CHAPTER 13

Auctions and Sealed Bids

Introduction

This chapter reviews the use of auctions and sealed bid marketing strategies by the Federal Deposit Insurance Corporation (FDIC) and the Resolution Trust Corporation (RTC). It examines how the FDIC and the RTC marketed loans through the sealed bid process, how they used auctions to sell loans, and how they used sealed bid sales and auctions to sell real estate that they held.

Asset disposition methods evolved from a strategy whereby FDIC account officers managed individual delinquent loans from beginning to end to a later strategy in which account officers managed loans using asset marketing techniques and auction or sealed bid marketing strategies in single, planned marketing events aimed at the disposal of a high volume of loans. Those strategies focused primarily on the disposition of nonperforming loans and real estate and, to a lesser extent, of performing loan portfolios.

Background

During the early 1980s, the FDIC adopted a workout strategy for dealing with acquired nonperforming loans. That strategy usually involved assigning delinquent loans to specific account officers, who would be responsible for negotiating repayment, restructure, or settlement of the debts with borrowers. To bring about final debt resolution, they frequently had to use litigation, foreclosure, or sale of available collateral. The strategy was similar to the approach that private and public entities used in handling delinquent loans.

As early as 1976, with the packaging and sale of performing residential and commercial mortgages that originated out of the Birmingham-Bloomfield Bank in a suburb of Detroit, Michigan, the FDIC began exploring the potential of whole loan sales. In the same year, there were several other whole loan sales; however, the FDIC did not make a concerted effort to package loans for resale until 1984.

Several factors prompted the move toward selling loans. First, the late 1970s and early 1980s were periods of record high interest rates that caused rapid deterioration in the value of the FDIC's mortgage portfolio. The growing cost to the receiverships, caused by severe value erosion, inspired a review of policy guidance. Second, failing bank activity was on the increase and the FDIC saw its receivership asset holdings increase to record levels. To avoid the volatility associated with holding assets, the FDIC adopted a policy of selling performing loans in large packages as early as practicable. It based prices on prevailing market interest rates and loan quality. Essentially, the FDIC sold the packages as sealed bid loan sales at the point of loan acquisition, or soon thereafter, and elected not to speculate on the direction of interest rates.

In a sealed bid loan sale, interested bidders submit their bids, usually in a sealed envelope, for pools they wish to purchase. Each loan pool is sold to the bidder with the highest bid, assuming it satisfies any minimum acceptable bid or reserve requirements of the FDIC. Rights and title to the pool are transferred to the purchaser upon receipt of the bid price, usually payable by wire or certified check.

FDIC Loan Sales Program

By the end of 1984, the FDIC initiated a formal loan sales program, known as the Asset Marketing Program, to accelerate the disposition of assets acquired from failed banks. Implementation of the program originated with the various regional offices, consolidated offices, and field sites with policy oversight from Washington, D.C.

The FDIC's asset marketing efforts at that time were directed toward performing loans of all types and sizes. As workload increased, the FDIC began to emphasize the sale of nonperforming loans, especially those with small individual balances (generally under $10,000). Although small loans made up the vast majority of the number of loans held by the FDIC, in the aggregate their total value represented a small fraction of the value of the receivership portfolios. Thus, by accelerating the disposition of those small loans, account officers could focus on larger loans that offered higher recoveries. In many cases, smaller loans were service intensive and efforts to collect on those loans were comparable to servicing larger loans with much higher realizable values. The first FDIC sale of nonperforming loans was conducted by the Atlanta office in the fourth quarter of 1985. It was a small sale conducted under regional authority with a value of approximately $1.5 million.

The FDIC packaged loans in pools based on size, asset quality, asset type, and geographic location. Asset types included installment paper, residential real estate mortgages, commercial mortgages, agricultural loans, charged-off loans, loans secured by mobile homes, timeshare loans, other real estate mortgages, business loans, and unsecured paper. Account officers assigned individual asset values based on projected cash flows and established minimum reserve prices for each package. The FDIC initially relied exclusively on in-house staff to perform all tasks associated with identifying, preparing, pricing, marketing, and closing loan sale transactions. By the late 1980s and early 1990s, however, it occasionally used contractors to run open outcry auctions and perform due diligence on performing mortgage portfolios and large nonperforming sales; but predominantly, the FDIC used in-house resources.

After firmly establishing asset marketing as an important liquidation strategy, the momentum in the loan sales area began to increase. By the end of the third quarter of 1986, the FDIC had closed 101 sales for the year, resulting in the transfer of 104,000 distressed loans to the private sector. Nationally, goals were set to dispose of all loans with individual balances of $5,000 or less. In several regions, the target was raised to $25,000. Because those loans were severely distressed, selling prices averaged in the 2 percent to 10 percent of book value range. The FDIC enjoyed substantial savings, by avoiding long-term servicing costs.

An important outgrowth of the asset marketing effort was increased emphasis on selling loan portfolios immediately after bank failure, which was in contrast to previous strategies in which the FDIC assigned individual assets to account officers for long-term collection activity with the possibility of packaging the assets in pools for sale. In many cases, the FDIC was successful in selling small portfolios soon after a bank failure. For example, in 1986, with the Southwest experiencing a substantial number of bank failures, the Dallas and Oklahoma City offices were forced to pursue portfolio sales immediately upon bank failure. The Dallas office successfully sold a portfolio of performing and nonperforming assets from two new receiverships and packaged the assets according to size and asset quality.

