

Lenders Compliance Group

Thursday, December 15, 2011

OCC Issues Foreclosure Guidance - Part I

The Office of the Comptroller of the Currency (OCC) is providing guidance to banks on obligations and risks related to foreclosed property. Issued on December 14, 2011, this guidance highlights legal, safety and soundness, and community impact considerations. It primarily focuses on residential foreclosed properties. (See OCC 2011-49)

A bank's obligations with respect to foreclosed residential properties may differ depending upon the bank's role in the foreclosure. For instance, a bank may be (1) an owner of the foreclosed property, or (2) a servicer and/or property manager, or (3) a securitization trustee.

Additionally, there are specific obligations when lenders release a lien securing a defaulted loan rather than foreclose on a residential property.

Furthermore, understanding the requirements imposed by Fannie Mae and Freddie Mac (GSEs) or the U.S. Department of Housing and Urban Development (HUD) on servicers is particularly important.

I will analyze the OCC's guidance as it relates to the aforementioned three roles of the bank in foreclosing on residential properties.

[This is a two-part newsletter.](#) I will offer a brief overview of the OCC 2011-49 bulletin pertaining to guidance on potential issues with foreclosed residential properties. Today, in this first part, I will outline the role of the bank as owner and servicer of foreclosed property. Tomorrow, in the second part, I will outline the role of the bank as trustee of a securitization trust, and also releasing a lien rather than foreclosing.

For detailed information and guidance, please consult with us or a regulatory compliance professional.

Regards,
[Jonathan](#)

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Safety and Soundness

As a matter of safety and soundness banking practices, banks should have robust policies and procedures in place to address risks associated with foreclosed (or soon to be foreclosed) properties.

Acquiring title to properties through foreclosure - either for the bank or as servicer for another mortgagee - results in new or expanded risks, including operating risk (which may include market valuation issues), compliance risk, and reputation risk.

Banks should be sure they have identified all the risks, and have policies and procedures for monitoring and controlling these risks. In each risk management consideration, it is critical to establish and implement policies and procedures, and bank management and the Board of Directors should consider, at a minimum, the role of the bank in foreclosure procedures and obligations.

Bank as Owner of Foreclosed Property

Obligations and Actions

- In acquiring title to foreclosed properties, banks assume the primary responsibilities of an owner, including providing maintenance and security, paying taxes and insurance, and serving as landlord for rental properties.
 - Banks should communicate with localities, including homeowner associations, about specific requirements with respect to foreclosed residential properties (i.e., localities may have requirements about certain aspects of upkeep, such as lawn mowing, property maintenance, and security, et cetera).
 - In the absence of these actions, banks should be aware of potential nuisance actions or the exercise of local receivership powers to seize properties.

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- For FHA-insured mortgages, the bank must ensure compliance with property and preservation guidance issued by HUD to preserve the insurance claim and obtain reimbursements for allowable expenses.
- Following foreclosure, the bank must record its ownership interest in local land records.
- Banks must comply with the other real estate owned (OREO) appraisal and accounting requirements.
- Banks should maintain appropriate insurance on the property.
- Some localities may require registration of foreclosed properties, properties in foreclosure, or vacant properties. Banks should be aware of and comply with such requirements.
- The Protecting Tenants at Foreclosure Act of 2009 (PTFA) provides tenants with protections from eviction as a result of foreclosure on the properties they are renting.
 - When a bank takes title to a house after foreclosure, it must honor any existing rental agreement with a bona fide tenant and must provide 90 days' notice to the tenant prior to eviction whether or not the tenant has a rental agreement.
 - State laws may impose additional requirements that are not preempted by the PTFA.
 - Additional potential requirements with respect to rental properties include:
 - reviewing the lease to determine if the property can be shown to prospective purchasers; and
 - returning any security deposit upon termination of the rental agreement.

Additional Issues as Owner

- Banks should have sufficient staffing to manage their foreclosed properties portfolios and policies, procedures, and risk management systems in place to properly oversee and manage third-party relationships.
 - Use of third parties does not diminish the responsibility of the bank board of directors and management to ensure that foreclosed properties are administered in a safe and sound manner and in compliance with applicable law.
 - These third-party relationships should be subject to the same risk management process that would be expected if a bank were conducting the activities directly. Such a risk management process should include:
 - written contracts outlining the duties, obligations, and responsibilities of the parties involved;
 - appropriate due diligence before entering a third-party contract; and
 - ongoing oversight of the third parties and third-party activities.
- Prior to undertaking the rehabilitation or improvement of foreclosed properties, banks should consider the legal authority to make expenditures on OREOs and any HUD requirements for mortgages insured by the Federal Housing Administration (FHA).

