

Bank _____
Charter _____

Date of Exam _____
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 3.5 “Other Real Estate” in the FDIC Examination Manual for more detailed guidance. Also refer to the related Reference file on DOBIE which identifies useful regulations, guidance, and other issuances by various regulatory authorities.

INSTRUCTIONS:

All examiners performing these procedures must be listed above in the “Prepared By” section. Completion of this procedure must be done electronically. 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 significant/critical findings in the CORE ANALYSIS PHASE or as directed by the EIC, the applicable SAP should also be performed. All findings in the SAP should be summarized in the corresponding CORE ANALYSIS comment section. Indicate if the SAP is performed in the comment section.

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

Navigation through the work program is facilitated by hyperlinks throughout the document. In order to reach the linked sections, place the cursor over the underlined text, hold down the control key, and click to follow the link. Links are also provided to return to the CORE ANALYSIS. These links are found whenever a blue arrow  appears.

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

1. Prior Criticism

1a. 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, if applicable.*

Comment:

2. Balance and Reconcile

2a. 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.

Comment:

3. Previously Existing OREO

3a. If OREO parcels were present at the last examination, then update the applicable OREO page in GENESYS from the report of examination. Verify compliance with 7 TAC 12.91(g) and 12.91(d) (3), Texas Finance Code Section 34.003 and 33.109. Ensure income and expenses associated with the OREO are not expensed to the ALLL. Refer to [Appendix](#) for further guidance on previously existing OREO properties and work paper requirements.

Comment:

4. Acquisitions & Dispositions

4a. For OREO [acquisitions](#) and/or [dispositions](#) since the last examination, complete each respective section in the [SAP](#). *Refer to Supervisory Memorandum 1008 for additional guidance.*



Comment: Performed SAP? _____

4b. 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:

4c. Ensure that no one individual has total control over the acquisition, booking, and disposition of OREO. Comment on any significant deficiencies.

Comment:
4d. Conduct formal discussions with senior management on any properties considered for classification and determine correct classification. <i>See Supervisory Memorandum 1008 for suggested classification treatment.</i>
Comment:
5. Mineral Interests
5a. 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:
5b. 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:
6 Final Analysis
6a. Prepare applicable OREO page in GENESYS for the report of examination and write-ups (violations) as directed by the EIC.
6b. Complete the <u>Summary of Findings</u> page.

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.

Report Worthy:

Not Report Worthy:

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

SUMMARY RISK RATING ASSIGNED:

Definitions:

1-Strong; 2-Satisfactory; 3-Less than satisfactory; 4-Deficient; 5-Critically deficient; NR-Not Rated

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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 AND WAIVER FORM (Planning and Control Worksheet #1).

SUPPLEMENTAL ASSESSMENT PHASE

4.	Acquisitions & Dispositions
Q4a.	<p>For OREO <u>acquisitions</u> and/or <u>dispositions</u> since the last examination, complete each respective SAP.</p> <p style="text-align: center;"><i>Summarize findings and other comments in the CORE section.</i></p>
	Acquisitions
	<p>Review a sample of new OREO since the last examination and determine the following:</p> <ul style="list-style-type: none"> • Did the method of acquisition comply with Section 34.003 of the Texas Finance Code? (If not, notify the EIC of the apparent violation.) • 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 –<i>Accounting for the Impairment or Disposal of Long-Lived Assets</i> (superseded SOP 92-3 – <i>Accounting for Foreclosed Assets</i>) See FASB ASC Topic 360 – <i>Property, Plant, and Equipment</i>. (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.) • Do any senior liens materially affect the bank’s collateral position? • Have all senior liens been properly reported on the call report under schedule RC, item 16 “Other borrowed money”? • 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. • Have the requirements of 7 TAC 12.91 (d) regarding appraisal/evaluation requirements been complied with? • Were only direct costs of acquisition (i.e., title insurance, payment of existing liens, recording fees, etc.) capitalized at the acquisition of the property? • 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? • Has the bank evaluated the potential environmental hazard of the property, which may give rise to a liability for the bank? (See FDIC FIL 14-93 which gives guidelines for the treatment of OREO with potential environmental hazards).



Guidelines for
Environmental Risk Pr

Dispositions

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

- 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?
- Was the sale price comparable to the most recent valuation obtained by the bank? If not, explain the reasons for the difference.
- 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.



FII-62-2008
Guidance on ORE.pdf

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

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APPENDIX

3a **Previously Existing Properties**

If OREO parcels were present at the last examination, update the applicable OREO page in GENESYS from the report of examination. Verify compliance with 7 TAC 12.91(g) and 12.91(d)(3), Texas Finance Code Section 34.003 and 33.109. Ensure income and expenses associated with the OREO are not expensed to the ALLL. Refer to [Appendix](#) for further guidance on previously existing OREO properties.

The following guidance will help determine compliance with TFC and TAC:

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

- 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.*
- Does the bank have title to any OREO which has been completely written off? If so, verify compliance with the holding period in Section 34.003, as these properties are not exempt.
- 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:
 1. 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 own disposal efforts?
 2. Documented reasonableness of the asking price relative to the appraised fair value.
 3. Records of all inquiries and offers.
 4. Records of decisions made on all verbal or written offers received.
 5. 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.

- Has the bank substantiated the carrying value of each property by obtaining an annual appraisal or a letter form certification from an independent, qualified appraiser?
- 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).
- 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).

- Is there evidence of adequate insurance when applicable, with the bank named as loss payee?
- 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?
- Are all abandoned facilities and/or future expansion property held beyond three years carried as OREO on the bank's books?
- Has the bank assessed its exposure to environmental liability as per FDIC FIL 14-93?

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4b	Income and Expenses
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Analyze OREO income and expenses to determine that no expenses are taken against the ALLL, and are appropriate under 7 TAC 12.91(e).

When reviewing OREO income and expenses, determine the following:

- Are any expenses taken against the Allowance for Loan and Lease Losses after foreclosure?
- Are the expenditures appropriate under 7 TAC 12.91(e)?
- Does the bank have adequate documentation supporting the transactions?
- 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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