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RESOLUTION TRUST CORPORATION

Asset Pooling and Marketing Practices Add Millions to Contract Costs

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The Honorable Donald W. Riegle, Jr.
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

The Honorable Henry B. Gonzalez
Chairman, Committee on Banking, Finance
and Urban Affairs
House of Representatives

This report discusses the Resolution Trust Corporation's (RTC) practices in structuring and managing asset portfolios placed with private sector contractors for disposition. Because $31 billion of assets have been placed with private sector contractors, we undertook this review to identify whether portfolio development and management practices could be improved.

We are sending this report to the Chief Executive Officer of RTC, interested congressional committees, and the Chairman of the Thrift Depositor Protection Oversight Board. We will make copies available to others upon request.

The major contributors to this report are listed in appendix II. If you have any questions about this report, please call me on (202) 736-0479.

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Executive Summary

Purpose

The Resolution Trust Corporation (RTC) was created to address the problem of massive thrift failures resulting from the savings and loan abuses of the 1980s. RTC was tasked with resolving failed thrifts and disposing of their assets under the provisions of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (12 U.S.C. 1441 a(b)). FIRREA also mandated RTC to use the private sector for asset management and disposition services if the services are available and it is determined that using these services is practical and efficient.

GAO undertook this review to determine whether RTC (1) identified assets that required the types of services described under its Standard Asset Management and Disposition Agreement (SAMDA) before hiring contractors, (2) paid fees to SAMDA contractors only for those services actually provided, and (3) pooled SAMDA assets into portfolios in a cost-effective way.

Background

RTC has used three general methods of disposing of assets from failed thrifts. First, RTC staff assigned to thrifts in conservatorship and receivership actively marketed assets to reduce the size of the thrifts. Second, assets from the failed thrifts were assembled into portfolios and marketed by SAMDA contractors. Third, assets were sold directly by RTC sales centers through bulk sales, auctions, and other methods.

From its inception, RTC has lacked adequate information and accounting systems, and problems relating to these systems continue to hamper RTC's operations. However, pressure to quickly dispose of assets from the hundreds of thrifts closed in the first year made RTC move aggressively to place assets with SAMDA contractors in spite of the information problems it faced. It awarded a total of 162 SAMDA contracts to 112 private sector firms between August 1990 and November 1991. These contractors were tasked with managing and selling about $31.5 billion (book value) in assets, mostly delinquent loans and real estate. RTC estimated the contractors will receive about $548 million in fees for these services.

RTC pays SAMDA contractors two types of fees: a monthly management fee and a one-time disposition fee for each asset sold. Management fees have generally cost RTC about 1 percent of a portfolio's asset value per year, and disposition fees have averaged about 2 percent of the asset's net selling price.

GAO analyzed about 73 percent of all SAMDA portfolios awarded to contractors by RTC to identify the location of assets included in the portfolios and determine the degree of geographic dispersion for each portfolio. GAO visited RTC consolidated field offices, which developed these portfolios, and reviewed both fee payments made to SAMDA contractors and implementation of RTC contracting policies.

Results in Brief

RTC had a massive challenge of quickly assembling a team of thousands of people and of developing systems and procedures to get control over billions of dollars of problem assets from failed savings and loans as quickly as possible so disposition of the assets could begin. In this environment, problems and mistakes were inevitable.

GAO recognizes that many RTC people have worked diligently to deal with the largest asset disposition effort ever undertaken in the United States. But GAO also believes it is important to report on some of the problems surrounding the management and disposition of assets because of the ongoing nature of these activities and the opportunity to improve them in the future.

RTC has paid or is contractually liable for at least \$4.7 million in unearned management and disposition fees to SAMDA contractors. This total includes about \$4.5 million paid or payable for assets in SAMDA portfolios even though the work was done entirely or primarily by staff at failed thrifts, RTC staff, or other contractors, plus over \$143,000 in fees on assets withdrawn from SAMDAS and sold by RTC.

RTC is also potentially liable for over \$35 million in disposition fees for assets earmarked for several planned RTC direct marketing efforts. Because SAMDA contractors did not act as the primary marketers of assets in these cases, RTC had the opportunity to renegotiate disposition fees and potentially realize savings.

The problems with SAMDA portfolios that were developed during RTC's first 2 years of operations were caused by the lack of adequate information systems on its assets, combined with a failure by local offices to follow certain RTC policies on portfolio development. The effects were SAMDA portfolios that included (1) performing loans (loans with up-to-date payments), which required little or no services from a SAMDA contractor; (2) real estate properties that were already under sales contract in which the SAMDA contractor had little to do but show up at the closing; (3) loans for which workout negotiations were essentially already completed by RTC staff; and (4) loans that had already been paid off by the borrower. When such assets were discovered in SAMDA portfolios, RTC consolidated office staff found that the SAMDA contract did not contain provisions allowing them to remove the assets without paying the contractor.

Also, although RTC had numerous assets in Arizona, California, Colorado, Florida, and Texas, its consolidated offices could not assemble geographically concentrated SAMDA portfolios because of inadequate information and accounting systems. Instead, RTC often structured SAMDA portfolios with real estate and loan assets in widely dispersed geographic locations. These portfolios increased contracting costs, increased management problems for distant assets, and made it more difficult for RTC to monitor the performance of contractors. Taken together, these conditions increased RTC's vulnerability to waste and mismanagement.

Principal Findings

Performing Loans Inappropriately Included in SAMDA Portfolios

Consolidated offices included at least 748 performing loans in 12 SAMDA portfolios even though RTC policy said that performing loans should be sent to loan servicers. For example, one consolidated office included $116.3 million of performing loans in three SAMDA portfolios. This and similar situations resulted in RTC paying over $2.8 million in fees to SAMDA contractors for performing loans that required little or no effort. At the same time, RTC was paying loan servicing contractors to process payments received from borrowers for these same loans.

Real Estate Under Contract and Nearly Settled Loans Were Included in SAMDA Portfolios

Many portfolios also included real estate and nonperforming loan assets that were on the verge of sale or settlement at the time the SAMDA contract was awarded. Specifically, GAO identified 205 real estate properties and 13 loans that required little or no services from contractors to complete the disposition of the assets. RTC had paid SAMDA contractors $1.3 million in disposition fees on these assets.

For example, a resort in Arizona was sold for $5.4 million by the staff at a failed thrift with the assistance of a local real estate broker. The sales contract was signed on March 13, 1991, and the closing was held on May 3, 1991. This property was included in a SAMDA portfolio awarded on March

21, 1991, and the SAMDA contractor was paid a disposition fee of $226,401 even though it had no important role in the sale.

Paid Loans Included in SAMDA Portfolios

SAMDA portfolios sometimes inadvertently included nonperforming loans that had already been settled and paid off by the borrowers before the contract award date. GAO identified 31 such instances in which RTC paid a total of $438,000 in unearned disposition fees. The primary reason these paid loans were included in the portfolios was inaccurate asset information.

RTC Liable for Millions on Assets Removed From SAMDA Portfolios

Since late 1991, RTC has been placing increased emphasis on auctions and structured sales through its sales centers, and it has withdrawn many assets from SAMDA portfolios to include in these sales events. When RTC did this, it was obligated to pay disposition fees to SAMDA contractors when the assets were sold. While RTC is making revisions to its fee structure to reflect these changing conditions, it paid or is contractually liable for over $143,000 in contractor fees for several instances GAO analyzed in which RTC's own staff consummated the sale.

Further, RTC is potentially liable for at least $35 million in fees for assets that have been included in several RTC direct sales programs but have not been sold yet. These situations present RTC with an opportunity to renegotiate with SAMDA contractors, which no longer have primary marketing responsibilities for the assets, and save considerable amounts on future sales.

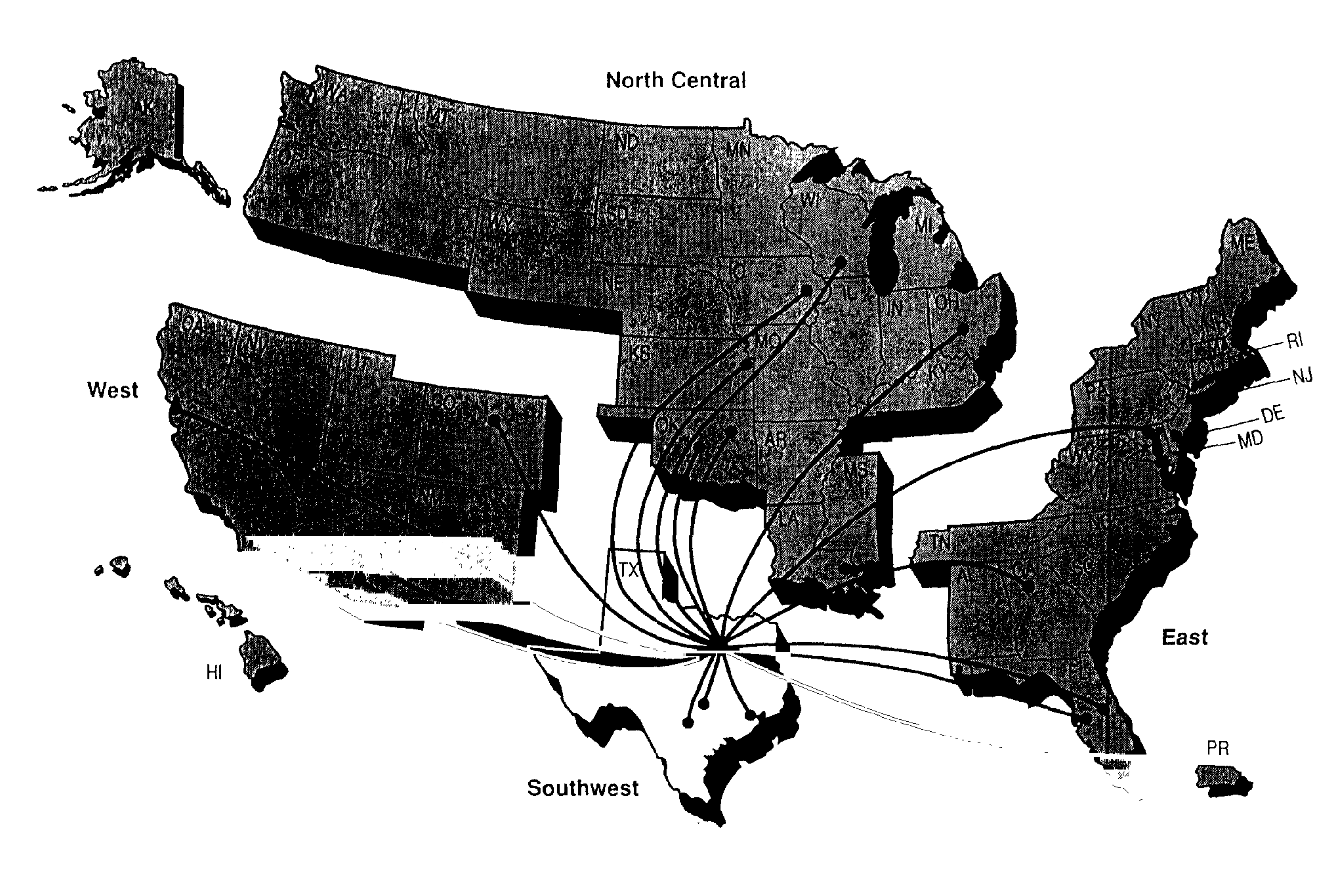
Weak Contract Provisions and Inconsistent Contract Administration Put RTC's Interests at Risk

When assets requiring little or no work were discovered in portfolios, RTC consolidated offices found that the SAMDA contract did not contain provisions allowing them to remove the assets without payment to the contractor. Because RTC had not developed guidance on how to manage these situations, staff at each office developed their own approaches for asset removals and fee payments. For example, some offices paid disposition fees to contractors for any asset included in the final awarded portfolio, whereas other offices simply withdrew assets from awarded portfolios and notified the contractor that disposition fees would not be paid because services contemplated under the contract were not needed. A third approach was to replace assets withdrawn from portfolios without payment of fees to the contractor.

RTC Awarded SAMDA Portfolios With Dispersed Asset Locations

About one-third of the 98 SAMDA portfolios we analyzed included assets located in from 10 to 27 states. RTC staff told us they were not able to structure geographically concentrated asset portfolios because information and accounting systems were not adequate to permit the transfer of asset information between RTC offices. Consequently, RTC consolidated offices structured portfolios by combining similar type assets from local failed thrifts, regardless of where the assets were located. The complexity of the management environment this created is exemplified by figure 1, which shows the office locations of contractors responsible for managing assets located in the Dallas/Fort Worth area. Of the 98 SAMDA portfolios GAO analyzed, 58 had assets located in Dallas/Fort Worth, but 40 of these contracts were managed from other states (see fig. 1).

Figure 1: SAMDA Contractors That Manage Asset Portfolios With Assets Located in the Dallas/Fort Worth Area



Portfolios With Dispersed Asset Locations Increase Contracting Costs and Risks

SAMDA contractors with assets in dispersed locations incurred additional costs to manage their portfolios, such as the cost of travel and satellite offices. As a result, RTC paid higher fees to manage these portfolios. In addition, the risk to RTC of mismanagement and waste was higher in the case of portfolios with dispersed asset locations because there were greater numbers of subcontractors performing services and relatively wider spans of control for RTC managers charged with contract oversight responsibilities.