(I would add that, generally, for OREOs, expenditures are permissible if reasonably calculated to reduce any shortfall between the parcel's market value and the bank's recorded investment amount. If such expenditures are permissible, banks must ensure compliance with local building codes and licensing requirements. I will treat this subject in a forthcoming newsletter.)

- When disposing of foreclosed residential properties, banks should consider:
 - disposition costs and delays, including advertising, broker, or maintenance fees and repair costs for defects found at inspection.
 - the provision of financing for OREO properties. While generally not subject to lending limits, financing the sale of a significant number of properties to the same borrower could result in unsafe or unsound concentrations.
 - negative reaction and potential reputation risk from disposition practices that favor, as purchasers of foreclosed properties, investors (paying cash) over owner-occupants (purchasing with financing).
 - opportunities to participate and coordinate with state and local land bank programs, neighborhood stabilization programs, redevelopment programs, and other anti-blight programs, or opportunities to enhance owner occupancy.
- When disposing of foreclosed residential properties from FHA-insured mortgages, either through sales or conveyance to HUD, banks must comply with HUD requirements to receive insurance payments or other allowable reimbursements.
- Holding period issues may arise if banks are not able to dispose of foreclosed

properties.

Bank as Servicer of Foreclosed Property

Obligations and Actions

Fannie Mae and Freddie Mac each have detailed servicing guides setting forth servicer obligations and responsibilities for foreclosed properties or vacant properties in the process of foreclosure.

In the case of private securitizations, the obligations are detailed in a document often called a pooling and servicing agreement (PSA).

- Servicers of foreclosed properties may be required to undertake many of the responsibilities of an owner, including providing maintenance and security, paying expenses, serving as the landlord for rentals, and marketing the property.
 - Servicers may be required to advance funds for taxes, insurance, and homeowners' association dues, as well as for maintenance and security expenses, some or all of which may be reimbursable.
 - Although rehabilitation, maintenance, and marketing of foreclosed properties acquired on behalf of Fannie Mae and Freddie Mac are typically handled by the GSEs, servicers may be required to perform routine upkeep - including winterization, as needed - until the property is assigned by the GSE to a property manager.
 - Servicers should ensure that they follow applicable GSE or PSA requirements and guidelines for performing necessary maintenance and upkeep on the property.
 - Banks should maintain appropriate insurance on the property.
 - Servicers may be required to file claims with any mortgage insurers.
- Some localities may require registration of foreclosed properties, properties in foreclosure, or vacant properties. Under the PSA or the Fannie Mae and Freddie Mac servicing guidelines, this requirement may be the responsibility of the servicer. Servicers should communicate with localities about other specific requirements with respect to foreclosed residential properties.
- When disposing of foreclosed properties, servicers should look to the PSA or other servicing document for specific requirements and responsibilities.
- Servicers may have responsibilities, as described above, under the PTFA or other applicable state law requirements that provide protections to tenants from eviction on the properties they are renting as a result of foreclosure.

Additional Issues as Servicer

- Banks acting as servicers should have sufficient staffing and appropriate third-party vendor oversight to manage the foreclosed properties portfolios.
- Rehabilitation or improvement of foreclosed properties should comply with local building codes, licensing requirements, and any requirements in servicing agreements.
- When disposing of foreclosed residential properties, banks acting as servicers should consider:
 - contractual requirements for valuing and marketing the properties and addressing defects found at inspection. The servicer may be required to advance funds for these activities, though these funds may be recovered.
 - that disposition practices may carry reputation and litigation risks. (To which I add that even when the servicer follows the disposition requirements in the servicing agreements, the impact of the dispositions reflects on the servicer and could result in reputation risk and risk of litigation.)
 - opportunities to participate and coordinate with state and local land bank programs, neighborhood stabilization programs, redevelopment programs, and other anti-bligh programs, consistent with servicing agreements.

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Office of the Comptroller of the Currency (OCC)

Foreclosed Properties

Guidance on Potential Issues With Foreclosed Residential Properties

OCC 2011-49

December 14, 2011



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