



State of Wisconsin
Department of Financial Institutions

Scott Walker, Governor

Ray Allen, Secretary

March 17, 2015

GENERAL LETTER CU 1-15
OTHER REAL ESTATE OWNED

TO ALL CREDIT UNIONS:

The Office of Credit Unions and the Credit Union Review Board have had discussions regarding the lack of guidance or regulation on Other Real Estate Owned (OREO). This letter provides guidance to assist credit unions in handling situations involving OREO. Credit unions should note the complexity and materiality of any foreclosure when considering the factors listed in this letter and application of those factors to an OREO situation.

There is no specific credit union rule or regulation in Wisconsin for Other Real Estate Owned (OREO). However, Wisconsin Statute Chapter 186.11 (2) states, "a credit union may purchase, hold, and dispose of property as necessary for or incidental to its operations." In addition, a Wisconsin state chartered credit union is permitted to own foreclosed and other OREO property based on its statutory power to make secured and unsecured loans to its members. If the borrower defaults on a loan secured by real property, the credit union has the authority to obtain title to the property as a power incidental to its normal course of business. A credit union often acquires OREO through loan foreclosure. OREO may also be obtained via a "deed in lieu of foreclosure". Generally, the credit union intends to sell the real estate to partially or totally satisfy the loan obligation.

Credit unions are strongly encouraged to consider whether investing additional material resources into or holding an OREO is in the best interest of the credit union. If management determines they are going to invest material resources, staff should complete a thorough risk assessment before the credit union takes title to the property. National Credit Union Administration (NCUA) Letter to Credit Unions No. 08-CU-25, *Credit Unions Holding Foreclosed Properties as Foreclosed and Repossessed Assets (FRA)*, states that "when determining the appropriate program and time frame for holding FRA, you should perform a risk assessment and develop policies and procedures establishing overall limits and guidelines for the level of risk your credit union can sustain and still ensure continued safety and soundness." Also, the policies and procedures should consider and address all applicable risks including: liquidity, transaction, compliance, strategic, and reputation.

The life cycle of foreclosed real estate consists of three phases: acquisition, holding period and disposition. Management must assess the risks during each phase and consider a variety of factors such as ongoing valuation of the OREO, expenses of each phase, and proper accounting.

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It is strongly recommended that management review this letter as well as other guidance and references (a list is noted at the end of this letter). It is imperative that credit unions understand the risks associated with OREO and have proper procedures, policies and controls in place to effectively manage OREO. Management should also consider obtaining expertise when acquiring, holding and disposing of OREO if staff does not have the applicable expertise.

Factors to Consider

- **Expenses:** Expenses, management and staff time and supervision of the OREO must be considered. OREOs are very expensive to maintain and expose the credit union to other liabilities. Management should consider costs to restore or prepare the property for sale, maintenance, insurance and taxes, property management, ongoing expenses, environmental hazards of the property, costs to sell the property (marketing; broker commissions; legal and transfer fees; closing costs), etc.
- **Valuation and Accounting:** The valuation, accounting and reporting for OREO must comply with generally accepted accounting principles (GAAP). Accurate recordkeeping and valuation of OREO is essential. If a credit union is not familiar with the valuation and accounting for OREO, it is recommended they utilize the services of a licensed, certified public accountant in the application of GAAP to financial reporting and filing the quarterly 5300 Call Report. In addition, credit unions may finance OREO to facilitate a sale. However, special accounting rules may apply (ASC 360-20) and a credit union should contact an accounting professional. A credit union's policies and procedures should set forth direction regarding if the credit union will finance an OREO.
- **Improvement of OREO:** Credit unions may improve a property in order to sell it. However, if a credit union forecloses on a partially completed project, they should analyze the economic cost and risk before deciding to complete a project. Management should consider the feasibility of the project under current market conditions. The credit union should also consider whether it has the skill and management resources to manage a construction project. In addition, management should evaluate if investing additional funds to complete the project will minimize its losses as compared to marketing and selling the property in "as is" condition.
- **Holding OREO:** Credit unions may derive income from the rental of an OREO while holding the property for sale. However, there are additional complexities if the credit union does this. For example, complying with landlord-tenant laws; accounting for rental income; etc. *It is expected that a credit union implement all efforts to dispose of the OREO versus holding it for rental income.* Letter to Credit Unions, No. 08-CU-25, states that "Foreclosed and Repossessed Assets (FRA) should only be held temporarily and not permanently as an income-producing asset." It goes on to say that "FRA should be actively marketed for sale as evidenced by the fact the credit union has committed to a plan of sale, is seeking a buyer, and expects to collect on the sale within 12 months."