Compounding the risk posed by dispersed asset locations is the high-risk nature of some of the assets themselves. For example, RTC holds many properties that generate rental income, require expenditures for operations, or require the resolution of environmental problems.

Recommendations

GAO is recommending, among other things, that RTC's Chief Executive Officer (1) include only those assets in SAMDA contractors' portfolios that require services, (2) revise RTC's future SAMDA contracts to avoid the payment of unearned or duplicate fees to contractors, (3) renegotiate disposition fees payable to SAMDA contractors for assets withdrawn from portfolios for inclusion in RTC sales center events, (4) resolve problems with information and accounting systems to ensure that they support effective asset management, and (5) ensure that RTC maintains adequate oversight over contractors.

Agency Comments

In written comments on a draft of this report, RTC responded that the reality of "getting the job done" to quickly place assets with contractors was more important than carefully organizing the assets into cost-effective and controllable portfolios. While GAO recognizes that RTC needed to place assets with contractors as quickly as possible to dispose of the assets, GAO believes that the 1 year of lead time gave RTC sufficient time to take appropriate steps to structure and manage these portfolios.

RTC disagreed with GAO's recommendations that it revise the language of future SAMDAS and renegotiate current agreements to avoid payment of unearned fees to contractors. RTC stated such revisions would be "one-sided" and that renegotiations would result in "poor contract management." GAO believes that both current and future SAMDAS should be written to minimize payments of unearned fees and thus protect the interests of the government. GAO believes that renegotiations with SAMDA contractors would be bilateral in nature because of incentives that RTC could offer the contractors.

RTC agreed with other GAO recommendations. It stated that recent policy and organizational changes should result in improved management controls and increased consistency in field office practices. RTC also stated that major efforts are under way to improve its information and accounting systems.

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Figures

Abbreviations

DACS	Division of Corporate and Accounting Services
ERV	estimated recovery value
FDIC	Federal Deposit Insurance Corporation
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act of 1989
LOAIS	Loans and Other Assets Inventory System
REOMS	Real Estate Owned Management System
RTC	Resolution Trust Corporation
SAMDA	standard asset management and disposition agreement
SAMA	standard asset management amendments

Introduction

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) created the Resolution Trust Corporation (RTC) to manage and dispose of the billions of dollars in assets owned by thrifts previously insured by the Federal Savings and Loan Insurance Corporation. The act (12 U.S.C. 1441a(b)(11)(A)(ii)) authorizes RTC to use private firms to manage and sell these assets if needed services are available in the private sector and it is determined that using these services is practical and efficient.

RTC had a massive challenge of quickly assembling a team of thousands of people and of developing systems and procedures to get control over billions of dollars of problem assets from failed savings and loans as quickly as possible so disposition of the assets could begin. In this environment, problems and mistakes were inevitable.

We recognize that many RTC people have worked diligently to deal with the largest asset disposition effort ever undertaken in the United States. But we also believe it is important to report on some of the problems surrounding the management and disposition of assets because of the ongoing nature of these activities and the opportunity to improve them in the future.

RTC's Organization

RTC initially organized its operations under two major units, (1) Resolutions and Operations and (2) Asset Management. Resolutions and Operations was responsible for managing the operations and ultimate sale of insolvent thrifts. Asset Management was responsible for managing and marketing the assets left with RTC after thrift resolutions. These units were supported by several other units including contracting, legal, information systems, finance, research, and program analysis. In addition, RTC set up a National Sales Center for direct marketing of assets.

RTC's field offices were to support its headquarters organization; about 85 percent of all its staff were assigned to those offices. RTC's four regional offices were located in Atlanta; Dallas; Denver; and Kansas City, Missouri. Each regional office had from three to five consolidated offices under its jurisdiction. These offices, working with staffs of about 175 to 350 each, carried out RTC's day-to-day activities for thrifts in their jurisdictions. Table 1.1 shows the field structure in 1991.[1]

[1]In March 1992, RTC announced plans to close its four regional offices by June 30, 1992. The consolidated field offices in Tampa, San Antonio, Baton Rouge, Minneapolis, Tulsa, and Phoenix will be phased out no later than January 31, 1993.

Table 1.1: Locations of RTC Field Offices in 1991

Regional offices	Consolidated offices
Eastern Region, Atlanta	Atlanta, Georgia Somerset, New Jersey Tampa, Florida King of Prussia, Pennsylvania
Southwest Region, Dallas	Dallas, Texas Houston, Texas San Antonio, Texas
Western Region, Denver	Denver, Colorado Costa Mesa, California Phoenix, Arizona
North Central Region, Kansas City	Kansas City, Missouri Baton Rouge, Louisiana Elk Grove Village, Illinois Eagan, Minnesota Tulsa, Oklahoma

RTC also set up sales centers at its regional and consolidated offices that planned and did independent direct asset marketing in addition to the asset planning and marketing done by the National Sales Center in Washington, D.C.

RTC Asset Portfolio Development Process

In its first year of operations, highlighted by Project Clean Sweep in the spring of 1990, RTC moved quickly to close hundreds of failed thrifts. These thrift closures created a large inventory of loans and real estate assets for RTC's management and disposition, and RTC exerted pressure on its consolidated offices to take aggressive action to dispose of assets as quickly as possible.

Real estate and loan specialists at consolidated offices identified thrift assets for Standard Asset Management and Disposition Agreement (SAMDA) portfolios and hired contractors to manage and dispose of the assets. To develop the portfolios, they generally relied on asset information from thrift staff and loan servicing contractors. Some offices, however, did their own research or hired outside contractors to verify the asset information.

After identifying assets requiring SAMDA services, the specialists categorized the assets by type and pooled them into portfolios. Real estate assets—residential and commercial properties—were subdivided into categories such as single-family homes, multifamily dwellings, office buildings, retail properties, raw land, and industrial properties. Similarly, residential and commercial loans and other types of loans and note assets were subdivided into categories based on underlying collateral and amount of money owed.

After the SAMDA portfolios, which varied greatly in both size and asset type, were assembled and approved by RTC management, the offices sent solicitations to contractors on RTC's approved list. During 1990 and 1991, RTC typically took from 4 to 6 months to award a SAMDA contract. Through November 1991, RTC had awarded 162 SAMDA contracts with asset portfolio book values ranging from about $1 million to $2.4 billion. These portfolios generally contained real estate or loan assets; some portfolios included both types of assets.

RTC has placed substantial amounts of assets with SAMDA contractors. Table 1.2 summarizes the SAMDA contracts RTC awarded from August 1990 through November 1991.

Table 1.2: SAMDAs Awarded in Each RTC Region Between August 1990 and November 1991

Dollars in millions

RTC region	Number of contracts	Estimated book value	Estimated recovery value	Estimated fees to contractors
Eastern - Atlanta	43	$ 8,354	$ 5,490	$144
North Central - Kansas City	42	3,801	2,567	82
Southwest - Dallas	40	10,761	6,295	178
Western - Denver	37	8,599	4,716	144
Total	**162**	**$31,515**	**$19,068**	**$548**

During the SAMDA portfolio development process, staff at failed thrifts continued their own efforts to manage and dispose of the assets. These efforts were sometimes concluded after the contract award date when property sales closed or loans were collected. RTC's sales centers also removed assets from SAMDA portfolios for direct marketing efforts.

Fee Structure in SAMDA Contracts

While SAMDA portfolios are being developed, consolidated office staff are to assign an estimated recovery value (ERV) to each asset based on its anticipated net sales proceeds. Contractor fees are to be based on the ERV of the portfolio assets. RTC has issued four versions of SAMDA, and it is now developing amendments, which provide for management services only. Each SAMDA version has some differences in fee computation procedures.

RTC pays SAMDA contractors two types of fees: a monthly management fee and a one-time disposition fee, which includes an incentive fee. Management fees are based on the remaining value of a contractor's portfolio and typically cost RTC about 1 percent of a portfolio's total ERV per year. As assets are sold, monthly management fees decline along with the value of the portfolio. Disposition fees are to be based on a number of factors, including the actual sales proceeds and ERV for each asset as well as the timing of the sale. To give contractors an incentive to maximize sales proceeds, fees are to be reduced if net proceeds are less than 90 percent of ERV, and a 50-percent bonus is to be paid if proceeds exceed 110 percent of ERV. To encourage quick sales, RTC is to pay contractors an incentive bonus equal to 20 percent of the disposition fee for sales closed in the first year of the contract. Table 1.3 shows an actual SAMDA disposition fee calculation.

Table 1.3: Example of a SAMDA Disposition Fee Worksheet

Notice of asset disposition fee calculation	
Asset name	3761 Beethoven Road
Asset no.	7307
Institution name	WESTCO SAV
Institution no.	6973
Estimated recovery value	$3,180,000.00
Date of sale/payoff or discovery of payoff	31-Dec-90
Gross proceeds received (Sec. 11.2.1.(b))	$4,200,000.00
Less costs (Sec. 11.2.1.(a)):	
Contractor's management fee earned:	
From	14-Dec-90
To	31-Dec-90
	$2,105.20
Costs of mandatory subcontracting:	0.00
Legal costs:	0.00
Asset file reproduction costs:	0.00
Total	**$2,105.20**
Net proceeds of sale	**$4,197,894.80**
Percent of ERV	132.01%
Initial asset disposition fee (Sec.11.2.2.) - 1%	$41,978.95
Adjustments (Sec.11.2.2.(a,b,c, or d)) if net proceeds of sale are:	
a. Less than 51% of ERV, then 25% of fee:	
b. Greater than 50% up to 90% of ERV, then 50% of fee:	
c. Greater than 90% up to 110% of ERV, then 100% of fee:	
d. Greater than 110% of ERV, then 150% of fee:	$62,968.42
Add - incentive bonus (Sec. 11.3.1)	
First year incentive bonus - 20%	12,593.68
Second year incentive bonus - 10%	
Total asset disposition fee	**$75,562.11**
Less - RTC's retention (Sec. 11.6.2) - 15%	**11,334.32**
Total asset disposition fee due now	**$64,227.79**

Objectives, Scope, and Methodology

We evaluated RTC's policies, procedures, and consolidated office practices to determine whether RTC had adequate information and systems of control to ensure that it consistently (1) identified appropriate assets requiring the types of services contemplated under the terms of its SAMDA, (2) made efficient use of funds paid for management and disposition fees, and (3) pooled SAMDA assets in a manner that enhanced the efficiency of both contractor performance and RTC oversight.

Through telephone and mail communication with RTC staff at 14 of the 15 consolidated offices, we obtained information on SAMDA contracts and listings of assets included in the portfolios. We excluded the Somerset, New Jersey, office because it was opened in the spring of 1991 and had little SAMDA activity at the time of our fieldwork. We analyzed geographic locations of assets for 98 of the 135 SAMDA portfolios awarded from August 1990 through August 1991. These 98 portfolios represented about 73 percent of SAMDAS that had been awarded by RTC through August 1991.

To accomplish our audit objectives, we visited RTC's Coastal (Costa Mesa), Central Western (Phoenix), Intermountain (Denver), Mid-Central (Kansas City), Lake Central (Elk Grove Village), Metroplex (Dallas), Southern (San Antonio), Mid-Atlantic (Atlanta), and Northeast (King of Prussia) consolidated offices. At these offices, we met with directors and assistant directors to discuss asset portfolio development policies and practices. We also met with (1) contracting department managers and contracting officers to obtain an understanding of policies and practices for contract modifications and portfolio adjustments and (2) asset specialists who developed the portfolios awarded to SAMDA contractors and oversight managers for operational SAMDA contracts. We discussed their perspectives on RTC policies, practices, and controls for portfolio design, additions and deletions to portfolios, and payment of disposition fees under varying circumstances.

We reviewed information on assets that had been sold in the first 90 days following award of the contract to evaluate whether RTC or the contractor was the primary provider of marketing services. We also analyzed the impact on SAMDA contracts of concurrent sales efforts by RTC sales centers.

We made on-site reviews of 44 SAMDA portfolios with assets valued at a total of $6.7 billion (ERV) and estimated contractor fees for the entire contract period of $177 million. At the time of our review, the 44 portfolios represented about 50 percent of ERV of RTC's SAMDA activity. Our on-site reviews included portfolios ranging in size from $11 million to $871 million.

After we completed our work at the consolidated offices, we met with RTC headquarters officials responsible for SAMDA contracting to discuss asset information, portfolio, and direct sales issues. These officials provided statistics on assets involved in both SAMDA processes and RTC sales. We also contacted staff at RTC's National Sales Center to obtain information on large sales of SAMDA assets planned for 1992.

We met with SAMDA contractors to discuss the impact of portfolio asset locations on management and disposition activities, fee income, and costs.

RTC provided written comments, included in appendix I, on a draft of this report. These comments are evaluated in chapters 2 and 3 and in appendix I. We did our review work in accordance with generally accepted government auditing standards from April to December 1991.