In 1987, 574 sales transactions resulted in the disposition of 91,123 loans. (See table I.13-1.) The total book value sold was $860.4 million and actual sale proceeds were $303.3 million, which was equivalent to 92 percent of the estimated value. Because the FDIC was unwilling to provide financing at that time, all transactions were on a cash basis. That year, the FDIC began experimenting more aggressively in the asset marketing arena. It examined bulk sales as a means of selling the remaining portfolios of entire offices that were winding down and ready to be closed. By the first quarter of 1988, the FDIC was able to sell most of the remaining loans in the St. Joseph, Missouri, office. Similarly, the FDIC sold roughly 2,500 loans with a book value of $54.5 million before closing the Omaha, Nebraska, office. The FDIC expanded and contracted its office locations throughout the 1980s and 1990s. When a large number of banks failed in one part of the country, the FDIC would set up an office close to the customers of those banks. As the local economies improved and fewer banks were closed, the FDIC reduced the number of its office locations in those parts of the country. To effectively reduce the remaining loan inventory of a closing office, the FDIC would arrange a sale of as many of the saleable assets as possible before that office closed.

Also in 1987, the FDIC developed a data processing program that selected loans within specific, predetermined parameters to be packaged for sale. If the loans were performing, the program had the ability to price the package. If the loans were nonperforming, the system could not compute the price, and internal staff or outside contractors would individually value the assets.

As the Asset Marketing Program grew in size and complexity, the FDIC developed policies to cover the basic parameters for conducting sealed bid sales. Those policies established delegation of authority, uniform procedures for estimating asset values, methods for establishing minimum or reserve prices, reporting requirements, appropriate information on disclosure to bidders, guidelines for sale of larger loans, and guidelines for sale of government guaranteed loans.

By using the Asset Marketing Program as a loan disposition strategy in the late 1980s and early 1990s, the FDIC was able to reduce the burden of acquiring a high volume of loans and to increase the liquidity of its insurance fund. The FDIC concentrated on three types of loan sales: small assets, severely distressed assets, and performing loans.

Table I.13-1

FDIC Sealed Bid Loan Sales

($ in Thousands)

Year	Number of Loans Sold*	Book Value	Estimated Value	Sales Price	Sales Price as a Percentage of Book Value
1986	128,779	$341,983	$156,606	$177,993	52.1
1987	91,123	860,360	331,071	303,338	35.3
1988	71,865	875,419	315,490	276,061	31.5
1989	28,284	493,132	213,597	210,778	42.7
1990	106,668	1,341,397	673,515	645,596	48.1
1991	143,462	2,119,000	1,413,000	1,452,000	68.5
1992	96,529	4,094,093	3,157,408	3,253,847	79.5
1993	136,347	5,386,787	3,338,579	3,332,402	61.9
1994	63,780	4,562,358	2,608,154	2,654,237	58.2
Totals/ Average	**866,837**	**$20,074,529**	**$12,207,420**	**$12,306,252**	**61.3**

* Includes performing and nonperforming loans.

Source: FDIC Division of Resolutions and Receiverships.

RTC Loan Sales Program

The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 mandated that the RTC dispose of its assets in a manner that would maximize the net present value return from the sale or other disposition of savings institutions and their assets. Early on, the RTC implemented the Bulk Sale Program, which initially focused on the RTC's vast holdings of performing residential and commercial mortgages. At first, the RTC adopted the FDIC methodology of internally packaging and selling asset portfolios, which was a logical step, given that, at that time, most of the RTC staff and the key managers were FDIC employees.

Like the FDIC, the RTC characterized and formulated its sealed bid sales to ensure maximum exposure to investors and purchasers and to secure the highest possible return. The RTC marketed its sealed bid sales widely and opened them to all bidders who either prequalified or paid an up-front "admission" fee. It grouped loans in homogeneous pools by size, asset type, performing or nonperforming status, quality, geographic distribution, and maturity. Other similarities also existed between the FDIC and RTC programs. For example, both agencies priced portfolios using a discounted cash flow methodology, which guided decisions regarding appropriate reserves for each transaction. Both employed aggressive and broad marketing tactics to ensure the maximum level of competition; as a rule, they always accepted the highest conforming bid.

Some critical differences developed between the agencies, however, in how they conducted sales. The RTC had a unique mission, and workload demands were virtually unprecedented. Also, it was a taxpayer-funded agency. Because of its relatively short life, the RTC had to hire many private-sector employees who had different philosophies than the FDIC had on the best strategies to use in selling assets.

By 1990, the RTC was relying predominantly on private-sector firms to evaluate, package, and market its loan portfolios. Wall Street investment houses, as well as other firms with comparable credentials, routinely assisted in all phases of selling those portfolios. The RTC relied on private-sector firms for a number of reasons. First, the RTC was reluctant to hire the additional thousands of employees that would have been necessary to successfully manage the large workload. Second, the RTC portfolio included sophisticated portfolios of securities, real estate projects, and other assets the size and complexity of which exceeded the training and technical skills of most of the existing RTC staff; such portfolio management required the expertise of professionals in the private sector. Third, because the RTC was selling in a depressed market, its use of private firms, particularly those with established reputations, lent more credibility to its valuation methodology, due diligence work, and marketing techniques. Finally, the legislation creating the RTC required the agency to use the private sector whenever it was deemed efficient and cost-effective.

