APPENDIX C

Asset Disposition Panel

The rapid increase of failures in the 1980s and early 1990s resulted in an unparalleled volume of assets in the hands of the FDIC and RTC. This panel will focus on the variety of techniques used by the FDIC and the RTC to dispose of the substantial volume of assets once held by both agencies, and will discuss the respective merits of each of the different strategies used by the agencies.

Possible Issues for Discussion

Asset Disposition Methods—The FDIC and RTC used a variety of asset disposition methods to handle the liquidation of over $400 billion in assets that the FDIC and RTC did not sell to an assuming institution during the resolution process. The methods used evolved in response to the circumstances of the times. The methods range from negotiating/compromising with a borrower on one asset to more sophisticated methods, including securitized sales of assets and equity partnerships with private sector firms. Other methods included auctions, sealed bid sales, and sales by brokers.

Selling at Resolution Vs. Outside of Resolution—The FDIC sold a majority of the assets in failed banks at the time of resolution by selling them to assuming banks. Of the $302.6 billion in failed bank assets, about $230 billion, or 76 percent, were sold immediately at resolution to assuming banks. Initially, the RTC tried to sell assets at resolution but found few takers. Later, the RTC found it more effective to split the assets from the deposit liabilities and therefore sold a relatively smaller percentage of assets at the time of resolution. Instead, the RTC disposed of the assets either during conservatorship or after completion of the resolution transaction. Of the $402.6 billion in assets from failed thrifts, only $75.3 billion, or 18.7 percent, were handled at the time of resolution.

Private Sector Contracting—At the beginning of the crisis years (1980–1984), the FDIC used primarily in-house staff to liquidate assets on an individual basis. However, as the number of failures rose and the total volume of assets to be liquidated increased, it became more difficult to perform these functions entirely with in-house personnel. In response, the FDIC began to use outside contractors to handle some of the assets. The FDIC first began using contractors to manage and dispose of distressed assets in the mid-1980s with the resolution of Continental. By the late 1980s, it was standard practice for contractors to be used by the FDIC for the management and disposition of assets retained from some of the larger bank failures. The early contracts evolved into the use of Asset Liquidation Agreements (ALAs) and Regional Asset Liquidation Agreements (RALAs). The FDIC used 16 asset management contracts to liquidate assets with a book value of over $33 billion, or nearly half, of the post-resolution assets the FDIC retained for liquidation. For the RTC, with its large volume of assets at day one, asset management contractors were utilized from the outset. In addition, FIRREA required the RTC to hire private-sector contractors if such services were available in the private sector and if such services were practicable, cost effective, and efficient. The RTC issued 199 Standard Asset Management and Disposition Agreements (SAMDAs) to 91 contractors covering assets with a book value of approximately $49 billion.

Bulk Sales—As asset inventories increased and bank-closing activity accelerated, FDIC policies began to emphasize bulk sales for broader classes of assets, including delinquent and charged-off loans. The RTC also implemented a Bulk Sale Program, which initially focused on the RTC's vast holdings of performing residential and commercial mortgages. At first, the RTC adopted the FDIC methodology of internally packaging and selling asset portfolios. However, some critical differences later developed between the agencies. By 1990, the RTC was relying predominantly on private-sector firms to evaluate, package, and market its loan portfolios. The RTC also adopted the use of seller financing as a marketing tool for portfolio sales. To boost the demand for non-performing multi-family and commercial mortgages and other real estate, the RTC introduced the Structured Transaction Program. A structured transaction was a form of portfolio sale created to achieve a high volume of portfolio sales, as opposed to the sale of commercial assets on an individual basis. Packages were structured based on input from investor groups and financing was made available.

Securitizations—Securitization is the process by which assets with generally predictable cash flows and similar features are packaged into interest-bearing securities with marketable investment characteristics. Securitized assets have been created using diverse types of collateral, including home mortgages, commercial mortgages, manufactured housing loans, leases, and installment contracts on personal property. The FDIC did not use securitized loan sales as a major asset disposition method. However, the RTC, due to the large volume of mortgage loans in its inventory, used securitized sales as a method to meet its FIRREA mandate of maximizing returns while also liquidating assets expeditiously. From June 1991 to June 1997, 72 RTC and 2 FDIC securitized transactions closed, representing loans with a book value of $42 billion for the RTC and $2 billion for the FDIC.