RTC Paid or Is Liable for Millions in Unearned SAMDA Contractor Fees

RTC has paid or is contractually liable for at least $4.7 million in unearned contractor fees for the management and disposal of assets. This total includes $4.51 million paid or payable to SAMDA contractors even though the asset work was done entirely or primarily by staff at failed thrifts or RTC sales centers, or by other contractors. Failure to follow certain RTC policies, a reluctance to exclude certain assets from portfolios, poor quality information on the current status of assets, and weaknesses in RTC's SAMDA contract contributed to this situation. The other $143,000 is unearned contractor fees for several instances in which RTC's staff consummated asset sales.

RTC is also potentially liable for at least $35 million in disposition fees for assets originally included in SAMDA contracts that were later selected for inclusion in national, regional, or local RTC direct sales activities. This presents an opportunity for RTC to save millions of dollars in disposition fees by renegotiating with SAMDA contractors who no longer have primary marketing responsibilities for assets in their portfolios.

When contractors discovered assets requiring little or no work in their portfolios, RTC consolidated office staff found that the SAMDA contract did not contain provisions allowing them to remove the assets without payment to the contractor. Because RTC had not developed and issued any guidance on this type of situation, staff in each of the offices developed their own approaches for asset removals and fee payments. Under these approaches, SAMDA contractors received different treatment under similar circumstances depending on which office or staff they were dealing with. Further, some of the approaches enabled offices to remove assets without payment of fees to the contractors while others resulted in increased costs to the government.

Millions Paid to SAMDA Contractors for Assets Not Requiring Services

RTC paid SAMDA contractors management and disposition fees totaling at least $4.5 million even though work on the assets was done entirely or primarily by staff from failed thrifts or RTC sales centers, or by other contractors. We identified hundreds of such assets in a sample of contractor portfolios developed during RTC's first 2 years of operations. However, because we analyzed only a portion of RTC's asset portfolios, the actual amount of unearned fees may be substantially higher. As shown in table 2.1, we classified these assets into three general categories: (1) performing loans being serviced by other contractors, (2) real estate under contract and nonperforming loans for which settlement arrangements were nearly worked out, and (3) paid-off loans that did not require any work on the part of the SAMDA contractor.

Table 2.1: Unearned Fees Paid to SAMDA Contractors

Dollars in Millions

Assets in SAMDA portfolios	Number of assets	Amount of unearned fees
Performing loans	748	$2.82
Real estate under contract and nearly settled nonperforming loans	218	1.25
Paid-off loans	31	0.44
Total	**997**	**$4.51**

Performing Loans Inappropriately Included in SAMDA Portfolios

RTC consolidated offices included 748 performing loans in 12 of the 44 SAMDA portfolios we analyzed, even though this practice was contrary to RTC policies on portfolio development. As a result, RTC paid at least $2.8 million in fees to SAMDA contractors on these loans in addition to amounts paid to loan servicing contractors for processing payments received from borrowers. Officials at one of the five offices that developed these portfolios said the loans were included by mistake because loan servicing records were not current; however, officials at another of the offices stated that they included performing loans as a matter of local policy.

In a February 1990 directive, RTC set forth general guidelines for developing SAMDA asset portfolios and identifying loans requiring full asset management and disposition services. The directive instructed consolidated offices to place performing loans with loan servicers, who would process payments from borrowers and keep the loan accounts up to date. All loans with payments 60 days or more in arrears—the so-called nonperforming loans—were to be placed with SAMDA contractors, who would then negotiate with defaulting borrowers and handle the foreclosure and sale of collateral, if necessary.

Implementation of these guidelines varied widely among the consolidated offices. While several offices applied the 60-day overdue standard for nonperforming loans, other offices used 90 days. One office modified the standard and considered other risk criteria as well in identifying nonperforming loans. It included performing loans in SAMDA portfolios if the interest rate exceeded current market rates, the value of the underlying collateral was less than the book value of the loan, or the same borrower also had one or more nonperforming loans.

The nine consolidated offices we visited also included some performing loans in SAMDA portfolios because loan servicing records showed they were nonperforming. Subsequent research by the SAMDA contractor disclosed that payments were current and the loan required no further management or disposition work. Nevertheless, RTC left these loans in the portfolios and paid SAMDA contractors management fees even though other contractors were being paid to service the loans. The following examples highlight some of the more significant instances of this problem.

Performing Loans Included in SAMDAs as a Result of Local Decisions

The Chicago office included performing loans valued at about $116.3 million in three SAMDAS because of local decisions on portfolio structure. Our review of asset listings for the portfolios showed that many of the loans had current payments with outstanding balances that were less than the value of the loan collateral. In total, performing loans represented about 46 percent of the combined ERV of the three portfolios. RTC paid or is now liable for over $1.2 million in management fees for these loans, even though they required few or no SAMDA services. RTC also had to pay a loan servicer to process payments received from the borrowers.

RTC's Dallas office also included performing loans in SAMDA portfolios even though its formal policy was to contract this type of asset out to loan servicers. GAO identified 280 loans in 2 portfolios valued at about $103 million that were shown as performing loans on RTC's asset listings. We estimated that RTC paid or is liable for about $958,000 in management fees for these loans. The Dallas office also added eight performing loans with a total ERV of $15,114,900 to a portfolio of real estate and loans even though the asset specialist responsible for the portfolio objected to the addition. The oversight manager expressed some concern over the addition and believed that the assets would have been more appropriately placed under the responsibility of the sales center. Nevertheless, he was instructed to prepare a case to obtain approval for the additions. We estimated that RTC paid or is liable for about $70,533 in management fees for the eight loans even though the contractor provided little or no services for the fees.

Performing Loans in SAMDAs as a Result of Inaccurate Information

RTC's Atlanta office mistakenly included performing loans valued at $2,874,633 in one of its first SAMDA portfolios because of inaccurate information on loan servicing reports showing the status of payments from borrowers. According to the oversight manager for this portfolio, services provided by the contractor consisted of monitoring the promptness of payments and ensuring that collateral for the loans had current appraisals, adequate insurance coverage, and paid-up taxes. The contractor did not have to perform the usual services required for nonperforming loans, such as negotiating with borrowers and handling legal matters such as litigation and foreclosure. Nevertheless, RTC paid or is liable for about $13,000 in management fees for the loans.

RTC's Denver office included performing loans valued at about $6.5 million in a portfolio with a total ERV of about $145 million because loan servicing reports mistakenly showed that payments on most of the loans in the portfolio were more than 60 days in arrears. An analysis done by the contractor hired to manage and dispose of this portfolio showed that a number of the loans were in fact performing. Although the contractor had to communicate with the borrowers concerning the status of loan payments, RTC itself processed the payments. Further, RTC took no steps to remove the loans from the portfolio before awarding the contract even though they did not require full SAMDA services. We estimated that RTC is liable for about $71,000 in SAMDA management fees for the loans.

Real Estate Under Contract and Nearly Settled Nonperforming Loans Included in SAMDA Contracts

The SAMDA portfolios we reviewed included real estate and nonperforming loans that were on the verge of sale or settlement at the time of the contract award. We identified 205 real estate properties and 13 loans that required little or no services by the SAMDA contractor to complete the transactions. Nevertheless, RTC paid these contractors about $1.25 million in disposition fees for these assets.

During the time consolidated offices took to structure SAMDA asset portfolios and award the contracts—typically from 4 to 6 months—staff of the failed thrifts and RTC sales centers continued their efforts to dispose of the same group of assets. Often, the outcome of these multiple efforts was that offers received by thrifts or sales centers would be accepted. In these situations, consolidated offices generally left the assets in the portfolios even though services needed from the SAMDA contractor to finalize the transaction would be minimal.

Asset specialists at a number of consolidated offices said that the primary reason these assets were left in SAMDA portfolios was that the offices lacked adequate staffing to manage and dispose of the assets if negotiations fell apart at the last minute. They also stated that, for many of the assets, substantial services would have to be performed before disposition efforts could be completed. For example, situations existed in which (1) the closing was not scheduled until several months after contract award, (2) the closing was contingent on completing improvements to the property or resolving environmental problems, or (3) the SAMDA contractor would provide important services to consummate the sale. For these latter situations, we concluded that the contractor earned its fees, and we did not consider them to be instances in which the contractor had provided little or no services.

However, we noted 218 instances in which assets in the portfolios we reviewed were not subject to the situation just described. RTC offices could have held these assets out of the SAMDA portfolios and completed the necessary work in-house. Examples of some of the more significant instances follow.

Sale of a Recreational Vehicle Resort in Arizona

A large thrift in Arizona, Western Savings and Loan, owned a 410-acre recreational vehicle resort in the Phoenix area called Happy Trails. The resort included 1,873 lots, an 18-hole golf course with pro shop, a 51,584-square-foot town center, and other services and amenities. Thrift staff began a marketing effort for this property in July 1990 and obtained conditional approval to sell the property to a qualified buyer affiliated with Nikkoh Corporation of Japan on March 13, 1991. The sale was closed on May 3, 1991, for $5.4 million by a real estate broker hired by the thrift. RTC paid the broker a commission of $262,500 at closing. Concurrent with thrift efforts to sell the property, the Phoenix consolidated office placed it in a SAMDA portfolio. On March 21, 1991—8 days after the thrift accepted the offer—the Phoenix office signed the SAMDA contract without removing Happy Trails Resort from the asset portfolio. Even though RTC staff provided essentially all marketing services for this property, the SAMDA contractor received a disposition fee of $226,401 for the sale, including a first-year incentive bonus of $37,734.

Sale of a Texas Office Building

Gibraltar Savings, a Southern California receivership, owned an office building in Addison, Texas. The real estate sales department at Gibraltar signed a contract in October 1990 to sell the building for $6.6 million to a Texas buyer. The sale closed on December 31, 1990, and RTC paid a commission of $195,000 to a real estate broker. The Costa Mesa consolidated office concurrently had included the building in a SAMDA portfolio awarded on November 28, 1990. Even though RTC staff at Gibraltar told us the SAMDA contractor played no role in the sale of this property—which occurred about 1 month after the SAMDA was signed—RTC paid the contractor a disposition fee of $146,972, including a first-year incentive bonus of $24,495.

Sale of Single-Family Properties in Texas

The Dallas office awarded a large portfolio of single-family residences to a SAMDA contractor on February 1, 1991. Because of a lack of staff at the consolidated office, RTC officials decided that any properties under contract, but not closed, as of February 1 would be sent to the contractor. In February and March 1991, the contractor closed 111 properties with gross proceeds of about $6.5 million. Most of these properties were placed under sales contracts by RTC before February 1. Even though the contractor was not involved in selling these houses, it received disposition fees of $191,914 when the contracts were executed, including a $31,986 first-year incentive bonus.

Collection of a Loan Held by an Illinois Thrift

The Chicago office awarded a portfolio with about $13 million in real estate and $42 million in loans to a SAMDA contractor in February 1991. The portfolio included a loan with ERV of $1,720,000 that was in the process of being collected. In July 1991, the thrift succeeded in collecting from the borrower $2,153,569, which exceeded ERV by about 25 percent. Even though the contractor did not have to negotiate with the borrower, it collected $10,098 in management fees and $77,163 in disposition fees, including a $12,860 first-year sale incentive fee.

Paid Loans Mistakenly Included in SAMDA Portfolios

SAMDA portfolios we reviewed also included nonperforming loans that had been settled and paid off by the borrower while the consolidated office staff worked on selecting a contractor. The primary reason these paid-off loans were included in the SAMDA contract was that RTC obtained inaccurate asset information from multiple sources.

While they were working to identify assets requiring SAMDA services, RTC staff at the failed thrifts and consolidated offices were hampered by incomplete thrift files and inaccurate loan records provided by loan servicers. For example, in a report to RTC's King of Prussia office, a SAMDA contractor stated that a substantial amount of critical documentation was missing from the files provided by RTC on assets in its portfolio. According to the contractor, entire sections of asset files were missing, including information on current litigation, servicing, historical construction plans, current offers, and correspondence.

As RTC resolved thrifts, it sometimes failed to exercise adequate controls over files and computer systems containing critical information on assets. Consolidated office staff responsible for SAMDA portfolios stated that asset files were sometimes haphazardly placed in boxes and sent to warehouses where they sat for months before being researched. We were also told of instances in which conversions from in-house computer systems were so poorly controlled that data on assets were lost. As a result, consolidated office staff had to rely on incomplete and inaccurate information when they developed SAMDA portfolios, and consequently the staff sometimes mistakenly included assets that did not require the services contemplated under the terms of the SAMDA contract.

We identified 31 instances in which RTC included paid-off loans in SAMDA portfolios. RTC later paid about $438,000 in disposition fees to the contractors for these loans when it removed them from the portfolios. Some examples of the more significant instances follow.

California Contractor Discovered Millions in Paid Loans

RTC's Costa Mesa office awarded a contract in November 1990 for the management and disposition of a portfolio of 226 nonperforming loans with ERV of about $93 million. Shortly after receiving the asset files, the contractor identified 21 loans that had been paid off before the effective date of the contract. The combined ERV on these loans was $11.9 million, making RTC liable for $304,848 in disposition fees under the terms of the contract. The contractor accepted the consolidated office's offer to simply accept replacement assets rather than be paid unearned fees, but the contracting department insisted that the disposition fees be paid because they were required by the terms of the SAMDA contract. The fees payable included $50,808 in incentive fees.

