
Real Estate Interests Examination Program

Examination Objectives

To determine the adequacy and/or effectiveness of the trust department's administration of real estate interests. Consider whether management:

- has a full understanding of the scope and nature of responsibilities for real estate interests held;
- has established adequate and effective policies, procedures and internal controls for the administration of real estate interests;
- has provided for quality administration of real estate interests by ensuring adequacy of available expertise;
- monitors compliance with governing instruments, applicable law and accepted fiduciary principles; and
- initiates prompt corrective action when violations of governing instruments, applicable law or accepted fiduciary principles have been noted or when policies, procedures or internal controls are deficient.

Examination Procedures

Wkp. Ref.

Level I

Level I procedures first focus on a review of the examination scoping materials. The next step consists of interviews with trust department personnel to confirm their qualifications and levels of expertise; to determine if the trust department's practices conform to written guidelines; to establish whether any significant changes in personnel, operations or business practices have occurred; or whether new products and/or services have been introduced. If items of concern are uncovered during a Level I procedure or if problems are identified during the preexamination monitoring and scoping, the examiner may need to perform certain Level II procedures.

1. Review examination scoping materials related to the management of real estate and mineral interest investments. Scoping material should include:
 - Risk profile
 - Relevant PERK documents
 - Previous trust and asset management examination report

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- Workpapers from the previous examination
- Board of director and other applicable committee minutes
- Examination reports of subordinate functionally regulated entities

2. Evaluate the trust department's policies and procedures related to real estate interests. Review all significant changes to policies, procedures and practices. Consider the following items:

- How compliance with applicable law or standards of fiduciary conduct is ensured
- Preacceptance guidelines that address environmental and other risks associated with real estate interests
- Documentation requirements to support the appropriate administration of real estate and mineral interests contained in customer accounts, including: clear title; inspections and appraisals; acquisitions and disposals; rental, lease or property management; insurance requirements; taxes; ongoing monitoring; or other pertinent issues
- Required knowledge and expertise of management
- Delegation of real estate management and/or interests to third parties
- Authority and approval levels for exceptions to policy

3. Evaluate whether management has the necessary expertise to effectively administer real estate interests. Determine if any significant personnel and/or organizational changes (including changes in outside property managers) have occurred.

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4. Review a summary of real estate interest holdings in discretionary accounts. Determine that the policies and procedures have been established to adequately address the specific characteristics of each type of real estate interest held, including: personal residences; residential income properties; commercial properties; vacant land; property under construction; timberland, farm and ranch land; real estate loans; and mineral interests.
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5. If administration of real estate interests is delegated to third parties, assess the selection and oversight process.
-
6. If there are material unresolved exceptions present from internal or external audit reports, compliance reports or examination reports, determine and evaluate the reasons for their presence. Evaluate management's plan to correct the exceptions.
-
7. Is the trust department accounting system adequate to handle real estate and mineral interests?
-
8. Are policies adequate to ensure that there is no leasing of mineral interests to savings association insiders, affiliates or their related interests?
-
9. Are fee schedules periodically reviewed to reflect appropriate charges for special services involving real estate and mineral interests?
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10. Consider whether the following risk contributors (if applicable) have been addressed:
- Does management fully understand all aspects of risk related to real estate investments?
 - Do policies and procedures address all significant activities?
 - Is management qualified to administer real estate interests?
 - Do management information systems and reports provide credible and comprehensive information?
 - Is the internal control environment adequate?
 - Are controls over outsourcing arrangements adequate?
 - Are environmental concerns properly managed?
 - Does management quickly identify weaknesses and take appropriate action?
 - Are there unresolved issues noted in audit, compliance or examination reports?

The completion of the Level I procedures may provide sufficient information to make a determination that no further examination procedures are necessary. If no determination can be made, proceed to Level II.

Level II

Level II procedures focus on an analysis of trust department documents such as reports and outsourcing contracts. The examiner should complete the appropriate Level II procedures when the completion of the Level I procedures does not reveal adequate information on which to base a conclusion that the trust department meets the examination objectives. Neither the Level I nor the Level II procedures include any significant verification procedures.

1. If agents are employed to manage real estate interests:

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- Are the qualifications and experience of the agent reviewed prior to employment?
 - Are the duties and responsibilities of the respective parties adequately set forth in a written agency agreement, including provisions relating to content and frequency of reports, authority to incur and pay expenses and compensation?
 - Is the agent's performance periodically evaluated?
-
2. Review and verify the accuracy of any applicable management exception reports.
-
3. Determine if the management systems are capable of monitoring and controlling income receipts, disbursements of expenses or other recurring activities.
-
4. Determine if appraisals are in accordance with state law or department policy.
-
5. Are appraisals and inspections made in accordance with trust department policy and are they performed by qualified and independent parties?
-
6. Evaluate how management handles environmental issues?
-
7. Evaluate the factors considered if management decides to purchase, retain or sell real estate loans. Are the factors considered adequate?
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8. Does the payment of real estate taxes and insurance premiums receive prompt attention?
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9. Does the savings association ensure that proper evidence of title is obtained for oil or mineral holdings, such as the deed, division order or assignment of interest?

10. Have all lease forms and other legal documents required to hold title to various mineral interests been reviewed by legal counsel?

11. If necessary to validate an assertion, finding or concern arising from the completion of the Level I and II procedures, judgmentally select a limited number of accounts for review considering the degree of risk to the institution. Not all types of accounts need to be reviewed to arrive at a well-founded conclusion.

