

RD AN No. 3939 (1980-D)
February 17, 2004

TO: State Directors
Rural Development

ATTENTION: Rural Housing Program Directors,
Guaranteed Loan Specialists,
Rural Development Managers and
Community Development Managers

FROM: Arthur A. Garcia (Signed by Arthur A. Garcia)
Administrator
Rural Housing Service

SUBJECT: Single Family Guaranteed Rural Housing
Occupied Real Estate Owned Inspection, Valuation and Loss Claims

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to clarify inspection, valuation and loss claim requirements for real estate owned (REO) when the property is occupied, subject to redemption rights or when there are lengthy eviction proceedings. Such circumstances can have a negative effect on the accurate valuation and expeditious disposition of the property, as well as the loss claim process itself, when it becomes necessary to process a claim based on estimated net recovery. This AN also provides guidelines for inspections, redemption periods, eviction, valuation, and the claim process for occupied REO property in other situations.

COMPARISON WITH PREVIOUS AN:

This is a revision of RD AN No. 3715 (1980-D), dated February 19, 2002, "Single Family - Guaranteed Rural Housing Loan Program Loss Claim Appraisal Requirements and Real Estate Owned Inspection Requirements," that expired February 28, 2002.

BACKGROUND:

Due to a lack of detail in RD Instruction 1980-D, the management of REO has been inconsistent when it is occupied and subject to a redemption period or eviction proceedings.

EXPIRATION DATE:
February 28, 2005

FILING INSTRUCTIONS:
Preceding RD Instruction 1980-D

When a security property is occupied at the time it is acquired, it is unlikely the lender/servicer will have sufficient access to be able to evaluate the interior condition of the property. This limits the lender's ability to:

1. Determine the need for property protection and/or preservation.
2. Identify repairs necessary to adequately market the property.
3. Obtain an accurate appraisal of market value.
4. Market and dispose of the property at a reasonable asking price.
5. Present a claim to RHS based on estimated net recovery

In addition to property preservation and protection, regular property inspections are necessary to determine occupancy status, which may in turn be the basis for taking possession of the property, initiating or monitoring eviction proceedings or seeking recourse from redemption rights, such as obtaining a waiver or a shortened period for abandoned property. The earliest possible access to the interior of the property is needed for an accurate assessment of property condition and market value, and the expeditious marketing and disposition of the REO.

IMPLEMENTATION RESPONSIBILITIES:

Property Inspection

Lenders are expected to obtain written property inspections, performed within 20 calendar days from the date of the foreclosure sale, for occupied properties subject to redemption periods or eviction proceedings. Subsequent monthly inspections must be obtained to verify occupancy status until the lender obtains physical possession. These requirements are permitted under paragraph I(B)(9) of Form RD 1980-16, the Lender's Agreement.

Lenders may obtain inspections through a property preservation vendor or real estate agent. The cost of property inspections performed by property preservation vendors are considered REO management expenses and are reimbursable to the lender within the limits of the guarantee. Verbal property inspection reports obtained from real estate agents are acceptable as long as they are documented on the lender's servicing system. The comment must include the date the comment was created, the date of the inspection and the occupancy status at the time of the inspection.

Documented property inspections allow the Agency to determine whether the lender expeditiously exercised its rights related to property possession. Failure to document property inspections may result in a reduction or denial of the loss claim for negligent servicing.

REO Subject to Redemption Rights

Lenders and Agency staff must be familiar with State statutes related to redemption periods and procedures. For example, in Alabama, there is a one-year redemption period, but the purchaser

at the foreclosure sale has the right to immediate possession; therefore, a delay in the marketing of the property is not warranted. Some States will reduce the redemption period if the property is abandoned or if the loan-to-value ratio is greater than a certain percentage.

REO Eviction Proceedings

If it is determined that the REO property is unlawfully occupied, eviction proceedings must be initiated and pursued diligently within 30 calendar days of the foreclosure sale if there is no redemption period precluding the lender from doing so. If there is a redemption period, the lender should initiate eviction within 30 calendar days after the redemption period expires. Documentation to support initiation of eviction includes legal documents such as the Summons and Complaint, Notice to Vacate, etc., or comments on the lender's servicing system indicating the date the comment was created along with the eviction status.

REO Disposition Plan

Currently, a lender is required to submit an REO Disposition Plan within 30 days from the date the property is acquired, under RD Instruction 1980-D, §1980.376. When the REO is occupied, the plan should address the lender's steps to gain physical possession.

If physical possession is imminent, the lender should arrange to have the REO evaluated immediately upon possession, based on interior and exterior observation, and submit to RHS a plan with recommendations for protection and preservation, repairs needed to market the REO, and a sale price based on current market value.

However, when it is apparent the occupancy status will not permit an accurate appraisal or adequate marketing time for the REO to be sold within the six-months following foreclosure, the lender may file an estimated net recovery (ENR) claim, subject to the provisions described below.

Estimated Net Recovery (ENR) Claims

When REO is not sold within the six-months following foreclosure, the lender is required to file an ENR claim. Under normal circumstances, the Agency obtains and uses a liquidation value appraisal of the property to estimate the lender's net recovery and process the claim.

When REO occupancy status will not permit an accurate appraisal, property valuation based only on exterior observation can be problematic. Previously unobserved interior conditions can be worse than estimated, with a profound effect on the value used to settle the claim. There is understandable concern when a lender is not permitted to recover additional losses.

Therefore, effective with this AN, if an interior inspection of a property cannot be obtained, due to a redemption period, incomplete eviction or other legitimate reason, by the time an ENR claim

must be filed, the lender should file the claim, and, stating the circumstances, request RHS to hold the claim pending notice from the lender that interior access to the property has been gained to permit an accurate liquidation value appraisal.

The lender will continue to report the REO with an ENR claim pending on Default Status reports. The Agency will allow interest accrued for a period no greater than six months from the date title to the property is acquired, in accordance with RD Instruction 1980-D, Section 1980.376.

This procedure will reduce the number of claims filed based on inadequate liquidation value appraisals. The limitation on accrued interest and penalties for failure to document property inspections will encourage lenders to aggressively pursue and complete evictions and resolve any redemption rights.

Loss Claim Review

Agency officials are responsible for reviewing property inspection documentation with regard to occupancy or possession status, redemption and/or eviction actions, at the time the loss claim is filed. The Agency official will also use property inspection reports to determine whether property deterioration or damage may be attributable to the lender's failure to promptly acquire and secure the property, or protect and preserve the property during the liquidation.

Lenders unable to provide evidence of timely inspections or actions to gain physical possession of REO may be subject to claim reduction or denial in accordance with RD Instruction 1980-D, §1980.376.

Compliance Reviews

During lender compliance reviews, the Agency will review REO and loss claim files to ensure that lenders are complying with these procedures.

Notice to Lenders

Each State Office is responsible for notifying state-approved lenders of the procedures in this AN. The National Office will advise nationally-approved lenders with the issuance of this AN.

If you have questions about this AN, contact Joyce M. Halasz, Sr. Realty Specialist, SFH Guaranteed Loan Division, USDA, Rural Housing Service, 1400 Independence Avenue SW, Washington, DC 20250-0784. The telephone number is (202) 720-1452.