Colorado Contractor Discovered Paid Loan and Deficiency

We found a similar example in a nonperforming loan portfolio awarded by RTC's Denver office. A SAMDA contract was awarded in January 1991 for the management and disposition of $170 million (ERV) in nonperforming loans. The portfolio included five loans that had been paid off before the award date because RTC's records were not up to date. The largest of these assets was a loan of $1,065,000 that had been paid off in October 1990. The SAMDA contractor billed RTC and was paid a disposition fee of $37,164 on this asset, including a first-year incentive bonus of $6,194, even though the contractor had no role in the settlement of this loan. Other loans in the same portfolio that were also paid off before the contract date resulted in the payment of unearned fees of about $26,600.

RTC Liable for Disposition Fees on SAMDA Assets Sold by Sales Centers

From August 1990 until late 1991, RTC relied primarily on SAMDA contractors to dispose of thrift assets on an asset-by-asset basis. Since then, however, RTC has shifted emphasis toward the use of its sales centers to dispose of large blocks of assets. RTC officials told us that because they considered the pace of individual asset sales being attained by the contractors to be too slow, they decided to dispose of the assets through bulk sales and auctions concurrently with the SAMDA process. Because the

SAMDA contract does not provide for RTC to withdraw assets for sale without paying the contractor, RTC has paid or is potentially liable for over $35 million in disposition fees on assets that were already included in SAMDA portfolios.

RTC headquarters officials stated that, to increase the pace of asset dispositions, RTC is now shifting its emphasis away from SAMDA contracting and toward the use of direct sales efforts by its own sales centers. However, RTC's decision to place more emphasis on sales centers and to include SAMDA assets in direct RTC sales has caused duplication both in disposition activities and the payment of fees. Selection of assets for direct RTC sales—both before and after the contract award dates—affected a number of SAMDA portfolios covered by our review. RTC is also potentially liable for fees on future asset removals in the event portfolio sales now planned by the National Sales Center result in more dispositions. These planned sales will involve billions of dollars worth of assets already included in SAMDA portfolios.

Because actual removals of assets sold by sales centers fell under "withdrawal for sale" provisions of SAMDA, RTC was contractually obligated to pay fees to its contractors for the dispositions. The following examples highlight this situation.

Sale of a Florida Apartment Building

In October 1990, the National Sales Center marketed three Florida apartment buildings owned by a Texas thrift. The sales center accepted an offer on the buildings that RTC approved on March 19, 1991. The sale of one of the buildings—a 166-unit apartment in Bradenton, Florida, called The Colony—was closed on May 22, 1991, for $2.78 million by a real estate broker who received a commission of $20,000 from RTC. Concurrent with the sales center effort, the San Antonio office included this asset in a SAMDA portfolio offering. The SAMDA contract was awarded on March 19, 1991—on the same day that RTC approved the sales center transaction—yet RTC neither removed the building from the final asset portfolio nor renegotiated fees payable to the contractor. Even though the contractor played no role in the sale of this property, it received a disposition fee of $29,618, including a first-year incentive bonus of $4,936.

Sale of Arizona Commercial Properties

The Phoenix sales center offered to sell 68 Arizona commercial properties with a sealed bid deadline of February 19, 1991. Many of these properties were then sold by the center. Concurrent with this effort, the Phoenix consolidated office developed a SAMDA portfolio that included seven of the sold properties. The SAMDA contract was signed on April 22, 1991, with the final portfolio including these seven properties. Even though the asset specialist working on the portfolio objected to including these properties, he was overruled by the contracting department's interpretation that properties could not be removed from the portfolio because the portfolio had already been sent out for bids. However, RTC's practice at that time was generally to revise asset portfolios up until the date of contract award. Even though the SAMDA contractor provided minimal services related to the sale of these properties, it received substantial fees, as shown in table 2.2.

Table 2.2: Disposition Fees Paid to Contractor for Seven Sold Properties Included in SAMDA Portfolio When Contract Was Awarded

Property	Sales price	Disposition fee
A	$4,795,745	$84,303
B	600,000	10,140
C	402,000	6,851
D	396,000	3,337
E	280,000	2,389
F	276,610	4,655
G	120,000	2,151
Total	**$6,870,355**	**$113,826**

RTC sales now in the planning stages have created a potential liability to SAMDA contractors for millions of dollars in disposition fees. The amount that RTC will ultimately be obligated to pay depends on how many of the assets it is able to sell and the SAMDA contract provisions. However, the planned sales are substantial in size and in the amount of potential fees payable to the contractors. For example, RTC's National Sales Center is developing three portfolios that include almost $1.2 billion (ERV) in real estate and loans awarded to one SAMDA contractor. RTC planned to market the portfolios in May, June, and July of 1992. The Center is also planning a sale of real estate and loans held by several failed thrifts in Arizona and has hired contractors to determine asset values and develop a marketing plan for the sale. When it selected the contractors, RTC evaluated their bids using the assumption that about $3.2 billion (book value) in assets would be included in the sale—many of which were already in SAMDA asset portfolios. As of May 1992, about $605.1 million (ERV) of the assets identified for inclusion in the sale were already under SAMDA contract.

If RTC is successful in its efforts to dispose of these SAMDA assets, it will be liable for fees set forth in the original contracts or subsequent amendments. Assuming disposition fee rates of 2 percent of the total ERV of sold assets, RTC could be liable for disposition fees of over $35 million for these sales alone, even though SAMDA contractors were removed as primary marketers of the assets. RTC has also paid and could be liable for disposition fees from other national, regional, and local direct sales.

While RTC's planned sales have created the risk that millions of dollars will be paid in unearned disposition fees, it is also possible that the sales may be canceled or that some assets included in RTC sales may not be sold. Because of this element of uncertainty, the exact amount of RTC's liability for fees from planned sales is unknown. The following example illustrates this situation.

Planned Sale of Texas Land and Improved Real Estate

The Dallas sales center selected the majority of assets from two SAMDA contracts for sales events shortly after the contracts were signed. One of the portfolios had 113 parcels of land with a gross book value of $327 million and ERV of $164 million. The other portfolio had 81 pieces of improved real estate with a book value of $178 million and ERV of $133 million. The sales center selected 77 of the parcels of land and 64 pieces of real estate from these portfolios for direct sales efforts. Even though RTC directed the SAMDA contractor to suspend all marketing activities for these assets, the contractor would have collected disposition fees on all assets sold. However, the Dallas sales center eventually canceled the planned sale and the assets remained in the SAMDA portfolios.

Weak Contract Provisions and Inconsistent Contract Administration Put Government's Interests at Risk

As alluded to earlier, RTC's SAMDA contract provisions did not adequately cover either the inclusion of assets requiring little or no services or the need to remove assets from contractors' portfolios. As a result, RTC remained liable to the contractor for management and disposition fees. Under this situation, consolidated office staff treated contractors differently relating to the payment of SAMDA fees. In some offices, these differences resulted in increased SAMDA contract costs to the government.

RTC's SAMDA addresses the following situations in which assets are no longer to be a part of a contractor's portfolio: (1) withdrawals for sale and (2) withdrawals for cause. In withdrawals for sale, assets are deemed to have been sold by the SAMDA contractor and are removed from the portfolio. At the time of removal, RTC pays disposition fees to the SAMDA contractor. In withdrawals for cause, contractors are deemed to have a conflict of interest with respect to the asset or to be unable to agree with RTC staff on an appropriate course of action to take on the asset. RTC does not pay disposition or incentive fees for withdrawals for cause.

When RTC or a contractor discovered in a portfolio real estate that was already sold or a loan that had already been paid by the borrower, the asset was removed from the portfolio using the withdrawal for sale option because the category of withdrawal for cause was deemed so clearly inapplicable. The confusion within RTC over this issue was expressed by an official in RTC's Western Region in a December 1990 memorandum on asset withdrawals:

"There has been considerable confusion recently regarding when and if assets are to be removed from the scope of the Standard Asset Management and Disposition Agreement (SAMDA). Although the SAMDA provides for withdrawal after execution of the contract, currently assets are being withdrawn during the contracting process, causing confusion and the potential for contractor protests. The competing concerns to making policy are the payment of money to contractors for work they did little or nothing to earn, or require rebidding on most contracts and causing consistently higher overall costs of management to account for the possibility of withdrawal."

As a result of the need to remove assets and the confusion within RTC relating to withdrawals, each consolidated office developed its own contract administration practices for fee payments. Practices also varied within a single consolidated office depending on the approach taken by each SAMDA oversight manager. Some offices and oversight managers paid unearned fees to contractors because they believed SAMDA required such payment while other offices and managers avoided paying unearned fees. The following examples highlight the inconsistencies in these practices.

Fee Payment Practices for Paid-Off Loans

The Costa Mesa office paid unearned fees to a contractor for paid-off loans mistakenly included in a portfolio because the Costa Mesa Contracting Department interpreted RTC's SAMDA contract to mean that all assets included in the awarded portfolio were subject to disposition fees.

By contrast, the Kansas City and Atlanta offices did not pay disposition fees to SAMDA contractors when mistakes were discovered in portfolios. These offices simply notified the contractor that the assets were being removed and that the assets would not be subject to disposition fee payments because no services were needed.

In RTC's Denver office, some oversight managers arranged for contract modifications containing provisions intended to preclude payment of unearned fees. These modifications provided for no disposition fees payable to the contractor for real estate closings occurring within the first 30 days of the contract period and reduced fees for closings occurring from 30 to 90 days into the contract. However, a different oversight manager in RTC's Denver office approved the payment of unearned fees to a SAMDA contractor when loan assets were removed from the portfolio when it was discovered that they needed no services.

Fee Payment Practices for Real Estate Sold by Thrift Staff and Staff in RTC's Sales Centers

The Dallas office routinely included real estate already under contract for sale in portfolios awarded to SAMDA contractors, and it paid disposition fees even though closings occurred within several days after the effective date of the contract. At the same time, RTC's Dallas office had a system for revising portfolios and often avoided paying unearned fees when sold assets were included in SAMDA portfolios. Under this system, RTC amended the portfolios 45 days after the effective date of the contract and encouraged oversight managers to "swap" new assets for ones that had to be removed from portfolios. For example, Dallas modified a SAMDA portfolio on March 15, 1991, 45 days after the effective date of the contract, by removing $19 million of the assets without paying disposition fees. These assets included a country club sold by the local RTC sales center at about the same time the portfolio was awarded to the contractor. We did not find any other consolidated offices using this system.

At the San Antonio office, an oversight manager modified a SAMDA to limit RTC's liability for fees on assets that would not require full services. He had discovered that some assets were nearly sold or paid off as the result of detailed research he performed on assets in the SAMDA portfolio. Even though this oversight manager found a way to protect the government's interests, his approach met with official disapproval. RTC's Southwest Regional Office subsequently issued a directive prohibiting modifications to other SAMDA contracts.

At the Phoenix office, we found inconsistent practices when assets were removed from portfolios for local sales center events. About $7 million of assets were removed from one portfolio, and the contractor was paid disposition fees of $114,000 under the withdrawal for sale provisions of the contract. About $2 million of assets were removed from a different SAMDA portfolio, and no disposition fees were paid to the contractor because the oversight manager negotiated an agreement with the contractor to waive the fees.

Conclusions

RTC paid millions of dollars in unearned fees to SAMDA contractors because asset portfolios included real estate and loans that needed few or none of the services contemplated under the terms of its standard contract. These fees resulted from a failure to implement RTC policies on the inclusion of performing loans in SAMDA portfolios, the lack of reliable information on thrift assets, and the inclusion of real estate properties in SAMDA portfolios that were nearly disposed of by thrifts. RTC also paid substantial unearned disposition fees to SAMDA contractors for assets removed from portfolios because of direct sales by RTC, and RTC is potentially liable for millions more on removals that may result from planned RTC sales. RTC's SAMDA contract did not contain adequate provisions to cover these situations. RTC's consolidated offices then developed inconsistent approaches to portfolio changes and payment of SAMDA fees because of weaknesses in the contract itself and confusion over policy implementation. Some of the approaches resulted in increased SAMDA contracting costs to the government.

Recommendations

We recommend that RTC's Chief Executive Officer take the following actions:

- improve controls over assets included in future SAMDA portfolios by identifying and excluding (1) assets that would more appropriately be disposed of through direct RTC sales, (2) real estate that has already been sold or that is under contract for sale with imminent closings, and (3) loans that already have been paid by the borrowers or are nearly settled, and performing loans that will be managed by loan servicing contractors;
- revise RTC's SAMDA to clearly avoid the payment of unearned or duplicative fees to contractors entering into agreements with RTC in the future, by including provisions covering removal of assets without payment of fees when post-award discoveries are made of assets requiring little or no services from the contractor;
- renegotiate disposition fees payable to SAMDA contractors on assets included in sales center marketing efforts or sold through other direct RTC sales or disposition activities to avoid payments of unearned or duplicate fees; and
- improve management controls over portfolio development and fee payments to ensure that RTC staff have adequate guidance on structuring and making changes to SAMDA portfolios and that they follow consistent practices in their treatment of SAMDA contractors.

