



Questions and Answers (Q&As) on the Management of Other Real Estate Owned (OREO)

September 27, 2012

Presented by Donald Gabbai, Carmen Holly,
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The “Ask the Fed” session addressed Federal Reserve SR Letter 12-10, [Questions and Answers for Federal Reserve-regulated Institutions Related to the Management of Other Real Estate Owned \(OREO\)](#). This guidance was issued in response to the recent rise in OREO levels. It reiterates existing guidance and highlights key concepts on financial reporting, loss recognition, management of OREO assets, and consumer protection issues.

Accounting and Reporting Treatment

An asset is re-categorized from a loan to OREO on the Call Report when an institution takes physical possession, regardless of whether formal foreclosure proceedings have taken place. An OREO asset is measured and reported at fair value (FV) less cost to sell at the time of foreclosure. This net value becomes the new “cost” of the OREO asset.

After taking possession, each OREO asset must be carried at the lower of the FV of the asset minus estimated costs to sell the asset or the “cost” of the asset as described above. Accounting rules allow the write-down to be recognized through a valuation allowance against the asset and an associated charge to expense. In the Call Report, operating income related to OREO is reported as other noninterest income, while operating expenses are reported as other noninterest expenses.

Sales of OREO are sometimes financed by the seller. Should this occur, the accounting for the sale must be consistent with ASC 360-20. This accounting standard establishes five methods to account for the disposition of real estate; full accrual, installment, cost recovery, reduced profit, and deposit. This area of generally acceptable accounting principles (GAAP) is very complex and requires a good understanding of the accounting requirements. In such cases where the OREO sale is financed by the seller, losses on the sale are recognized immediately. Recognition of a gain on sale depends on the accounting treatment utilized. OREO sales financed by another institution result in the immediate recognition of gains or losses. Sales of OREO to a related party must also comply with market terms requirement of Regulation W.

Classification of OREO Assets

When an asset is transferred into OREO, the asset should generally be adversely classified because of its well-defined weaknesses.. An OREO asset may be considered “pass” only in limited circumstances, which include: a firm contract in place that contemplates sale of the asset in the reasonably near future; the sale proceeds cover the carrying value; the purchaser has the financial resources to complete the purchase; and the bank has no contingent liability. A separate guidance, SR12-5 “Policy Statement on Rental of Residential OREO Properties” contemplates an OREO residential rental asset being classified “pass” under specific circumstances.

Appraisal Concepts

At a minimum, an evaluation is required when a property is transferred to OREO through foreclosure or deed in lieu of foreclosure (refer to [SR Letter 95-16](#)). Additionally, state banking laws or the internal policies of an institution may require an appraisal upon transfer to OREO (refer to [SR Letter 10-16](#)). The appraisal or evaluation of OREO property should reflect the market value of the property in its “as-is” condition. Factors to consider in reviewing an appraisal or evaluation include the condition of the property, the use of the property, and the stability of the property. The institution should also have policies and procedures in place for monitoring its OREO assets.



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Community Development Expectations

OREO asset holders should have a clear and effective approach for management and disposition of OREO, including: compliance with all federal, state, and local laws and regulations; implementing effective property maintenance standards and third-party vendor oversight; and considering practices that support neighborhood stabilization. Selling OREO properties to owner/occupants or donating them to groups involved in neighborhood stabilization efforts can help financial institutions receive credit under the Community Reinvestment Act. If OREO is rented, asset holders should follow the provisions of the Federal Reserve Policy Statement on Rental of Residential OREO Properties.