By September 1990, the RTC established a national sales center in Washington, D.C., which assumed direct responsibility for overseeing the sale of assets. It then set up regional sales centers in each field office. The RTC contracted out more of the work associated with the sales to private firms. One set of contracts was for the due diligence and evaluation work that involved identifying saleable assets, preparing files for investor review, evaluating the product, and pricing. The second set of contracts was for financial analysis from advisers who were responsible for making recommendations on appropriate packaging, marketing methods, negotiations, bid evaluation, and final closing.

The RTC adopted the use of seller financing as a marketing tool for nonperforming asset portfolio sales. That development came about because most of the RTC's assets were real estate based, and disposition was hampered by a nationwide decline in the real estate markets, which forced the agency to adopt a more aggressive posture to achieve loan sales.

Structured Transactions

In 1991, to boost the demand for nonperforming multi-family and commercial mortgages and other real estate, the RTC formally introduced the Structured Transaction Program. A structured transaction was a form of portfolio sale created to achieve a high volume of portfolio sales, as opposed to the sale of commercial assets on an individual basis. The national sales center, and subsequently the regional sales centers, conducted structured transactions by structuring the portfolios into packages based on input from investor groups. They generally organized the packages by institution, by groups of specific products (for example, office buildings, nursing homes, golf courses, offices, and hotels and motels), or by geographic location. They then offered the structured portfolios for competitive bidding. The preferred transaction was one that had 50 to 100 assets and a book value between $100 million and $150 million.

The RTC supplied three types of financing: bridge, term, and step-rate. Bridge financing was set up to be refinanced within two years. Term financing typically was a seven-year fixed payment loan to be repaid from the disposition of the asset pool over the life of the loan. Step-rate financing had an initial interest rate below current market rates that progressively increased over the term of the loan. If held to maturity, the interest rate on a step-rate loan eventually would exceed the market rate available at the time of settlement. The RTC designed the step-rate loans to accommodate cash flows from a pool of assets; initially, they might be insufficient to pay a market rate of interest, but as cash flows increase over time, payments on increasing interest rates could be maintained.

The direct costs for selling $19.6 billion in book value of assets through the Structured Transaction Program was approximately $173 million, or 0.9 percent of the value of loans sold. Because structured transactions garnered proceeds of $10.7 billion, however, direct costs represented 1.62 percent of recoveries. (See table I.13-2 for a summary of the RTC structured transactions.)

Asset Valuation Procedures

In determining its asset valuation procedures, the RTC first looked at how the FDIC operated. At the FDIC, which relied on in-house staff to value assets for bulk sale

Table I.13-2

Summary of RTC Structured Transactions 1990–1995

($ in Thousands)

Year	No. of Transactions	Book Value	Derived Investment Value*	Sales Price	Sales Price as a Percentage of Book Value
1990	2	$362,088.8	$362,088.8	$259,189.5	71.6
1991	29	5,203,268.9	4,018,809.0	3,246,103.2	62.4
1992	32	8,615,621.1	4,451,556.7	4,013,784.0	46.6
1993	28	5,421,141.9	2,969,252.8	3,153,523.6	58.2
1994	1	28,303.5	28,303.5	28,367.3	100.2
1995	0	0	0	0	0
Totals	**92**	**$19,630,424.2**	**$11,830,010.8**	**$10,700,967.6**	**54.5**

* Derived investment value (DIV) was an internal RTC reference to a means of calculating the net present value of a nonperforming loan. It was used to establish reserve prices for assets to be sold as whole loans and as a benchmark for nonperforming loan sales.

Source: RTC Megaport Automated Information System.

purposes, account officers would estimate projected collections from all sources of recovery (collateral, guarantors, borrowers, and so forth), subtract anticipated expenses, and apply a present value to the cash flows to arrive at an individual asset's estimated value. The RTC decided to turn to the private sector. Because the sheer volume of work was beyond the RTC in-house capability, it hired private professional firms to perform due diligence and asset valuation work.

The RTC relied on an asset valuation methodology developed by a national real estate and financial consulting firm. That methodology, known as the derived investment value (DIV), attempted to value individual assets packaged for portfolio sales as investors would perceive the value of those assets. Cash flow projections were based predominantly on actual cash flows generated by collateral with little, if any, weight given to increased "lease-ups," guarantor and borrower financials, or other sources that were more speculative and subjective. Critics of DIV believed the methodology systematically generated lower valuations than were appropriate. Critics of the FDIC's approach believed, however, their valuations were unduly optimistic and relied too heavily on in-house staff projections that failed to adequately discount for marketplace realities.

Although both agencies used reserves to set base prices and required wide marketing to ensure maximum competition, the RTC was more inclined to accept bids that were lower than anticipated, thereby relying on the philosophy that the properties were only worth what reasonable bidders were willing to pay. The FDIC's approach was more appraisal driven and relied more on internal reserves to set guideposts for determining the acceptability of bids. If the bids were not comparable with the internally derived value, they were rejected.