RTC Comments and Our Evaluation

In written comments on a draft of this report, RTC stated that "vast" delays and costs would have occurred had it attempted to have no inappropriate assets included in SAMDA contracts. We disagree. As discussed in this chapter, RTC staff in some offices eliminated inappropriate assets from SAMDA portfolios and avoided payment of unearned fees without significant delays or costs. RTC had complete control over this process and could have employed methods that would have enabled it to construct cost-effective and controllable portfolios.

RTC also asserted that its approach was justified because it is required to rely heavily on the private sector. RTC's mandate is to use private sector contractors if the services are available and it determines their use is practical and efficient. We did not question the use of SAMDA contractors. Rather, our concern was how assets were assigned to contractors and managed.

In response to our recommendation that RTC improve controls over assets included in future SAMDA portfolios, RTC noted that our recommendation reflects what is already RTC policy. RTC has issued procedures to improve controls over assets included in future SAMDA portfolios. These actions include developing the Standard Asset Management Amendments (SAMAS) for SAMDA contracts that will allow assets RTC intends to sell through its own sales initiatives to be placed under management but not disposition services. RTC believes fees for SAMAS should be significantly less than total fees under existing SAMDAS. RTC also stated that it has work under way to improve and implement the Real Estate Owned Management System and the Asset Manager System that RTC believes will greatly improve information and accounting systems to support effective asset management.

RTC does not intend to implement our second recommendation to revise the SAMDA contract to avoid paying unearned or duplicative fees in the future. RTC commented that such a change would constitute a "one-sided provision that would raise SAMDA fees." We disagree. As discussed earlier in this chapter, several RTC offices have already successfully modified the SAMDA contract to preclude the payment of unearned fees. Furthermore, RTC has offered no evidence to support its contention that such modifications would result in a net increase in SAMDA fees.

Regarding our third recommendation that RTC renegotiate disposition fees payable to SAMDA contractors on assets included in sales center or other direct sales events, RTC argued that this was impractical because RTC could not "unilaterally renegotiate" SAMDA terms in its own favor; it further stated that such an approach would result in "poor contract management." We disagree. Because the SAMDA contractor has been removed as an active participant in the marketing process, we believe bilateral renegotiations of the contract are appropriate. In many instances, RTC can offer incentives in the form of new assets in exchange for reductions in disposition fees on assets removed for sales center events.

RTC agreed with our fourth recommendation and stated that its recent steps taken to reduce the number of field offices will "greatly facilitate a higher degree of uniformity in management practices within RTC."

RTC Designed SAMDA Portfolios That Were Difficult and Inefficient to Manage

Although RTC had concentrations of assets in Arizona, California, Colorado, Florida, and Texas, it was not able to structure geographically concentrated portfolios for SAMDA contracts because of inadequate asset information and accounting systems. Instead, RTC structured SAMDA portfolios consisting of real estate and loans with collateral in widely dispersed geographic locations. This practice increased contracting costs incurred by RTC, created additional management problems for contractors with distant assets in their portfolios, and made it more difficult for RTC to monitor the performance of subcontractors. Taken together, these conditions increased RTC's vulnerability to waste and mismanagement. After nearly 2-1/2 years of operations, RTC still lacks integrated asset information and accounting systems needed to structure SAMDA asset portfolios by geographic location.

RTC Awarded Geographically Dispersed Asset Portfolios to SAMDA Contractors

RTC's formal policy for portfolio design was to group assets by geographic location into the same portfolio. Further, RTC had concentrations of assets in states such as Arizona, California, Colorado, Florida, and Texas that its offices could have pooled into geographically concentrated SAMDA portfolios. However, the consolidated offices were not able to combine assets from one location into a single portfolio because RTC lacked reliable information on its nationwide inventory of assets and did not have accounting systems that permitted the transfer of asset information among consolidated offices. As a result, the consolidated offices structured portfolios by including assets of similar type from a failed thrift in the same SAMDA portfolio, regardless of where the assets were located. This practice resulted in portfolios that often included assets in at least 10 states and created an inefficient SAMDA environment with dozens of out-of-state SAMDA contractors managing RTC assets in the same locations.

Because historical lending practices of failed thrifts varied from making loans to borrowers located all around the United States to only local lending, SAMDA portfolios showed great variance in the geographic dispersion of their assets. About one-third of the 98 portfolios we analyzed had assets in from 10 to 27 states, whereas, at the other end of the spectrum, about one-third of the portfolios had assets located in 3 or fewer states.

Table 3.1 summarizes the relative dispersion of assets of RTC's SAMDA portfolios.

Table 3.1: Dispersion of Asset Locations in 98 RTC SAMDA Portfolios

Number of states with portfolio assets	Number of portfolios
1 - 3	31
4 - 9	37
10 - 14	18
15 - 27	12
Total portfolios analyzed	**98**

The complexity of the contract management environment created by RTC's portfolio design practices is exemplified by the Dallas/Fort Worth area, which has the greatest concentration of RTC assets under SAMDA management. Of the 98 SAMDA contract portfolios we analyzed, 58 had assets located in this metropolitan area. Further, of these 58 SAMDA contracts, 40 were managed by contractors with offices located outside the Dallas/Fort Worth area, as shown by table 3.2.

Table 3.2: Locations of SAMDA Contractor Offices for Portfolios With Assets Located in the Dallas/Fort Worth Area

City and state	Number of contracts
Dallas, TX	18
Atlanta, GA	4
Houston, TX	4
Miami, FL	3
Phoenix, AZ	3
Denver, CO	3
San Antonio, TX	3
Austin, TX	3
Columbus, OH	2
Madison, WI	2
Kansas City, MO	2
Tulsa, OK	2
Oklahoma City, OK	2
Baltimore, MD	2
Tampa, FL	1
Winter Park, FL	1
Cedar Rapids, IA	1
Tucson, AZ	1
San Francisco, CA	1
Total	**58**

Our analysis of these 98 portfolios also showed geographic concentrations of assets in other states. Table 3.3 shows the number of SAMDA contractors managing assets in Arizona, California, Colorado, and Florida, and whether they have management offices in the same state as the portfolio assets.

Table 3.3: Locations of SAMDA Contractor Offices Responsible for Assets In Selected Areas

	Location of contractors		
Location of assets	In-state	Out-of-state	Total contracts
Arizona	9	35	**44**
California	2	39	**41**
Colorado	7	52	**59**
Florida	5	36	**41**

SAMDA contractors responsible for assets in Arizona, California, Colorado, and Florida—like those responsible for assets in the Dallas/Fort Worth areas—had management offices located in distant cities. Figures 3.1, 3.2, 3.3, and 3.4 show the locations of contractors' offices responsible for managing SAMDA assets located in each of those states individually. Figure 3.5 shows the combined effect of the dispersion of contractor locations for assets in the states of Arizona, California, Colorado, Florida, and Texas.

Figure 3.1: Management Offices for SAMDA Assets Located in the State of Arizona

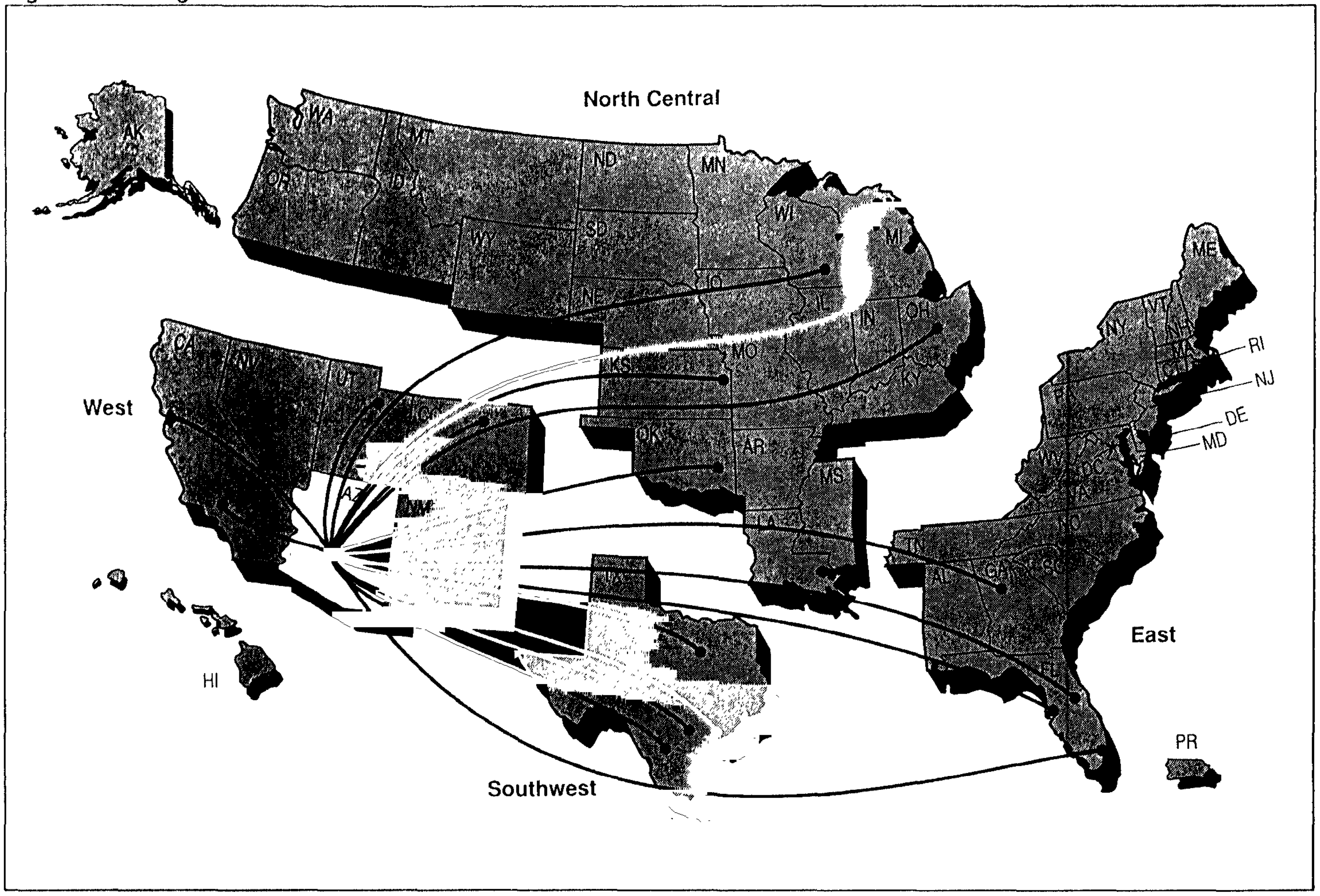


Figure 3.2: Management Offices for SAMDA Assets Located in the State of California