Equity Partnerships—The RTC, and to a much more limited extent, the FDIC used equity partnership programs with private-sector partners as an asset disposition method. During the 1990s, the RTC created 72 partnerships with a total book value of about $21 billion. The FDIC became a partner in two partnerships holding assets having a book value of about $4 billion. Under the equity partnership program, the RTC established joint ventures between itself, acting as limited partner (LP), and a private sector investor, usually a joint venture between an equity investor and an asset management company, acting as general partner (GP). The RTC contributed asset pools (usually subperforming loans, nonperforming loans, and owned real estate), and arranged for financing to the partnership. The GP invested both equity capital and asset management services. After the debt was paid off, the remaining proceeds were usually split according to the ownership percentage each respective partner held. Thus, unlike a direct asset sale, the RTC retained a residual interest, which entitled it to receive some proceeds at closing and, as the assets were liquidated, receive the remainder of the proceeds periodically throughout the life of the portfolio. It was believed by the RTC that the net present value of the residual income stream, when added to the upfront cash receipts would be greater than the total proceeds that would have been received from a direct asset sale.

Asset Valuation—The FDIC and RTC differed in their asset valuation procedures. The FDIC generally relied on in-house staff to value assets based on estimated collections from all sources of recovery, subtracted anticipated expenses, and applied a present value to the cash flows. The RTC relied on an asset evaluation methodology developed in coordination with outside real estate professionals. That methodology attempted to value asset portfolios as investors would perceive their value. The RTC relied predominantly on actual net cash flows, and gave less weight to other, more subjective sources of recovery. In general, RTC procedures resulted in lower estimates of value. Both agencies used reserves to set base prices for portfolio sales and required wide marketing to ensure maximum competition. The RTC, however, tended to be more market oriented and more inclined to let the market speak concerning the acceptability of bids. In contrast, the FDIC was driven more by appraisals and relied more on internal reserves to set benchmarks for determining the acceptability of bids.

Liquidation Differential—While there is no empirical evidence, it is generally believed that after an asset from a failing bank is transferred to a receivership, the asset suffers a loss in value. Loans have unique characteristics and prospective purchasers need to gather information about the loans to properly evaluate them. Such “information costs” are factored into the price that the outside parties are willing to pay for the loans. A loss in value can also occur because of the break in the bank-customer relationship.

Environmental/Historical Assets Policy—In the early 1990s, the FDIC and RTC developed environmental programs to prepare and train staff to oversee implementation of federal and state environmental statutory provisions. The environmental programs were premised on identifying hazardous environmental conditions or substances, such as underground storage tanks, lead based paint, damaged, friable asbestos, and special environmental resources including wetlands, habitats of endangered species, and nationally significant historic sites. To help identify assets with environmental conditions, contractors with expertise in resource identification and environmental site assessments were engaged. Various disposition methods were used including national sales and environmental representations and warranties for loans collateralized by real estate that were securitized or sold into trust arrangements. A primary difference between the RTC's and FDIC's sales of real estate with environmental conditions was the RTC's use of "buyer remediation agreements." The RTC, as part of its standard sales documents, established requirements for buyer remediation, including an asset specific statement and schedule of work, an escrow account for funding such remediation from the sale proceeds, and a system for determining when remediation was completed. The FDIC, on the other hand, sold the properties "as is" without formally requiring that the buyer take corrective action.

Affordable Housing Program—Marketing and sales of owned real estate were affected in both the FDIC and RTC by legally mandated affordable housing programs. FIRREA established the framework for such programs, and required that the RTC implement an affordable housing program, whose purpose was to provide home ownership and rental housing opportunities for families with low-to-moderate incomes. Section 40 of FDICIA required that the FDIC establish an affordable housing program for the same purpose. The major difference between the FDIC and RTC programs was in the funding of the programs. Because the FDIC does not use public funds for its operations, it required a separate federal appropriation for an affordable housing program. The FDIC and RTC developed many strategies for marketing affordable housing. Those strategies included using clearinghouses, retaining assistance advisers, developing seller financing, establishing repair funding, developing a direct sale program, adjusting the value for a reduced price, developing a donation policy, establishing an exclusive marketing period, and using auctions and sealed bids.

While the FDIC and RTC affordable housing programs provided housing to low-income and moderate-income households, it did come at a price to taxpayers. The added costs are not high relative to the overall cost of the FDIC and RTC as a whole, but may be considered significant when viewed within the smaller confines of the affordable housing programs themselves.

PREVIOUS CHAPTER NEXT CHAPTER TABLE OF CONTENTS