Representations and Warranties

Representations and warranties are a set of legally binding statements drawn by the seller to give buyers the assurance that assets being sold meet certain qualitative expectations. They are accompanied by obligations to cure conditions that are breaches of the original representations, as well as remedies available to the investor, if the condition cannot be cured. Such remedies may require the seller to repurchase or replace an asset in the original pool.

Consistent with an ongoing effort to be market oriented and generate maximum competition and sales results, the RTC initially gave more representations and warranties associated with loan sale packages than was customary at the FDIC. By 1994, the RTC and the FDIC offered generally comparable representations and warranties for the sale of similar loan products. In some instances, such as in the bulk sale of performing and nonperforming commercial real estate mortgages (including securitization), the RTC set the standards. In other instances, such as in large bulk sales of performing residential and multi-family mortgages, the secondary market had already established the acceptable level of representations and warranties.

The majority of the FDIC loan sales consisted of small, nonperforming loans that required only limited representations and warranties. The warranties stated that (1) there had been no discharge in bankruptcy of debt represented by the loan(s), (2) there was no voidance of the debt obligation by any court, and (3) there had been no release of the debtor by the seller or the failed institution. The representations and warranties generally had a life of 120 days.

FDIC sales of performing residential mortgage loans carried more comprehensive representations and warranties consistent with the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) guidelines and a longer life of five years. In 1993, the FDIC offered more extensive warranties that were generally consistent with the RTC and industry standards on two large pilot bulk sales of nonperforming commercial real estate loan sales. The warranties were extended to a six-month life.

In May 1990, the RTC began to provide standard representations and warranties with most of its whole loan sale programs, excluding auctions, for single-family loan assets and mortgage servicing rights. The representations were devised after consulting with Fannie Mae and Freddie Mac. They were identical to the representations required by Fannie Mae and Freddie Mac in sales to them and were generally recognized as the customary or standard representations in the secondary mortgage market. The RTC offered representations and warranties directly in its corporate capacity. The duration of the coverage for loan documentation deficiencies was limited to a five-year discovery period. Compensation for any breach of representation discovered during that period would be provided for the life of the loan, but only to the extent that actual losses were incurred as a result of such a breach.

In August 1990, the RTC extended its representations and warranties to conform with those customarily granted in the secondary mortgage market. It increased the duration of the coverage for loan documentation deficiencies from five years to the life of the loan and authorized the repurchase or substitution of another qualified loan if a defect was found that would have been adverse to the buyer. The RTC also established the policy that the insolvent institution would provide the representations and warranties that the RTC would then guarantee.

In July 1991, the RTC extended the customary secondary market representations and warranties to sales of whole consumer, multi-family, and commercial loans. The standard representations and warranties for multi-family and commercial mortgage loans included environmental representations. Depending on the quality of the loan, the dollar amount of the outstanding principal balance, and the type of collateral security, the RTC offered one or more of the following environmental provisions:

- "Where is, as is" sale;
- Environmental inspection before bidding;
- Six-month indemnification for large balance assets (with a book value equal to or greater than $500,000) with monetary cure or repurchase if material contamination was demonstrated; or
- Life of loan indemnification for small balance assets (with a book value less than $500,000), with monetary cure or repurchase if material contamination was demonstrated.

Loan Auctions

The FDIC and the RTC have considerable experience with all types of loan and real estate auctions. Historically, auctions were used to sell real estate or assets such as equipment, automobiles, and trucks; however, both agencies expanded the use of that strategy to include pools of both performing and nonperforming loans.

The process was generally the same for the FDIC and the RTC, although initially no formal internal policies existed for auctions. Both agencies stratified loan portfolios into pools for sale based on various criteria: geographic area, asset type, asset quality, asset maturity, and other parameters. Using the appropriate valuation methodology, they valued the loan pools. They then developed a bidder's information package providing information regarding the auction, the availability of loan information for review by bidders, and the requirements that bidders must meet to bid and purchase loans at the auction.

The FDIC and RTC packages included the procedures, terms, and conditions of the sale. The loan sale agreements were not negotiable; however, the FDIC or the RTC could modify them before the auction and notify bidders of those modifications. Potential bidders then would return the certification statements and forms before any release of loan information and file review by the potential bidder. The certifications provided bidder qualifications and acknowledged that, according to the criteria provided, the bidders had no ethical conflicts in purchasing assets from the FDIC or the RTC and had the financial means to complete the transaction. In addition, each person who would be reviewing or had access to the loan data had to sign and return a confidentiality agreement. The agreement acknowledged that the loan information provided for review before the auction would be kept confidential and used only for the potential bidder's use.

Approximately four to six weeks before a scheduled auction, the FDIC and RTC allowed all interested and qualified potential bidders to review loan file information. The information was indexed for every loan in a package and included the available loan file documents, credit reports on the borrowers, and payment histories. The FDIC and RTC did not warrant the correctness of any documents.

