supervisory Memorandum 1008).
7. Is there evidence of adequate insurance when applicable, with the bank named as loss payee?
8. If any OREO is being rented to an insider or their related interest, was prior approval required under Section 33.109 of the Texas Finance Code obtained?
9. Are all abandoned facilities and/or future expansion property held beyond three years carried as OREO on the bank's books?
10. Has the bank assessed its exposure to environmental liability as per FDIC [FIL-98-2006](#)?

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Income and Expenses

When reviewing OREO income and expenses, consider the following:

1. Are any expenses taken against the Allowance for Loan and Lease Losses after foreclosure?
2. Are the expenditures appropriate under 7 TAC 12.91(e)?
3. Does the bank have adequate documentation supporting the transactions?
4. For any property generating income, does the rate of return exceed the average yield on the bank's real estate loans plus 100 basis points? If so, the property may be excluded from classification pursuant to DOB Supervisory Memorandum 1008.

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