

Subject: Foreclosed Properties
Date: December 14, 2011

**To: Chief Executive Officers of All
 National Banks and Federal
 Savings Associations, Department
 and Division Heads, and All
 Examining Personnel**

Description: Guidance on Potential Issues With Foreclosed Residential Properties

Background

In the current economic environment, national banks and federal savings associations (collectively, banks) are facing challenges resulting from unprecedented numbers of troubled residential mortgage loans. Foreclosures on residential properties also are occurring in unprecedented numbers and are projected to continue this trend in the near term. Among the many consequences of high levels of foreclosures are growing inventories of foreclosed residential and commercial properties. The Office of the Comptroller of the Currency (OCC) is providing guidance to banks on obligations and risks related to foreclosed property. This guidance highlights legal, safety and soundness, and community impact considerations.¹ It primarily focuses on residential foreclosed properties, but many of the same principles apply to commercial properties.

A bank's obligations with respect to foreclosed residential properties may differ depending upon the bank's role in the foreclosure—as owner of the foreclosed property, as servicer/property manager, or as securitization trustee—and the contractual agreements under which it operates. Understanding the requirements imposed by Fannie Mae and Freddie Mac (the Enterprises) or the U.S. Department of Housing and Urban Development (HUD) on servicers is particularly crucial, given the current role of these entities in the mortgage market.

Considerations

As a matter of safe and sound 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 establishing and implementing the policies and procedures, bank management and the board of directors should consider, at a minimum, the following obligations and risks:

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. For example, localities may have requirements about certain aspects of upkeep, such as lawn mowing, property maintenance, and security, and requirements may become applicable at different stages of the foreclosure process.
 - In the absence of these actions, banks should be aware of potential nuisance actions or the exercise of local receivership powers to seize properties.
- 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 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 act.
 - 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 OREO and any HUD requirements for mortgages insured by the Federal Housing Administration (FHA). Generally, for OREO, such expenditures are permissible if reasonably calculated to reduce any shortfall between the parcel's market value and the bank's recorded investment amount.² If such expenditures are permissible, banks should ensure compliance with local building codes and licensing requirements.
- 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.³

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 Enterprises, servicers may be required to perform routine upkeep—including winterization, as needed—until the property is assigned by the Enterprise to a property manager.
 - Servicers should ensure that they follow applicable Enterprise 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 Protecting Tenants at Foreclosure Act 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. 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-blight programs, consistent with servicing agreements.

Bank as Trustee of Securitization Trust Holding Title to Foreclosed Property

The securitization trustee is primarily responsible for holding a lien on the trust assets for the benefit of the investors who purchase securities issued pursuant to the securitization and administering the trust in conformance with requisite agreements. The trustee's duties and responsibilities are established by a PSA, trust agreement, or indenture. These agreements direct a securitization trustee to perform various complex ministerial functions. Such functions may include ensuring the timely receipt of payments from the servicer, calculating payments, remitting payments to the investors, circulating information to investors, monitoring compliance, and determining if an event of default is triggered.

As permitted by the PSA, the trustee should work with the servicer to ensure the performance of its responsibilities. The securitization agreements may require

a trustee to appoint a successor servicer or to take over servicing in the event the original servicer fails to perform its duties or defaults. These agreements generally do not grant the trustee any powers or duties with respect to the foreclosure or with the maintenance, sale, or disposition of foreclosed properties. Instead, these responsibilities typically reside with the servicer.

Nevertheless, to the extent a servicer undertakes foreclosure actions in the trustee's name as the secured party, a bank trustee should be aware of potential reputation and litigation risks. Additionally, if the securitization agreements require a bank trustee to act as a replacement servicer until a successor servicer is appointed, the bank trustee would also be exposed to credit risk.

Releasing a Lien Rather Than Foreclosing

At times, lenders may release a lien securing a defaulted loan rather than foreclose on the residential property. This decision is often based on financial considerations when the bank or servicer/investor determines that the costs to foreclose, rehabilitate, and sell a property exceed its current fair-market value. When this decision is made after a bank or servicer has initiated foreclosure, the borrower may have already abandoned the property or discontinued the care and maintenance of the property, increasing the chance of a blighted property in the community. Because the decision to release a lien is typically a financial decision, banks and servicers should ensure that their valuation of the property provides the best information practicable, while complying with investor requirements, before initiating foreclosure and subsequently deciding to release the lien. While the financial risk must be considered, banks and servicers should also consider the potential for reputation and litigation risk arising from their position as a prior mortgagee or servicer of a now-abandoned property.

If the decision is made to forego foreclosure and release the lien, the bank or servicer should notify, or attempt to notify, the borrower of the decision. Borrowers should be notified that (1) the mortgage holder is not pursuing foreclosure and has released the mortgage lien, (2) the borrower may continue to occupy the property, and (3) the borrower is obligated to maintain the property consistent with all local codes and ordinances and to pay property taxes and the debt owed. The bank or servicer should also make appropriate notifications to the local jurisdiction when it makes the decision to release a lien in lieu of foreclosure.

Additional Information

For additional information, please contact Steven V. Key, Assistant Director, Bank Activities and Structure Division, (202) 874-5300; or Kevin R. Russell, Director, Retail Credit Risk Division, (202) 874-5170.

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¹ Office of Thrift Supervision CEO Letter 319, "Tenant Protection During Foreclosure: 'Helping Families Save Their Homes Act of 2009,'" dated September 2, 2009, is hereby rescinded, as this bulletin also references these protections.

² For regulations and guidance applicable to banks' authority to make additional expenditures on OREO properties, see www.occ.gov.

³ For regulations and guidance addressing the OREO holding period, see www.occ.gov.