If the examiner cannot rely on the trust and asset management Level I and Level II procedures, or data contained in department records or internal or external audit reports, proceed to Level III.

Level III

Level III procedures include verification procedures that auditors usually perform. Although certain situations may require that Level III procedures be completed, it is not the standard practice of Office of Thrift Supervision (OTS) examination staff to duplicate or substitute for the testing performed by auditors.

1. Select a sample of directed accounts that hold real estate interests and determine that proper authorization exists, such as a current direction letter.

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2. Determine that the trust department is qualified to conduct business in the state where the real estate is located or that an ancillary fiduciary or agent has been appointed to administer the property.

3. Select a sample of different types of discretionary real estate interests for a detailed account review and determine whether real estate interests held are of trust quality and otherwise suitable for the accounts. If not considered suitable, determine what efforts are being taken to dispose of the interests. Determine the presence of the following:

- all relevant factors were considered prior to purchasing any interest in real estate and in the decision to retain any interest in real estate, including the investment objective of the account, yield on the real estate and tax implications;
- sufficient documentation is on file to support the investment decision and to support the proper administration of the account;
- clear and valid title has been obtained;
- proper authorization for purchasing or retaining any real estate interest is present in the governing instrument or other specific authorization;
- receipts showing current payment of taxes and insurance premiums are on file;
- copies of leases, rental agreements or documents pertaining to the specialized administration of particular properties are present;
- copies of inspection and appraisal reports are on file;
- environmental risk assessments, if applicable, have been performed; and
- all income and expenses are clearly documented and authorized.

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Optional Topic Questions

The following list of questions is offered merely as a tool and reference for the examiner and is not a required part of the examination process.

Policies and Procedures

Do the policy and procedures:
<ul style="list-style-type: none">• Before acceptance, require that holdings are reviewed and physically inspected to identify potential environmental liability or exposure?
<ul style="list-style-type: none">• Ensure clear title is obtained upon receipt of the property?
<ul style="list-style-type: none">• Require that essential documents, such as deeds, mortgages, insurance policies, contracts for sale, tax receipts, etc. are obtained?
<ul style="list-style-type: none">• Require appraisals and inspections, including the need to have updated values?
<ul style="list-style-type: none">• Require procedures for determining when ancillary trustee services will be required?
<ul style="list-style-type: none">• Address foreclosure practices?
<ul style="list-style-type: none">• Address effective rental and lease agreements or contracts?
<ul style="list-style-type: none">• Address qualifications of the real estate agents and managers used to manage property?
<ul style="list-style-type: none">• Require that fees paid to third parties are reasonable in relation to services provided?
<ul style="list-style-type: none">• Address tickler systems for tracking receipt of rental and lease payments and monitoring of delinquent payments?

Property Conveyance

Are the following documents on file:
<ul style="list-style-type: none">• Original purchase and conveyance documents showing evidence of title (contract of sale (real estate); deed (real estate, real estate loan, mineral interest); note or mortgage (real estate loan); division order or assignment (mineral interest)?
<ul style="list-style-type: none">• An updated appraisal report from a qualified individual?
<ul style="list-style-type: none">• Title insurance or other documentation considered necessary to demonstrate clear title?
<ul style="list-style-type: none">• Insurance policies (e.g., for property or liability coverage), and current paid receipts?
<ul style="list-style-type: none">• Property tax receipts?
<ul style="list-style-type: none">• Any other information pertinent to the interest (leases, mortgages, liens or releases (real estate); documents relating to security and collateral (real estate loan); leases, licenses, permits, operating agreements (mineral interest))?

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Appraisals and Inspections

Are appraisals and inspections:
<ul style="list-style-type: none">• Performed by qualified and independent personnel?
<ul style="list-style-type: none">• Obtained prior to purchase?
<ul style="list-style-type: none">• Made in accordance with, as applicable, state law or governing instrument requirements, trust department policy or sound fiduciary principles?

Real Estate Administration

Are the following items monitored and controlled:
<ul style="list-style-type: none">• Adequate insurance is maintained in accordance with, as applicable, state law or governing instrument requirements, department policy or sound fiduciary principles?
<ul style="list-style-type: none">• Payment of real estate taxes?
<ul style="list-style-type: none">• Payment of insurance premiums?
<ul style="list-style-type: none">• Collection of rent or other income?
<ul style="list-style-type: none">• Payment of expenses?

Mineral Interests

Are all the following relevant factors considered prior to purchasing or retaining any mineral interests?
<ul style="list-style-type: none">• The status of the interest received (such as whether it is leased, producing or nonproducing, its location, etc.)?
<ul style="list-style-type: none">• Is the department's accounting system adequate for handling mineral interests?
<ul style="list-style-type: none">• Are interests leased only in accordance with standardized procedures which address such items as the following:<ul style="list-style-type: none">• The form of lease agreement to be used.• Fees to be charged.• Responsibility for maintenance of insurance coverage.• Counsel or an appropriate committee reviews lease agreements prior to execution review.• The department maintains a system to monitor and control the following:<ul style="list-style-type: none">▪ Lease and royalty payments, including delinquencies.▪ Delayed rental payments on nonproducing interests.▪ Expiration of leases and insurance.▪ Receipt of income, including expected due date.▪ Disbursement of expenses.

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|--|
| ▪ Any other special or recurring activities. |
| • Are guidelines in effect to avoid leasing mineral interests to employees of the savings association and other related parties? |

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