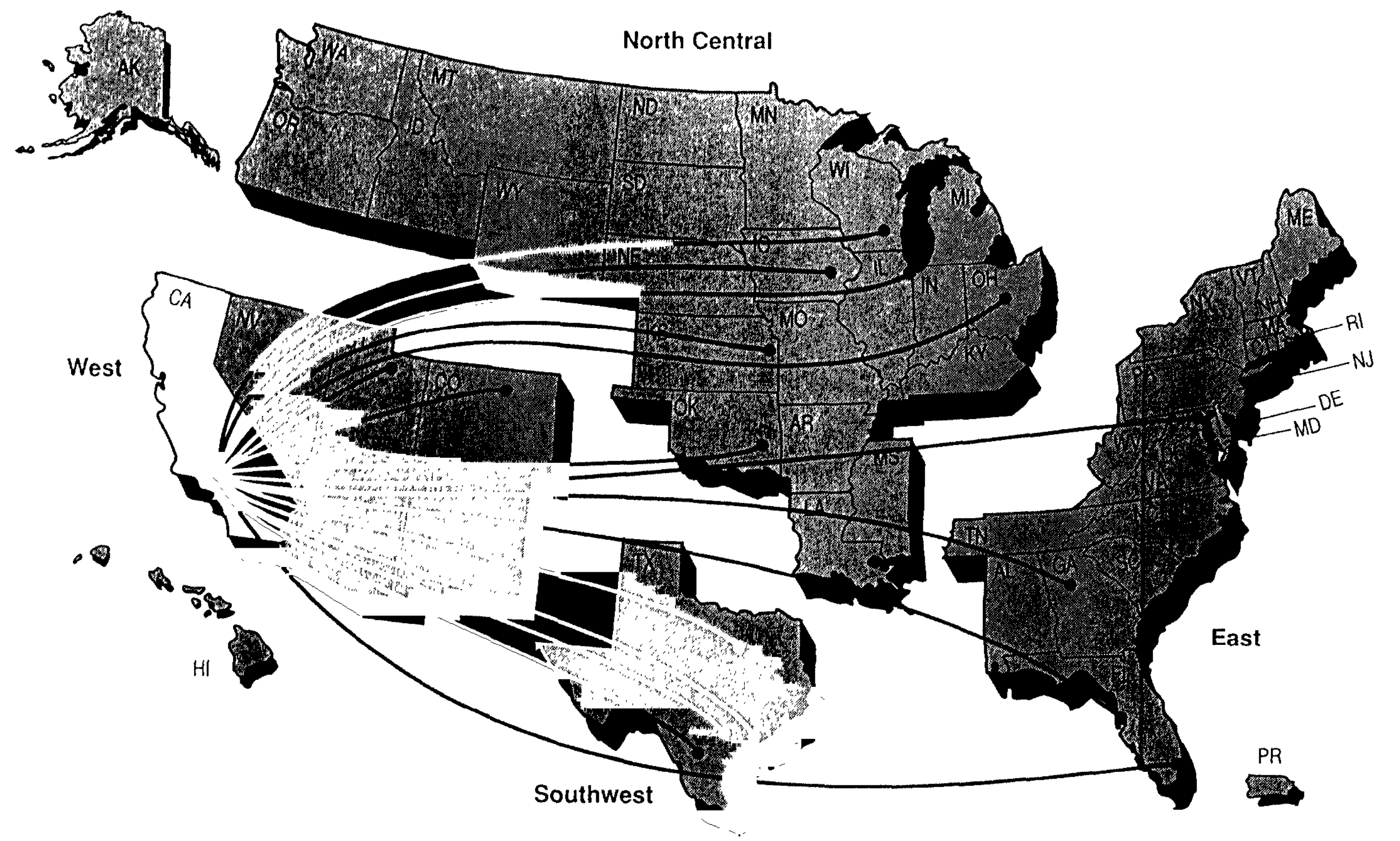


Figure 3.3: Management Offices for SAMDA Assets Located in the State of Colorado

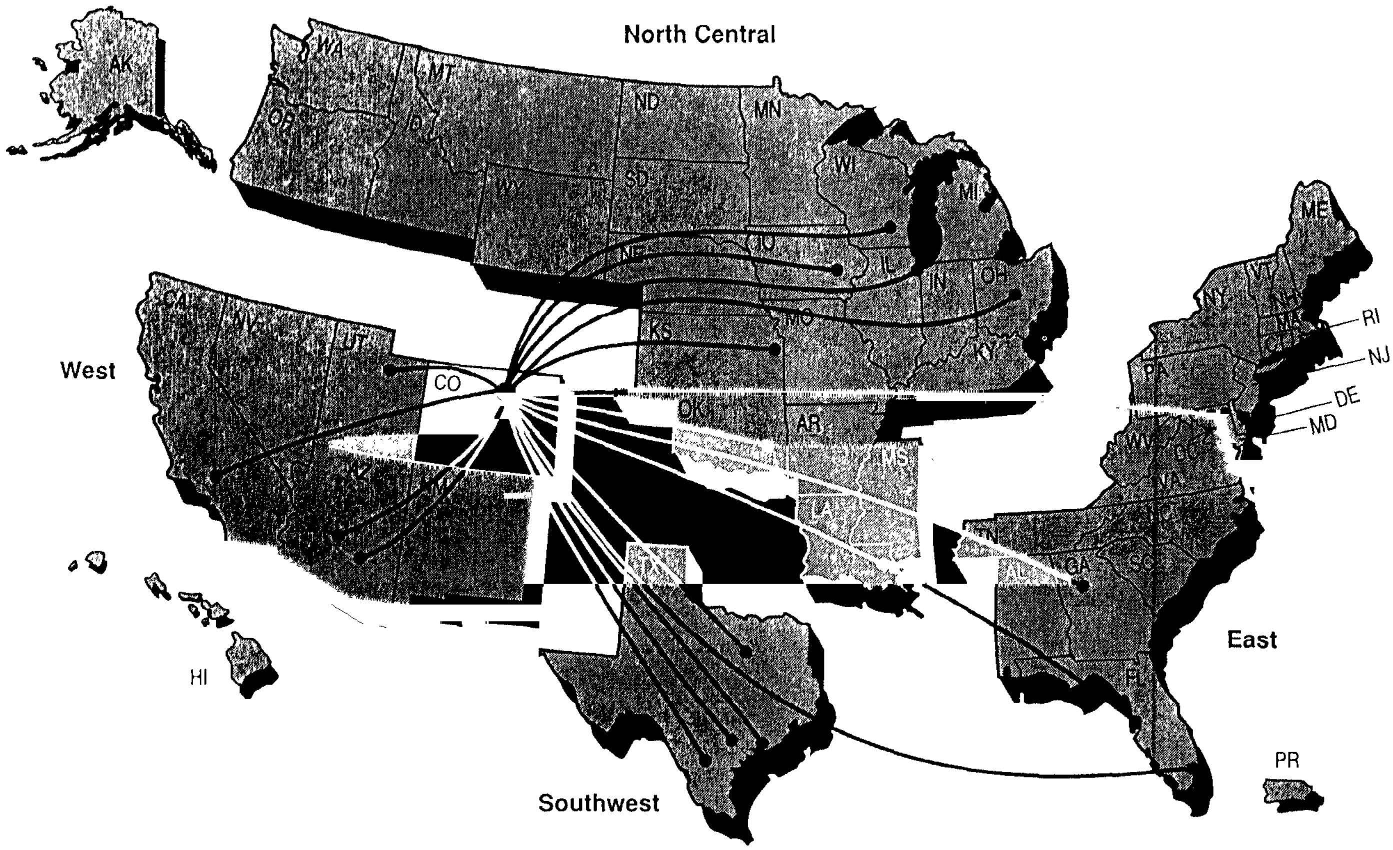


Figure 3.4: Management Offices for SAMDA Assets Located in the State of Florida

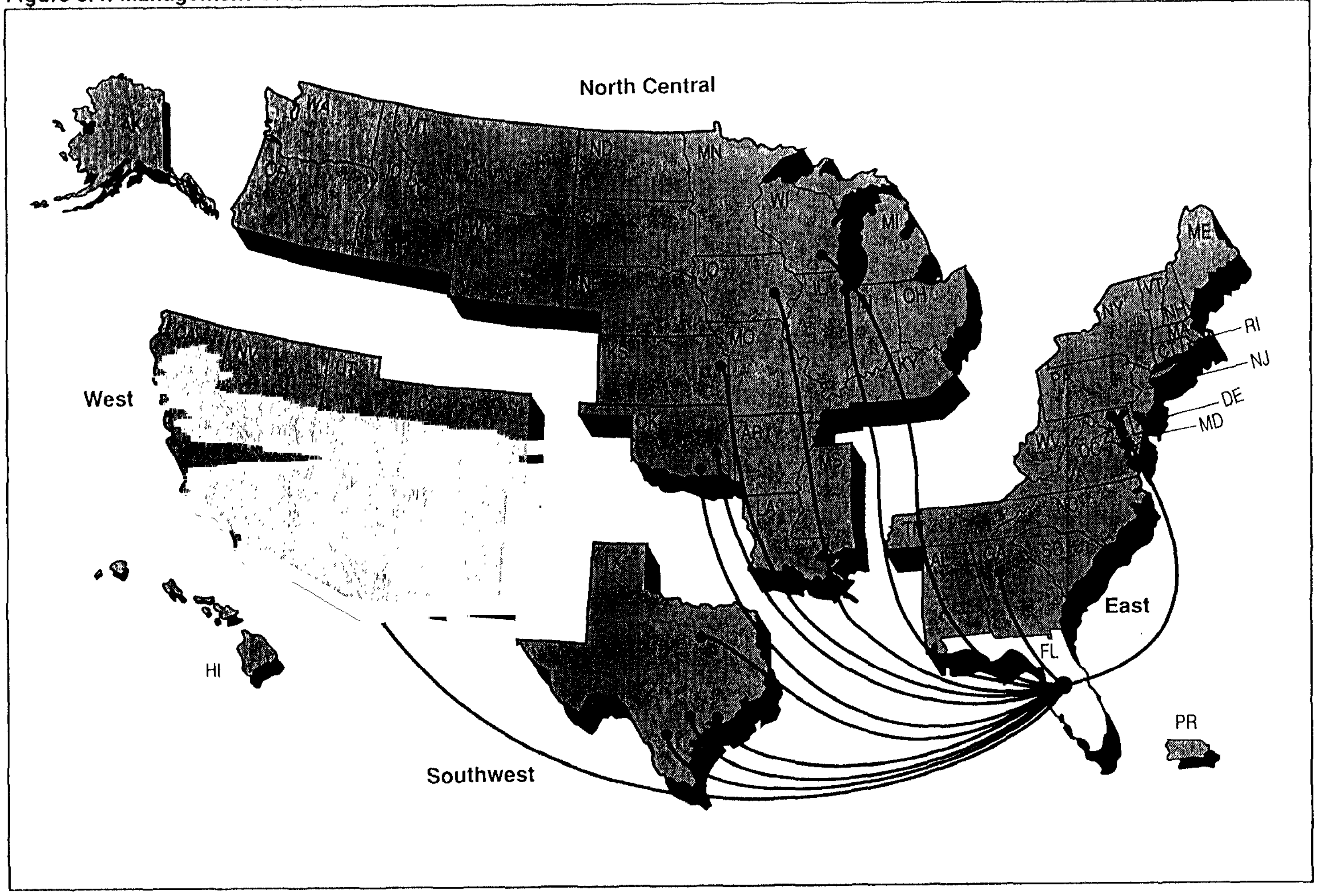
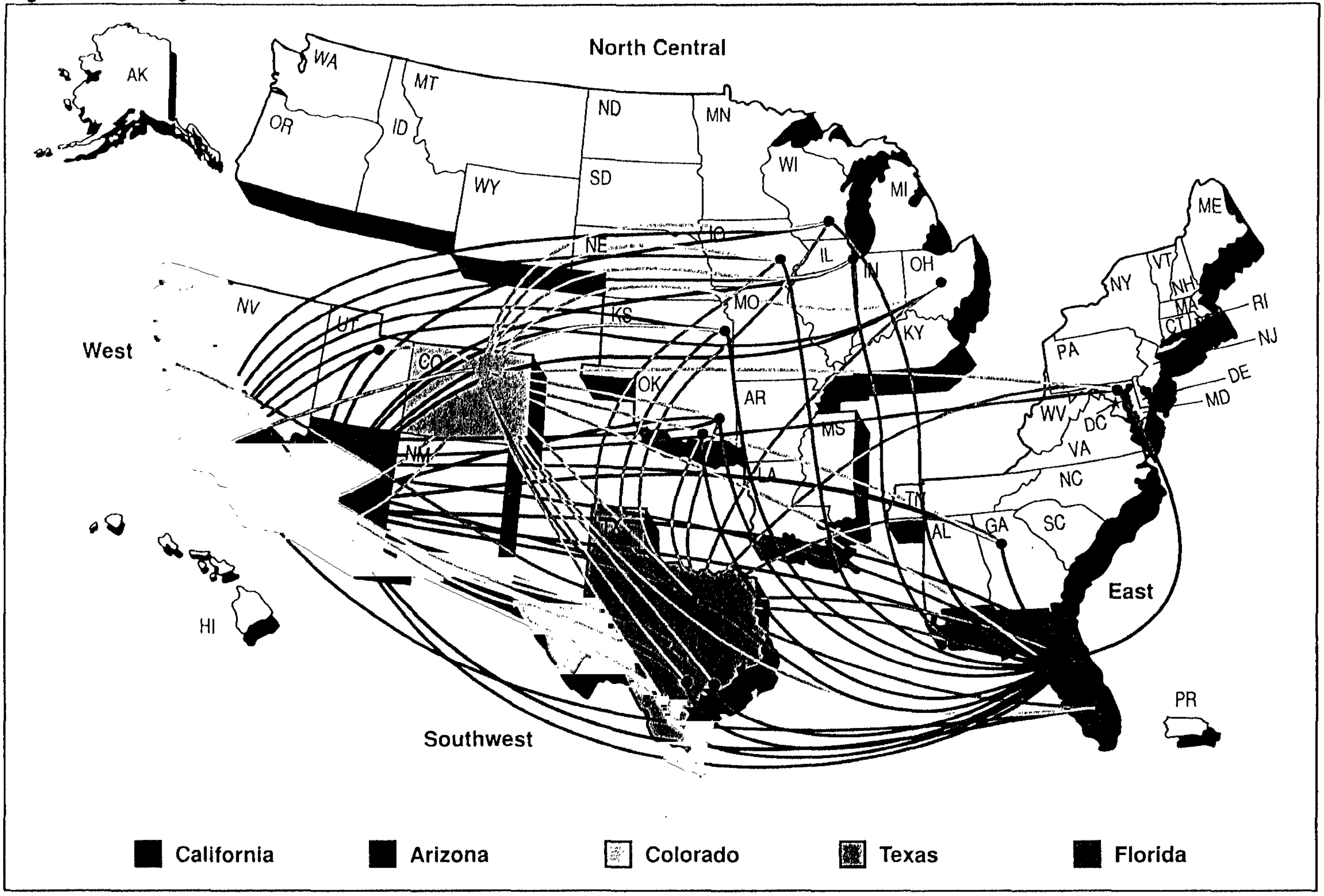


Figure 3.5: Management Offices for SAMDA Assets in All Five States



Portfolios With Dispersed Asset Locations Are Costly and Susceptible to Mismanagement or Waste

Under the terms of RTC's SAMDA, contractors must subcontract for certain types of services, including property management, brokerage, and appraisals. While this requirement enables local contractors to have a role in the management and disposition process for RTC properties and gives SAMDA contractors access to others with local market knowledge, it creates—under the best of circumstances—a wide span of control for many SAMDA contracts. Some of RTC's contractors have hired and must oversee the work of dozens of subcontractors in a number of locations. Thus, when portfolios contain assets with widespread geographic locations, RTC oversight managers and SAMDA contractors are left vulnerable to waste and mismanagement.