The statute is clear in that a credit union may hold property as *necessary for or incidental* to its operation. A credit union must be careful in what it does with an OREO. As mentioned above, an OREO can be improved in order to sell. However, a credit union must not hold an OREO and engage in an activity that is not necessary or incidental in order to profit from it without trying to dispose of it. In addition, holding property in speculation that values could change is not an

acceptable reason to hold OREO. If a credit union has questions when holding and/or considering improvements of an OREO, they should contact the Office of Credit Unions (OCU).

Policy

Credit unions unfamiliar with OREO or dealing with complex or multiple OREOs should strongly consider implementing a policy. The policy should address procedures for acquiring, holding and disposing of OREO. At a minimum, the policy should include:

- Staffing requirements for qualified management of OREO and identification of person responsible for OREO management
- Plan to obtain legal advice regarding the acquisition, holding and disposition of OREO
- The intended holding period for OREO
- The appraisal policy or fair value methodology for OREO
- The authorization of reasonable funds to improve and protect OREO
- The plan to market and dispose of OREO
- OREO internal controls
- Accounting policy for the acquisition, holding and disposition of OREO
- Independent audit policy for OREO
- Responsibility for OREO file maintenance; documents and storage, retrieval and retention of OREO documents

Examiner Expectations

Examiners may review the credit union strategy, OREO policy and procedures and conformance to policy and procedures. In addition, the board minutes should reflect that the board of directors is regularly informed of the nature and extent of the credit union's OREO holdings. Examiners will want to also ensure that:

- A credit union's interests are protected when determining the final remedy for OREO
- OREO is accounted for in conformance with generally accepted accounting principles and call report instructions
- The credit union is in compliance with federal and state laws pertaining to holding OREO

This guidance is not intended to be a comprehensive resource on all OREO issues. Prudent handling of OREO is complex. It is critical that a credit union seek legal, tax and accounting advice from professionals with expertise in this matter.

General questions can be directed to the Office of Credit Unions at 608-261-9543.

Sincerely,



Kim Santos, Director
OFFICE OF CREDIT UNIONS

Resources and References:

- NCUA Letter to Credit Unions No. 08-CU-25, *Credit Unions Holding Foreclosed Properties as Foreclosed and Repossessed Assets (FRA)*
- Washington State Department of Financial Institutions, *OREO Guidance & Best Practices*, No. B-10-06
- Wisconsin Banking Statute 221.0319, *Real Estate*
- Federal Deposit Insurance Corporation (FDIC) Financial Institution Letter, FIL-62-2008, *Other Real Estate – Guidance on Other Real Estate*
- Federal Deposit Insurance Corporation (FDIC), RMS Manual of Examination Policies, Section 3.6, Other Real Estate
- Federal Reserve *Policy Statement on Rental of Other Real Estate Owned*, SR 12-5; CA 12-3; April 5, 2012
- Federal Reserve *Questions and Answers for Federal Reserve-Regulated Institutions Related to the Management of Other Real Estate Owned*, SR 12-10; CA 12-9, June 28, 2012
- Office of the Comptroller of the Currency Handbook, A-OREO, *Other Real Estate Owned*, September 2013