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Handbook: Thrift Activities
Subjects: Real Estate Owned

Section: 251
TB 7

November 14, 1988

Real Estate Owned (REO) Workout Proposal

RESCINDED

Summary: Institution management should be alert to risks in third-party real estate owned workout proposals and carefully analyze their economic merits. Such third-party proposals do not receive Federal Home Loan Bank Board or Federal Home Loan Bank System approval or endorsement.

For Further Information Contact:
The FHLBank District in which you are located or the Policy Division of the Office of Regulatory Activities, Washington, DC.

Thrift Bulletin 7

Introduction

In recent months, there have been a number of REO workout organizations that have approached the Board, some FHLBanks and individual savings and loan institutions with proposals to remove non-performing assets, specifically REO, from the portfolios of troubled institutions. While the specific proposals differ, all claim that their program will enable an insured institution to transfer the REO out of its portfolio in some manner that will allow it not to have to book any losses on these non-performing assets and may even provide an immediate boost to profits.

Risks of Program

This Office is concerned that some of these programs may harm participating insured institutions. The purported benefits of the program may be inflated while the potential risks are minimized. The claim has also been made that the REO can be transferred at a profit with an immediate gain in earnings. At the same time, the sole value-added of the program may be nothing more than creative accounting with no true gain to the institution. In fact, insured institutions may be in a riskier position, because the REO is transferred to the workout organization, which assumes no risk but utilizes the institution's REO to finance their program. These proposals are structured to provide for the properties to be acquired at fire sale prices and held until the market improves.

Representations of Board Approval

When marketing these programs, some of the groups may make certain representations regarding their discussions and meetings with the Board and Bank System staff. This happened recently when one workout organization was promoting its program. The organization represented in a mailing that the Securities and Exchange Commission, the Federal Home Loan Bank Board, and a Federal Home Loan Bank had already given, or soon would give, their collective approvals to the limited partnership interest.

This, in fact, was not the case. In meetings and correspondence with these groups, it is consistently stated that:

- neither this Office nor the District Banks specifically approve or endorse REO acquisition plans;
- no communication from this Office can be utilized as a letter of approval/comfort or as a marketing tool to insured institutions; and
- any investor group may market their plans directly to insured institutions.

Responsibilities of Management

The exercise of due diligence regarding the economic merits of REO disposition plans is the responsibility of each individual institution's management. If an institution identifies any regulatory issues of concern during its process of analysis, it should raise these issues with the appropriate examination and supervisory personnel who will provide advice on whether the proposal conforms with regulatory procedures and safe and sound practices.

Darrel W. Dochow

— *Darrel Dochow, Executive Director*