At the beginning of the auction, announcements were made that governed the sale. The bidding then commenced for each loan package. For those loan packages with a reserve price, the auctioneer would announce that the package would be sold after the reserve price had been met. Successful bidders signed a high-bid acknowledgment and surrendered their "earnest money" checks. When bidders were finished for the day, they were escorted to the contract signing room, where a loan sale agreement was executed.

The terms of purchase required the bidder to wire sufficient funds to increase the deposit under the loan sale agreement to 10 percent of the purchase price within 48 hours of the close of the auction. Within 10 business days of the last day of the auction, the balance of the purchase price had to be wired to the seller. No contingencies existed in the loan sale agreement for financing, and the FDIC and RTC did not provide seller financing.

Neither the FDIC nor the RTC provided representations or warranties on the loan packages sold, but both did provide very limited repurchase provisions. Buyers had 120 days from the closing date to make claims regarding loan qualification for repurchase by the FDIC under the terms of the loan sale agreement (one year from closing for title defects). Buyers had 180 days from the transfer date to make claims regarding loan qualifications for repurchase by the RTC. After that time, no claims were accepted.

FDIC Open Outcry Auctions

By 1987, while managing more than $11 billion in assets, the FDIC began experimenting with public auctions for selling loans. In August 1987, the FDIC conducted its first open outcry auction of loans. The auction took place in the Wichita, Kansas, office and consisted of 15 separate pools of loans charged off by banks before their failure. A total of 1,166 assets with an unpaid balance of $10,345,576 were sold for $176,078, or approximately 1.7 percent of the unpaid balance before expenses. Fifty-two bidders, each paying a registration fee of $2,500, participated in the auction. The FDIC paid the auctioneer a setup fee of $5,000, plus 5 percent of the purchase price on pools that sold for 5 percent or less of book value, and an additional 2.5 percent for those sold above that amount; the FDIC split the advertising costs 50/50 with the auctioneer. The assets were offered without representations or warranties and on an all-cash basis.

The auction of charged-off loans led to the FDIC's adoption of a strategy for other loans that was similar to its approach for sealed bid bulk sales; that is, implementation was cautious and, generally, only smaller, more distressed assets were pooled for sale. The FDIC had few loan auctions, more often choosing to adopt the sealed bid approach. The largest loan auction held by the FDIC was in 1995; it generated a relatively small $10.6 million in sales proceeds. See table I.13-3 for a summary of FDIC loan auctions held after the auction of charged-off loans.

Table I.13-3

FDIC Loan Auctions

($ in Thousands)

Auction Date	Location	Aggregate Book Value	Number of Loans Sold	Number of Pools Sold	Sales Price	Sales Price as a Percentage of Book Value
Oct. 1987	Oak Brook, IL	$7,983.3	392	8	$2,430.0	30.4
Oct. 1988	San Fran, CA	15,227.1	473	23	3,523.6	23.1
Oct. 1988	Lafayette, LA	15,093.2	37	21	N/A	N/A
Jan. 1989	Dallas, TX	15,838.4	794	26	2,359.9	14.9
Jan. 1990	Irvine, CA	9,491.8	983	12	2,360.0	24.9
June 1995	Dallas, TX	58,840.8	1,438	19	10,570.0	18.0
Totals		**$122,474.6**	**4,117**	**109**	**N/A**	**N/A**

N/A: Not available.

Source: FDIC Division of Resolutions and Receiverships.

RTC Regional Loan Auctions

The RTC conducted its first regional loan auction in June 1991. After conducting 11 more regional loan auctions between June 1991 and December 1992, the RTC began conducting loan auctions nationwide.

The RTC held regional loan auctions to sell the large inventory of small loans that it had acquired. At the beginning of the RTC's operations, each regional office had its own information system. The large number of assets to be converted to those regional systems, along with the lack of sophistication of many of the failed thrifts' own systems, put enormous strain on the resources of the regional offices. As a result, the asset data on the regional information systems was not always accurate. The development of a new, integrated information system for the RTC assets necessitated that the current inventory of small assets be sold so that the new system could be effectively started and staff efforts could be focused on large, complex assets in the RTC's inventory. See table I.13-4 for a summary of RTC regional loan auctions.

Table I.13-4

RTC Regional Loan Auctions
($ in Thousands)

Auction Date	Location	Book Value	Number of Loans Sold	Number of Loan Pools Sold	Sales Price	Sales Price as a Percentage of Book Value
June 1991	Chicago, IL	$56,492.6	3,970	64	$32,653.1	57.8
June 1991	Denver, CO	61,930.6	4,056	55	23,280.0	37.6
July 1991	Dallas, TX	24,517.5	3,299	22	5,030.0	20.5
Dec. 1991	Denver, CO	93,698.7	5,437	49	46,410.0	49.5
April 1992	Atlanta, GA	203,995.1	3,366	57	105,875.0	51.9
May 1992	San Antonio, TX	24,359.4	1,319	19	4,259.0	17.5
Aug. 1992	San Antonio, TX	17,114.3	1,046	12	6,175.0	36.1
Sept. 1992	Valley Forge, PA	78,243.0	689	38	21,210.0	27.1
Oct. 1992	Dallas, TX	46,030.0	796	27	28,500.0	61.9
Dec. 1992	Phoenix, AZ	19,059.4	45	14	7,133.0	37.4
Dec. 1992 *	Houston, TX	648,442.2	657	39	7,172.5	1.1
Dec. 1992 *	Atlanta, GA	58,840.8	44,000	77	9,377.0	15.9
Totals/Average		**$1,332,723.6**	**68,680**	**473**	**$297,074.6**	**22.3**

* These two regional loan auctions consisted primarily of judgments, deficiencies, and charge-offs (JDCs)
Source: FDIC Division of Resolution and Receiverships.