Compounding the risks caused by dispersion of portfolio assets, many assets from failed thrifts under SAMDA management have characteristics that make them susceptible to fraud, waste, and abuse. For example, SAMDA portfolios include properties that generate substantial amounts of income or require substantial expenditures for operations, the resolution of environmental problems, or completion of construction.

SAMDA contractors and RTC staff disclosed several key problems that could result from portfolios with dispersed assets, including increased contracting costs, weakened management controls over distant assets, reduced market knowledge, and reduced effectiveness of contract monitoring. For example, several contractors told us that their firms incurred extra costs because of the need to (1) set up offices in one or more other locations, (2) travel to visit the assets and monitor subcontractor performance, and (3) communicate among remote offices. RTC paid for these added costs through higher SAMDA contractor and subcontractor fees.

Contractors and oversight managers also said that widespread asset locations increased their span of control and thus the level of effort required to monitor subcontractor performance and asset condition. Although RTC requires periodic visits to many assets in SAMDA portfolios, contractors and RTC staff told us that assets located a long distance from the contractor's offices sometimes received less management attention and control.

The difficulty of developing in-depth knowledge of local markets increases as the number of asset locations in a single portfolio increases. As a result, portfolios with dispersed asset locations decrease the likelihood that RTC and its SAMDA contractors will have adequate knowledge of all of the relevant markets. Although SAMDA contractors must subcontract for property management and brokerage services, the contractors need some direct market knowledge to assess and control subcontractor performance and to ensure that returns received on the assets are reasonable. RTC oversight managers also need some direct knowledge in order to properly monitor SAMDA contractor performance.

Inadequate Information and Accounting Systems for Geographically Concentrated SAMDA Portfolios

Timely, accurate, and complete information is essential to support RTC's mission of managing and selling the assets of failed thrift institutions. However, even though RTC has been operating for 2-1/2 years, it still does not have adequate systems in place to fully support its mission. Specifically, the systems that RTC has had under development to support consolidated offices during the process of developing SAMDA asset portfolios—including the Real Estate Owned Management System and the Loans and Other Asset Inventory System—have not provided the intended RTC-wide benefits. RTC has experienced a number of problems with these systems, including unclear or changing requirements, inaccurate and incomplete data, poor response times, and software that was relatively difficult for its staff to use.[1] RTC also lacks accounting systems to keep track of individual assets if they are transferred among the consolidated offices. Taken together, these problems and systems limitations prevented RTC from developing SAMDA portfolios that minimized the dispersion of asset locations.

Asset Information Systems Were Inadequate

RTC designed its SAMDA portfolios relying almost exclusively on hybrid systems developed on an ad hoc basis by its consolidated offices. In his testimony before the Committee on Banking, Finance and Urban Affairs,[2] RTC's then Executive Director stated that:

> "Given that the RTC had to 'start up' operations with a very heavy workload, the RTC relied principally on existing systems and personal computers to support individual office and information management functions."

Consequently, consolidated offices developed asset portfolios using manual systems and PC-based spreadsheets at the outset. Some of the offices also designed and implemented their own automated systems to support contracting functions. As a result, RTC now has a number of incompatible local systems with information on thrift assets, and it still lacks an integrated, functioning information system to aid in the management and disposition of real estate and loans.

RTC's primary system for real estate assets is the Real Estate Owned Management System (REOMS), for which RTC awarded a contract in January 1991. When fully developed, it is to be a nationwide, on-line system for use in the management, sale, and accounting of real estate assets. However,

[1] Resolution Trust Corporation: Performance Assessment for 1991 (GAO/T-GGD-92-14, Feb. 20, 1991).

[2] Testimony of Resolution Trust Corporation before the RTC Task Force, Committee on Banking, Finance and Urban Affairs (Oct. 16, 1990).

the development of the system has suffered numerous setbacks. Further, the usefulness of REOMS has been reduced by significant system limitations and data integrity problems. As a result, it is not effectively supporting RTC's critical missions in asset management and sales. Its specific weaknesses include (1) inability to generate reports at operational levels, (2) slow and cumbersome processes for sales transactions and responses to customer queries, and (3) incomplete and inconsistent data.[3]

RTC is also developing an information system for loan management and sales called the Loans and Other Assets Inventory System (LOAIS). RTC needs such a system because loans represent the largest category of assets held by the failed thrifts. However, poor project management has characterized the development of LOAIS. Specific weaknesses with the system design include (1) the lack of a clear corporate strategy for the system, (2) inadequate definition of user requirements, (3) inadequate definition of system requirements and interfaces with other systems, and (4) a complex and time-consuming process for loading data into the system.[4] As a result, over half of RTC's loan data were not yet included in its LOAIS database as of February 1992. An RTC Western Region official told us that data were input on only 11 percent of the loans held by thrifts under its responsibility by that date.

Accounting System Limitations Prevented Asset Transfers

Although RTC issued a policy directive in February 1990 that said SAMDA portfolios should be structured to be homogenous by asset type and geographic location, consolidated offices could not implement the policy. Their capacities were limited not only by information systems weaknesses as stated previously but also by the parameters of RTC's accounting system.

RTC had to rely on Federal Deposit Insurance Corporation's (FDIC) Division of Corporate and Accounting Services (DACS) during the time the SAMDA portfolios we reviewed were being developed because it had no accounting system of its own. However, DACS' systems were not capable of meeting RTC's needs. FDIC designed its accounting system for an environment where relatively few banks were closed at one time and where asset management, disposition, and reporting occurred on an individual-bank basis. Because RTC closed hundreds of thrifts in less than 1 year's time and therefore had very large numbers of assets available for its

[3] Resolution Trust Corporation: Status of Real Estate Owned Management System (GAO/IMTEC-92-36BR, Mar. 5, 1992).

[4] Resolution Trust Corporation: Status of Loans and Other Assets Inventory System (GAO/IMTEC-92-35BR, Mar. 5, 1992).

SAMDA portfolios, it needed a system capable of inventorying and reporting on assets on a nationwide basis.

RTC officials said that DACS could not produce reports on individual thrift assets if they were transferred between consolidated offices. Because RTC had a fiduciary responsibility to creditors and shareholders—which meant that it had to be able to track income and expense items for each thrift's assets—the ability to report on transferred assets was a critical factor in decisions made on portfolio development.

An RTC Western Region official wrote a memorandum to headquarters management late in 1990 that recommended extending the concept of combining assets held by thrifts located in a single office's area to a wider area involving transfers among offices. Specifically, the official recommended developing a system for identifying, tracking, and monitoring assets that would transcend regional boundaries. His suggestion was never adopted. RTC officials stated that RTC did not want to transfer assets among offices to develop geographically concentrated portfolios because of the administrative and accounting difficulties involved.

Conclusions

Although RTC policies on portfolio development recognized the benefits of pooling assets by geographic location, many of the portfolios awarded to SAMDA contractors included real estate and loan collateral located from coast to coast. RTC had concentrations of assets in Arizona, California, Colorado, Florida, and Texas, but—primarily because of weaknesses in its information and accounting systems—it did little to structure geographically concentrated portfolios.

According to SAMDA contractors, portfolios with widespread asset locations increased contracting costs, hindered the contractors' ability to devote sufficient management attention to distant assets, reduced market knowledge, and made it difficult to monitor subcontractor performance. RTC staff also said that portfolios with dispersed assets made it more difficult to assess and monitor SAMDA contractor performance. Taken together, these conditions increased RTC's vulnerability to waste and mismanagement.

As RTC creates more SAMDA portfolios and adds assets to existing contracts, we believe RTC management should take steps to improve the ability of its offices to develop geographically concentrated portfolios.

Recommendations

We recommend that RTC's Chief Executive Officer

- resolve problems with information and accounting systems to ensure that they support effective asset management;
- encourage the transfer of management responsibility for assets between field offices to create geographically concentrated portfolios for new assets placed with contractors; and
- ensure that adequate management controls are maintained over SAMDA contracts, particularly in view of the widespread asset and subcontractor locations that exist now.

RTC Comments and Our Evaluation

RTC disagreed with two of the three recommendations made in this chapter. The two unimplemented recommendations focused on reducing the geographic dispersion of assets in SAMDA portfolios to reduce costs and improve the control and monitoring of RTC's assets.

RTC disagreed with our recommendation concerning transfer of management responsibility for assets between field offices. RTC asserted that attempts at "unilateral" changes to existing portfolios would not be productive. We agree. However, the thrust of our recommendation was to ensure that RTC make asset additions to existing portfolios and construct new portfolios in a manner that will minimize geographic dispersion. We recognize that RTC can probably do little to correct the administrative inefficiencies its past practices have created. However, we believe RTC will have significant opportunities to improve new portfolios as additional thrifts are closed with assets requiring management and disposition services.

In response to our other recommendation on geographic dispersion of assets, RTC denied that major problems or costs necessarily result from widespread SAMDA asset locations. We disagree. As discussed in this chapter, SAMDA contractors told us that geographically diverse portfolios increased their costs and, accordingly, RTC paid for these costs through higher fees. In addition, as discussed earlier, RTC's geographically dispersed portfolios have created a high risk of mismanagement with weak internal controls resulting from wide spans of control. Considering that over $30 billion of assets were managed under SAMDAS, we believe that RTC needs to take every step possible to reduce its vulnerability to fraud, waste, and mismanagement in the operation of these asset portfolios.

RTC agreed with our recommendation to resolve current problems with systems under development to support asset management and disposition activities, and RTC said that it has major work under way in that area.

Comments From the Resolution Trust Corporation

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

RTC
Resolution Trust Corporation

June 2, 1992

Mr. Richard L. Fogel
Assistant Comptroller General
U.S. General Accounting Office
General Government Division
Washington, D.C. 20548

Re: GAO Draft Report - "Asset Pooling and Marketing Practices Add Millions to Contract Costs"

Dear Mr. Fogel:

The subject report argues that RTC should generally have been much more careful and deliberate in analyzing individual assets and in assembling portfolios of assets to be managed and disposed of by contractors using our Standard Asset Management and Disposition Agreement (SAMDA). The GAO points out that some performing loans were included in SAMDA contracts and some SAMDA portfolio assets were either sold or paid off, or well on their way to resolution, at the time that SAMDA contracts were executed. Further, the report implies that the RTC should have waited in letting SAMDA contracts until it had fully developed accounting and information systems permitting much more sophisticated allocation of assets from multiple institutions into geographically concentrated portfolios.

See comment 1.

Although some of the examples chosen by GAO are instances of genuine concern to the RTC, we believe GAO is entirely focusing on a few "trees" while completely missing the "forest." The "forest" is the reality that RTC had a massive job of getting control over tens of billions of dollars of problem assets for which records and information systems and files were often missing or completely inadequate. This was to be done with new staff put together <u>after</u> the assets were assigned to RTC. The statutory mandate for RTC to use private resources (<u>i.e.</u>, contracting for services) to the maximum extent feasible, was appropriate under those circumstances.

See comment 2.

The quickly assembled RTC staff put the $35 billion in complex, problem assets out to SAMDA contractors as quickly as possible so that the resources of those contractors could do the careful review and organizing of those assets that was needed for management and effective disposition. RTC did not have the staff in-house to do that work; indeed that was the point of contracting. If RTC had set its goal to have <u>no</u> inappropriate

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See comment 3.

assets included in any SAMDA contracts, it would have meant vast delay. That would have greatly deferred getting appropriate management resources to the problem assets. The losses which would have been incurred by such an irresponsible policy would have greatly outweighed any additional fees from the very small number of inappropriate assets which did, in fact, get included in SAMDA contracts. Even if the "excess" fee estimate of $4.5 million used by GAO were true, that would be less than one one-hundredth of one percent of the book value of the assets assigned to over 100 SAMDA contractors. The delay in getting those assets into the hands of competent asset management and disposition staff (which would have resulted if RTC had followed the GAO after-the-fact advice) would have increased losses to the taxpayer from the savings and loan crisis far beyond the one one-hundredth of one percent focused on by GAO.

GAO's specific estimates of costs from inappropriate assets being included in SAMDA contracts are substantially flawed.

See comment 4.

GAO claims that RTC paid $2.8 million unnecessarily for management of performing loans in SAMDA contracts. This figure (which accounts for the bulk of the $4.5 million gross "excess" fees alleged by GAO) has no basis in reality. GAO claims that no asset management for these loans was necessary because loan servicers had already been hired. Asset management is a necessary function <u>in addition to</u> loan servicing. It is a function which must be performed by institution staff, by in-house RTC staff or by contract staff. Asset management is a cost that must be borne. It is an essential cost, not an "excess" payment.

It is true that RTC strongly prefers not to include performing loans in SAMDA contracts because the incentive structure of SAMDA disposition fees is designed for managing and disposing of assets requiring a different kind and level of involvement than does managing performing assets. However, RTC has not absolutely prohibited its staff from including performing loans because it recognizes, in some circumstances, especially when other asset management is not immediately available, that inclusion of performing loans in a SAMDA contract is reasonable. RTC agrees that some offices in the early rush of establishing SAMDA contracts did include more performing loans than strictly necessary.

See comment 5.

