

HOUSE RESEARCH

Bill Summary

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Subject: Bank accounting for improvements to "other real estate owned"

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Overview

This bill repeals a paragraph of a Department of Commerce rule that regulates bank accounting procedures involving money the bank spent to improve real estate it acquired through foreclosure or similar situation. Usually this is done to make the property more appealing to prospective buyers, resulting in a quicker sale and/or a higher sale price. In bank accounting, real estate the bank acquired through foreclosure or similar situation is called "other real estate owned" and abbreviated "REO."

- 1 Rule repealer; repealing an administrative rule restricting the capitalization of permanent improvements to other real estate owned by a bank.** Repeals a paragraph of a department of commerce rule that limits the extent to which a bank can count as an asset money the bank spent on improving property the bank acquired through foreclosure or similar circumstances. This rule applies only to state-chartered banks and not to national banks. The text of this entire rule, including the paragraph F that this bill repeals, is as follows:

2675.2170 OTHER REAL ESTATE.

Other real estate:

A. Any real estate acquired or owned by a bank:

- (1) pursuant to Minnesota Statutes, section 48.21, subdivision 1, clauses (2) to (5);
- (2) not used in the business resulting from relocation of the principal office, or closing of a detached facility; or
- (3) abandonment of plans to use real estate acquired for future expansion, shall be designated as "other real estate."

The property acquired pursuant to subitem (1) shall be so designated from the date upon which the bank actually acquires title and upon expiration of any redemption period. Property owned pursuant to subitems (2) and (3) shall be so designated from the date the determination is made to divert or abandon as actual operating bank premises.

B. "Other real estate" shall not be entered upon the books of a bank at an amount greater than the balance of the principal amount of the indebtedness at the time of acquisition or the remaining book value if owned. In any case, the book value of other real estate shall never exceed the estimated fair market value of the property. The fair market value shall be determined by an appraisal prepared by an independent qualified appraiser within 60 days of acquisition. The appraisal shall be made part of the other real estate file.

C. Reasonable attempts shall be made to dispose of other real estate by sale. The other real estate file shall be documented with disposal attempts. The maximum period for holding other real estate as an asset shall be five years.

D. "Other real estate" sold on contract for deed may be carried as a loan at the lesser of the principal balance due on the contract, or at its present book value. Loss on sale of "other real estate" shall be recognized in the period the sale occurs. Gains on sale of other real estate shall be either accreted ratably on the same basis as repayment, or may be deferred until title is transferred to the buyer.

E. "Other real estate" shall be documented with an attorney's opinion or equivalent evidence to reflect title and all encumbrances. Insurance must be maintained where necessary and taxes must be kept current if the "other real estate" is carried as an asset.

F. Expenditures approved by the board for permanent improvements to other real estate owned, in order to improve marketability, may be capitalized up to ten percent of the amounts referred to in item B and further provided the original amount plus the additional capitalization does not exceed the amount of the appraisal required by item B.