RTC National Loan Auction Program

The National Loan Auction Program, which grew out of the regional loan auctions, began in September 1992. Altogether, the RTC conducted eight national loan auctions, with the last one taking place December 13-15, 1995.

Under the direction of the national sales center, the RTC established the national loan auction to provide a common forum for the RTC field offices to market their hard-to-sell loans. The overall goal was to achieve the highest possible prices by providing sufficient concentrations of like assets in geographically similar locations that would attract numerous potential bidders and elicit strong competition. Originally designed to sell only nonperforming loans, the criteria were expanded in 1994 to include marginally performing loans. National Loan Auction V, which was held in September 1994, was the first auction to offer performing loans; specifically, they were performing loans that were not securitizable, were underperforming, or had other problems that rendered them unmarketable by other means.

Central to the success of the National Loan Auction Program was the establishment of the RTC auction center in Kansas City, Missouri, which housed all loan files. There, bidders were able to perform due diligence on copies of files (either documents or microfiche) that had been sent from field offices to the auction center. With its state-of-the-art facilities, including 175 computer workstations available at all times to accommodate investors, the auction center provided for four weeks of investor file review before each auction.

In an effort to maximize the sales price, the RTC stratified loans to produce homogenous packages. The sales staff first sorted the loans based on performing versus nonperforming status, then by asset type, geographic location, and lien position. Stratification was also controlled to some degree by the RTC Completion Act (Completion Act) of 1993 and by the principles of the RTC's Small Investor Program. That program was designed to appeal to small investors who wished to purchase RTC assets but lacked the resources to bid on the large asset portfolios the agency had been offering for sale. Before requirements of the Completion Act changed the playing field, nonperforming real estate loans with balances of more than $1 million were sold in multi-asset packages. To make the auction accessible and affordable for the relatively small investor, the RTC's Small Investor Program sales staff attempted to stratify the loans in a way that would keep the average package size under $2 million.

By trying various combinations of media and by tracking the sources of investor inquiries, the RTC determined that a heavy emphasis on direct mail, with support by limited exposure in *The Wall Street Journal* and a few major regional papers, provided excellent results. In addition, auctioneers made direct calls to previous buyers, as well as to important prospective buyers, to solicit their involvement.

The RTC encouraged investors to do their own due diligence; provided them with all available information about the loans, including trial balance loan detail; and permitted them to view all the documents in the individual loan files. For a nonrefundable fee of $250, each investor could receive either a diskette with all the trial balance information or access to the same information on a computer network by modem. Contractor and RTC personnel were on hand to assist investors and answer questions.

While the investors reviewed loan documents, RTC personnel evaluated packages and set reserves. In general, reserves for performing loans were based on market yields, and reserves on nonperforming loans were based on either a percentage of the appraised value of the underlying collateral, or on a percentage of the book value based on the historical results achieved on like assets sold at previous auctions.

Typically, because of the number of packages offered, an auction lasted two or three days. Although many investors took advantage of preregistration, many registration procedures were completed each auction day. RTC attorneys worked with the auction contractor and the bidders to complete documents and to collect the $50,000 deposit required each day of the auction.

Loan auction experience led the RTC to believe that (1) loan auctions were cost-effective only when the asset inventory was above a critical level; (2) small regional auctions were just as effective as large-scale national auctions; (3) reserve pricing was critical for the sale of difficult, more complex products as a means to guide the market value; and (4) performing standard assets did not need reserve pricing. The bidders would easily establish a market price for those assets. See table I.13-5 for a summary of the RTC National Loan Auction Program results.

The RTC viewed conducting auctions as a successful method for selling a large inventory of small value loans or as a way to reduce its inventory before closing an office. It viewed sealed bid loan sales as more successful when the inventory was smaller, or in the "normal" course of business. The RTC believed that the competitive atmosphere of an open-outcry auction generated higher prices for loan pools than did other sales methods. On the downside, those auctions sometimes resulted in logistical problems after the sales event. Sometimes delays in accounting for the sales led to contractors continuing to manage sold assets and even, in some cases, resulted in assets being sold to more than one buyer. Overall, the RTC believed that its auctions were entirely suitable for the sale of nonperforming loans and nonstandard loans that were hard to sell by other methods.