Even in those circumstances, however, RTC does not agree that the entire fee for management and disposition of those loans is excessive, or that any of the fee is necessarily excessive. Contractors bid management fees as a cash amount based on their expected workload in managing the <u>particular</u> portfolio upon which they are bidding. The disposition fees also reflect the nature

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of the actual portfolio. Fees are bid in a competitive market. Any contractor hoping for "excessive" fees would tend to be driven out by competition in the bidding. To the extent that large numbers of performing loans were included in a portfolio, that fact was known to prospective contractors and would certainly be a factor in their bidding. Although individual instances vary, competitive bidding generally does produce the best pricing under the circumstances, and thus there is no evidence offered by GAO that the fees bid on portfolios including performing loans were inappropriate for the particular mix of assets upon which the contractors were bidding. In other words, the inclusion of performing loans would be reflected in the SAMDA fee bidding.

See comment 6.

GAO is particularly concerned that SAMDA contractors received windfalls by fees on assets for which they did little or no work. A homeowner who sells his or her house quickly through a real estate agent often feels that the real estate agent received a windfall in the commission, but those engaged in the real estate business know that on a volume basis, windfalls are averaged out by those other properties which require extraordinary work for little or no fee. GAO seems to miss entirely that basic tenet of commission disposition of assets.

RTC has been inundated with complaints from contractors who have lost fees because of factors they did not predict about the assets in their SAMDA portfolios. They often find large, unpaid prior tax liens which virtually wipe out the net proceeds from sale, tremendously reducing their disposition fees, but not their work. Often they find that Estimated Recovery Values (ERVs) set by RTC were unrealistically high because RTC overlooked, or was unaware of, many factors; that greatly reduces disposition fees. GAO suggests that we could unilaterally go back and renegotiate fees on those assets when it was in our interest to do so and totally ignore the multiplicity of claims to renegotiate fees when it is not in our interest. That is unrealistic. Further, if RTC had offered its contracts with one-sided provisions authorizing RTC to take such unilateral actions, that would have been taken into account in the competitive bidding and would have greatly driven up overall fees, probably beyond any reasonable possibility of recovery.

See comment 7.

GAO believes that RTC should unilaterally renegotiate fees when assets were sold primarily through the efforts of RTC's Sales Centers. Again, there is no basis for such unilateral reduction in fees nor is there any expectation that SAMDA contractors would voluntarily agree to such reductions. It is true that when RTC Sales Centers sell assets that are also within a SAMDA contractor portfolio, there is an overlap of functions. With the job faced by RTC, however, it has been necessary to aggressively and

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creatively try multiple strategies for disposition. Any difficulty arising from conflicts between sales through SAMDA contractors and sales through the Sales Centers, we believe, has been well covered by the advantages of disposing of assets through wholesale (portfolio and auction) techniques rather than relying only on the more retail oriented process of the SAMDA contractors.

There are problems in trying and adopting new policies, but the cost of not doing so for an organization with the task of the RTC greatly exceeds the cost of having that aggressiveness and flexibility.

See comment 8.

GAO also criticizes RTC for not assembling all SAMDA portfolios on a geographic basis. RTC agrees there would be some general advantage to geographic concentration and concentration by asset type. We do not agree that RTC should have held its SAMDA contracting until after developing the accounting and asset information systems needed to be able to do that on a national level. The delay in getting the needed attention brought to the assets by SAMDA contractors would have been costly indeed. In addition, we believe that GAO greatly overestimates the value of geographically concentrated portfolios.

See comment 9.

Many portfolios did have a significant concentration of assets, especially in those areas with a large number of assets identified in a GAO report. Often national asset management companies would win such SAMDA contracts against more locally focused companies because the combination of cost and technical skill on which the selection is based proved them the most cost effective. Asset management should not be confused with property management, which is required to be at the property site. Asset management for loan assets, in particular, is often performed by entities distant from some or all of the assets and their collateral. Travel cost is only one small factor in determining the cost and competence of an asset management contractor. It is simplistic to take that factor out of all proportion, as does GAO with no empirical analysis to support such a presumption.

The RTC has the following specific comments on recommendations stated in the report:

1. Improve controls over assets included in future SAMDA portfolios by identifying and excluding (1) assets which would more appropriately be disposed of through direct RTC sales, (2) real estate which has already been sold or which is under contract for sale with imminent closings, and (3) loans which had already been paid by the borrowers or are nearly-settled, and

performing loans which will be managed by loan servicing contractors.

Comments:

See chapter 2.

The recommendation does reflect RTC policy and now that the major portion of SAMDA contracting is passed, we expect that fewer inappropriate assets will be included in SAMDA contracts. To some extent, some errors in judgment and guessing the future will continue to be made. A sale which appears imminent often does not occur and those assets should not be excluded from SAMDA portfolios for that reasons. Some tough judgment calls will be necessary and some of them will be wrong. The same holds true for "nearly settled" loans.

For performing (and nonperforming) loans, the choice is not between asset management and loan servicing. All such assets will require both. RTC policy is generally not to include performing loans in SAMDA contracts, but there may still be some circumstances when that is the best asset management alternative available for the asset.

Finally, the RTC has developed Standard Asset Management Amendments (SAMAs) for SAMDA contracts. Assets targeted for RTC-sponsored sales initiatives that require professional, interim management services (until the assets are sold by the RTC) may be given to contractors under the SAMA. The contractors do not provide disposition services for SAMA assets, and therefore earn no disposition fees when assets are sold by the RTC (although a nominal "transfer fee" is earned at the time of sale to compensate the contractor for assistance in closing the sale). Accordingly, total fees for SAMA assets should be significantly less than the management, disposition, and incentives fees that would be paid under the SAMDA.

See chapter 2.

2. Revise RTC's SAMDA to clearly avoid the payment of unearned or duplicative fees to contractors entering into agreements with RTC in the future, by including provisions covering removals of assets without payment of fees when post-award discoveries are made of assets requiring little or no services from the contractors.

Comments:

RTC believes that including such a one-sided provision in the SAMDA would simply raise SAMDA fees bid far

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beyond any expectation of recovery through the provision.

See chapter 2.

3. Renegotiate disposition fees payable to SAMDA contractors on assets included in Sales Center marketing efforts or sold through other direct RTC sales or disposition activities to avoid payments of unearned or duplicate fees.

Comments:

Negotiation is a mutually voluntary activity. There is no contractual basis for RTC unilaterally making retroactive changes in its own favor. Any attempt to renegotiate fees in the RTC's favor would open up contractors' attempts to renegotiate all of the many fees which have proven disadvantageous to the contractors. RTC believes the recommendation would be poor contract management.

See chapter 2.

4. Improve management controls over portfolio development and fee payments to ensure that RTC staff have adequate guidance on structuring and making changes to SAMDA portfolios, and that they follow consistent practices in their treatment of SAMDA contractors.

Comments:

The reorganization of SAMDA management into six offices working directly with the Washington Office will greatly facilitate a higher degree of uniformity in management practices within the RTC. We believe that portfolio assembly policies are well understood by RTC staff, although very little new SAMDA contracting is taking place at this time.

See chapter 3.

5. Resolve problems with information and accounting systems to ensure that they support effective asset management.

Comments:

Major work is underway to improve and implement the Real Estate Owned Management System (REOMS) and the Asset Manager System (AMS) which will greatly facilitate and support asset management.

See chapter 3.

See chapter 3.

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6. Encourage the transfer of management responsibility for assets between field offices to create geographically concentrated portfolios for asset management contractors.

Comments:

Portfolios of existing SAMDA contracts cannot unilaterally be changed and attempts to do so would not be productive. RTC has issued policies requiring that REO assets of value over $1 million be managed by the nearest RTC office when feasible to do so.

7. Ensure that adequate management controls are maintained over SAMDA contracts, particularly in view of the widespread asset and subcontractor locations in the current environment.

Comments:

RTC continues to work to improve management information systems and management controls over SAMDA contracts. We do not believe that the "widespread asset and subcontractors locations in the current environment" create any major problems or costs.

Thank you for the opportunity to comment on the subject draft report. Should you have any questions, please feel free to contact Robert I. Dodge, Assistant Director for SAMDA Program Management, at (202) 416-7475.

Sincerely,

Lamar Kelly

Lamar C. Kelly, Jr.
Senior Vice President
Asset Management and Sales
Division

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GAO Comments

The following are GAO's comments on the Resolution Trust Corporation's letter dated June 2, 1992.

1. We did not imply that RTC delay outside contracting until it had "fully developed" accounting and information systems. Instead, we concluded that RTC lacked even the most basic of asset information systems and that such systems would have enabled it to have implemented its own portfolio policies. Our audit work showed that RTC could have used its own employees to perform much of the needed information analysis to identify assets that should not have been included in SAMDA portfolios. Further, as discussed in chapter 3, RTC ignored recommendations by its staff to decrease the geographic diversity of SAMDA portfolios. Accordingly, RTC management was aware of this problem but took no corrective actions.

2. RTC's assertion that our report focused on a few "trees" instead of the "forest," which its overall mission represented, ignores the implications of our results. Because we analyzed only a sample of cases, actual losses RTC incurred were likely larger than the amounts reported. The language contained in FIRREA should not be used to justify costly and risky portfolios in order to quickly make use of private sector asset management services. FIRREA authorizes RTC to select a "practical and efficient" means of managing and disposing of assets from the failed thrifts. Our report points out that, in many cases, RTC could have taken additional actions to ensure that the SAMDA portfolios it designed contained the properties that needed this type of management. RTC's use of the private sector does not affect its responsibility to minimize its cost of asset disposition. Our concern is that RTC has to have better controls over managing and assigning assets to SAMDA contractors in order to avoid paying unnecessary costs.

RTC also said that it did not have the in-house staff available to carefully review the portfolios before issuing SAMDA contracts and that this was a service to be provided by contractors. We disagree. The SAMDA contractors could do little to improve the efficiency of poorly constructed portfolios. We believe that RTC, and not its SAMDA contractors, has the responsibility to ensure that its contracting program is efficiently structured. To that end, RTC should have obtained the needed additional temporary staff or consultant assistance.

3. RTC argued that "vast" and "costly" delays would have resulted had its own staff attempted to analyze thrift asset information. We believe this was not the case. As discussed in chapter 2 of the report, three RTC offices took actions to carefully review their portfolios before signing contracts

with SAMDA contractors and thus avoided payment of unearned fees. This process did not create significant delays.

RTC stated that a $4.5 million loss was a small loss in comparison to the value of the portfolios and that delays in hiring contractors would have created far greater losses. We agree that delays in hiring the contractors could have resulted in losses. However, RTC had over a year before the first SAMDA contract was awarded. It was during this period of time that we believe RTC could have developed portfolios that better protected the interests of the taxpayers. Furthermore, as previously discussed, three RTC offices minimized losses without delays in issuing the contracts.

4. RTC said that our reported estimates of excess costs were "substantially flawed," because amounts paid to SAMDA contractors for the management of performing loans were in fact earned. However, RTC also said that it strongly preferred excluding performing loans from SAMDA portfolios because they require a "different kind and level of involvement" on the part of the contractor. As discussed in chapter 2, SAMDA contractors performed no substantial management or disposition services in relation to performing loans included in their portfolios, and RTC's loan servicing contractors processed and accounted for payments received from borrowers.

5. RTC also argued that SAMDA contractors competitively bid lower fees for portfolios containing performing loans and that, as a result, no unearned management fees were paid. RTC assumes that contractors had full and complete information regarding the quality of assets to be placed in SAMDA portfolios. Accordingly, contractors would use this information to precisely calculate their bids. However, in subsequent comments, RTC said that SAMDA contractors frequently did not know the exact composition or quality of their portfolios before submitting their bids. Accordingly, they could not have accurately based their bids on the amount of work required to manage actual assets in the portfolios.

6. RTC also challenged our assertion that SAMDA contractors received "windfalls by fees on assets on which they did little or no work." RTC said that in a commission system, the "windfalls" are "averaged out" by those properties requiring "extraordinary work." We accept that basic tenet of commission work. However, we believe that principle is inapplicable to the facts identified by our work. We found that rather than averaging easy sales with difficult sales, RTC has paid for unneeded work. As discussed in

chapter 2, RTC made full payments to SAMDA contractors for essentially no work.

7. We did not say that RTC should unilaterally renegotiate contractor fees. Instead, the report recommended that RTC should make certain efforts to avoid payment of unearned or duplicate fees. RTC could offer SAMDA contractors new assets in exchange for modifications relating to sold or nearly sold assets and other assets requiring minimal services. For example, numerous SAMDA contractors recently signed an amendment package with RTC reducing fees for new assets requiring management services only.

8. We did not say that RTC should have delayed its formal contracting process for placing assets in SAMDA portfolios. We believe that RTC did not immediately take appropriate steps to minimize the diversity of portfolios. As discussed in the report, although RTC offices suggested in late 1990 that related assets should be combined, RTC management did not implement the recommendation. Accordingly, we believe that geographic consolidation was never done, because RTC management never emphasized correcting the problem.

9. We have not confused asset management with property management. We agree that both asset and property management need to be done. Regardless of the type of management performed, as discussed in the chapter, SAMDA contractors said that additional costs were incurred to manage geographically diverse SAMDA portfolios. The contractors also said that these costs were paid for by RTC through higher fees.

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