Real Estate Sales Programs

The disposition of real estate was not of great concern to the FDIC until the early 1990s. Before 1989, the FDIC's inventory of real estate received from bank failures averaged only about $300 million, peaking at $600 million in 1987. Beginning in 1989, the level of inventory increased dramatically as the pace of bank failures increased. In 1989, FDIC's inventory of real estate jumped to $5 billion, representing 19 percent of the FDIC's total assets in liquidation; it would later peak at $6 billion by year-end 1991. In comparison, the RTC ended 1989 with $14.6 billion in real estate; it would peak at $18.1 billion by year-end 1990. In 1991, the RTC began offering seller financing to

Table I.13-5

RTC National Loan Auction Program

($ in Millions)

Auction Number and Date	Book Value	Sales Price	Sales Price as a Percentage of Book Value	Number of Loans Sold	Number of Packages Sold	Number of Buyers	Total Costs	Costs as a Percentage of Book Value	Costs as a Percentage of Sales Price
I Sept 92	$416	$248	59.62	6,966	196	39	$5.2	1.25	2.10
II March 93	501	249	49.70	17,814	190	40	3.8	0.76	1.51
III Aug 93	673	335	49.78	11,198	311	55	4.5	0.67	1.34
IV April 94	318	191	60.06	5,809	225	45	2.8	0.88	1.47
V Sept 94	399	223	55.89	8,814	317	81	3.5	0.88	1.57
VI Dec 94	370	229	61.89	9,786	258	73	3.7	1.00	1.62
VII May 95	353	231	65.44	7,178	296	76	3.9	1.10	1.69
VIII Dec 95	569	403	70.83	5,349	336	96	3.2	0.56	0.79
Totals/ Averages	**$3,599**	**$2,109**	**58.60**	**72,914**	**2,129**	**505**	**$30.6**	**0.85**	**1.45**

Source: RTC National Loan Auction Program Database.

encourage real estate sales in reaction to a market that was severely distressed and lacked more traditional sources of financing.

Sealed Bids

The FDIC has always made a regular practice of employing a sealed bid process for real estate sales. Unlike bulk sales or auctions, sealed bid events were almost always single asset sales until the early 1990s. At that time, the FDIC's inventory increased to such levels that sealed bid marketing efforts included multiple assets, although bids were accepted on individual real estate properties. Typically, sales were advertised in a variety of newspapers, with specific bid dates established. Contract terms were generally all cash, and winning bidders were required to make nonrefundable earnest money deposits. The

RTC also made regular use of sealed bids and operated under procedures similar to those of the FDIC. Generally, sealed bid sales satisfied agency requirements for broad marketing and competitive bidding. In addition, they set a certain date for selling the property, assuming an adequate bid was received. The RTC usually established reserve prices based on a percentage of appraised value. Sealed bid sales, which typically ran for 30 to 60 days, were conducted directly by the account officer or through the services of an exclusive listing broker, known as a lead broker.

The sealed bid process gives all interested parties an opportunity to submit their offers under structured guidelines. The process levels the playing field and eliminates any potential inquiries concerning possible unequal treatment of participants. The process also requires buyers to submit their bids in conformance with the sealed bid instructions, bid format, and prescribed deadlines—or risk being disqualified. The sealed bid sale method has been effective for larger, higher profile assets for which the target market is primarily national in scope and a rapid and extensive marketing campaign seems appropriate. In the early 1990s, the process also facilitated a faster sale, which proved effective for properties that were experiencing significant negative cash flows or holding costs.

Real Estate Auctions

By the late 1980s, the FDIC periodically began holding real estate auctions to dispose of large inventories of relatively small real estate properties such as condominiums and vacant lots. The FDIC saw those sales as opportunities to unload large numbers of labor-intensive properties. During that time, the use of real estate auctions was generally limited to small and distressed properties and connoted the image of a “fire sale,” in which the seller was willing to accept heavily discounted prices to unload undesirable real estate.

Interestingly, fear of a fire sale mentality, or the “dumping” of assets, was prevalent when the RTC was created. As a result, FIRREA included language requiring the RTC to sell real estate for no less than 95 percent of market value—defined as appraised value. Consequently, in the early stages of the RTC’s existence, real estate auctions were prohibited for fear that they would aggravate already distressed markets, reduce prices generally, erode collateral values, and damage the financial standing of banks and thrifts that were heavily invested in real estate markets.

By 1990, the RTC real estate inventory was more than $18 billion and efforts to sell the inventory through normal channels, such as brokers, were insufficient to move substantial amounts of property. Congressional concerns about the RTC’s slow pace in selling assets, the cost of carrying the inventory, difficulties in managing large numbers of assets, and the continuing decline in real estate prices generally began to change outside perceptions of how the RTC should proceed.

In March 1991, the RTC approved a new real estate pricing policy for all real estate sales and, particularly, authorized the use of auctions to sell real estate. The resulting effect was significant. The RTC determined that its auctions would require extensive marketing efforts with large-scale regional, national, and possibly international exposure. It planned to sell properties in absolute auctions if the property had an established market value below $100,000 and if the property had been widely exposed to the market. The RTC would reserve the right to reject any offers that were made in the absence of a competitive bidding environment. It planned to sell all other properties at auctions with reserve prices set at levels to take into account the benefits of an expedited sale, including savings of holding costs and marketing costs. To stimulate bidding, the RTC could set reserve prices at less than the expected sale price, accepting under no circumstances less than 70 percent of the current appraised value, adjusted for any savings of sales expenses or costs as a result of an expedited sale. As the RTC and the FDIC saw their inventories increase substantially and both began acquiring larger real estate properties, they both initiated large-scale national auctions.

National Real Estate Auctions

To promote sales and to respond to criticism that the RTC was slow in disposing of assets, the RTC created the National Satellite Auction. The first of its kind, the auction, based in Dallas, Texas, was scheduled for November 15, 1990, with satellite transmission to nine U.S. cities, as well as to London and Tokyo. More than 71 commercial properties were expected to be included with an aggregate value of $500 million. Notwithstanding the best of efforts and intentions, the auction was ultimately canceled because the auctioneer was unable to meet a contract commitment for funding. It was a rocky start for the RTC's auction efforts, but the RTC continued to embrace the national auction methodology.

Through its national sales office, the RTC planned, coordinated, and executed many major asset sales, including the sale of real estate pools worth more than $100 million. The RTC held many national real estate sealed bid sales including the 1992 offering of its first structured portfolio of hotel properties and related loans, which had a book value of approximately $237 million, and one national real estate auction in November 1991. The office conducted a number of other national sales of unique properties such as mini-warehouses, shopping centers, and nursing homes. The office also developed the National Land Fund strategy to dispose of the hard-to-sell land assets. [1]

The FDIC also saw opportunity in employing large-scale real estate auctions. In March 1989, the New York office coordinated the first nationwide auction of large real estate holdings. At the auction, conducted at Christie's in New York City, 14 properties were sold for $40.7 million, a significant 99.4 percent of their aggregate appraised value.

In December 1991, the FDIC held its first national satellite real estate auction. Properties included in the auction were from 23 states and consisted of 178 commercial

1. For more information, see Chapter 17, Partnership Programs.

properties with an aggregate appraised value of $443 million. With satellite hookups in five cities, the event attracted 1,000 bidders and yielded $240 million in cash, plus notes. Of the 178 properties exposed to the market, 115 were placed under sales contracts at an aggregate price equivalent to 82 percent of the portfolio's appraised value. The FDIC offered seller financing on properties with an appraised value of more than $500,000 and also offered a 5 percent cash discount on those properties.

In 1992 and 1993, the FDIC conducted its second and third national satellite real estate auctions. In addition to selling many properties at auction, the FDIC discovered that the promotion leading up to the events could result in sales before the actual auction date. Typically, a group of properties were targeted for auction. To maintain adequate inventory for the sale and show good faith to investors who spent considerable time and money performing due diligence on those properties, the FDIC typically froze property sales at about the time information packets and brochures were distributed. Investors already interested in properties on the market and scheduled for auction could be threatened by the prospect of having to bid for the property in an open outcry auction environment for fear of either paying a higher price or losing the property altogether. Consequently, a significant number of investors acted to lock in the purchase of the property before the freeze date, thus bringing about earlier sales than might have otherwise occurred.

As inventory levels and asset sizes no longer supported a large national initiative, the FDIC suspended the use of national auctions after 1993 and, instead, relied principally on smaller regional initiatives. See table I.13-6 for a summary of the FDIC national auction results.

Conclusion

The banking and thrift crisis caused an unprecedented volume of assets to be transferred to the FDIC and the RTC. In response to an overwhelming workload, both the FDIC and the RTC experimented with disposition strategies to facilitate disposition at prices that maximized the overall return.

The experience gained from the period clearly indicates that sealed bid sales and auctions are effective marketing strategies for disposing of distressed assets in a timely and effective manner. The multitude of variables involved in evaluating independently unique assets, timeframes, and situations makes it difficult to determine which approach is more acceptable or will generate better returns in a given situation. Sufficient experience has occurred in both the public and private sectors, however, to substantiate both strategies as reasonable approaches to disposing of real estate, loans, and other assets, especially when a large volume of distressed assets needs to be sold within a relatively short time.

In either marketing strategy, the FDIC found that it was important to have good information about the assets before marketing them, because they brought a better price when the bidders were able to receive good information before bidding. The RTC, more so than the FDIC, found itself with an extraordinary volume of assets. As a result, unlike the FDIC, which up to a point was able to take the assets in, manage them for a short period, clean them up, and then sell them, the RTC generally did not have the luxury of time and would market assets without much prior due diligence. For that reason and because the assets held by the RTC were, on the whole, of a lesser quality, the FDIC was generally able to receive a better sales price.

Table I.13-6

FDIC National Auction Results

($ in Thousands)

1992 Auction

	Number	Appraised Value	Sales Price	Sales Price as a Percentage of Appraised Value
Properties in the Auction	270	$599,497	—	—
Total Sold at Auction	218	474,365	$412,170	86.9
Financed Sales	153	373,091	328,665	88.1
Cash Sales	65	101,274	83,505	82.5
Sold Before Auction	144	282,477	261,805	92.7

1993 Auction

	Number	Appraised Value	Sales Price	Sales Price as a Percentage of Appraised Value
Properties in the Auction	197	$398,138	—	—
Total Sold at Auction	165	345,138	$312,231	90.5
Financed Sales	100	219,810	195,514	89.0
Cash Sales	65	125,329	116,718	93.1

Source: FDIC Division of Resolutions and Receiverships.

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Although it cannot be said that one type of asset management contract worked better than another type, the private-sector contractors generally performed well under any type of contract, when they were given the proper incentives.