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Report to the Ranking Minority Member, Committee on Banking, Finance and Urban Affairs, House of Representatives

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RESOLUTION TRUST CORPORATION

A More Flexible Contracting-Out Policy Is Needed

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The Honorable Chalmers P. Wylie
Ranking Minority Member
Committee on Banking, Finance
and Urban Affairs
House of Representatives

Dear Mr. Wylie:

Your December 6, 1990, letter requested information on the Resolution Trust Corporation's (RTC) contracting process and practices. As agreed with your office, this report addresses whether RTC uses an approach that allows it to select between contractors and RTC staff for the most advantageous approach to handle asset management and disposition. The other contracting issues in which you expressed interest were addressed, preliminarily, in our February 20, 1991, testimony before the Committee. Those issues are being further addressed in a series of ongoing assignments.

Results in Brief

RTC staff do not need to justify hiring private contractors based on a comparison of in-house and private sector contractor costs. The applicable law states that RTC shall use the private sector whenever "practical and efficient" and does not require a justification. In practice, GAO found that RTC directs its staff to use only private sector asset management and disposition contractors for real estate and problem loan assets.

We expressed the view that this policy may not be the most effective asset management and disposition approach for RTC in some instances. However, RTC staff did not believe that the policy needed to be changed because of a concern that such a change in its contracting policy would divert the staff's attention from the primary goal of contracting out asset management and disposition. We recognize that it is necessary for RTC to contract out most of its activities; however, there are situations where it clearly would be less expensive to use in-house staff. Accordingly, we believe that RTC's policy regarding contracting out should be clarified to help ensure that it can take full advantage of such opportunities.

Background

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) authorized RTC to use the private sector in managing the savings and loan industry cleanup effort. FIRREA states that RTC, in carrying out its duties, shall use the private sector "if such services are available in the private sector and the Corporation determines utilization of such services are practicable and efficient."[1] This FIRREA provision was enacted, in part, to promote RTC's general asset disposition objectives and to minimize RTC's reliance on government sources.

Based on this authorization, the RTC Oversight Board's strategic plan for RTC emphasized that RTC would extensively use the private sector for asset management and disposition. The plan states that "the sheer number of assets to be worked out will require that the RTC rely heavily on private sector contractors." As of June 30, 1991, RTC held assets for disposition valued at approximately $158.5 billion.[2] As shown in table 1, RTC's inventory included a variety of assets.

Table 1: RTC's Asset Inventory as of June 30, 1991

Dollars in Billions

Asset type	Dollar value
Cash and securities	$28.8
Mortgage loans	82.5
Other loans	12.6
Real estate owned	18.2
Other assets	16.4
Total	**$158.5**

Source: RTC data.

The asset disposition process starts immediately after RTC's appointment as a thrift's conservator. At that time, RTC develops an integrated marketing strategy for the thrift's assets by identifying the assets that may be transferred to an acquirer as part of the sale of the thrift, and those financial assets to be sold or securitized by RTC.[3] Real estate and problem loan assets are identified for inclusion in portfolio sales (e.g., bulk sales, structured transactions, and auctions), and they are identified to be placed with a private contractor for management and disposition.

Since its inception in August 1989, RTC has hired many contractors to assist with the management and disposal of thrift assets. Through

[1] 12 U.S.C. 1441a(b)(11)(A)(ii).

[2] All assets are presented at book value.

[3] The integrated marketing strategy was issued to RTC regional and consolidated field offices on February 28, 1991.

May 31, 1991, RTC had placed $24.2 billion of its assets with contractors for management and disposition. Further, according to RTC's contracting information system, from August 1989 through August 1, 1991, RTC had issued 133 asset management contracts with estimated fees of $459 million.

Objectives, Scope, and Methodology

Our objectives were to determine what approach RTC was using to manage and sell assets and whether this approach allowed RTC to select between contractors and RTC staff for the most advantageous asset disposition approach. As agreed with your office, we did not estimate the cost of RTC's operations using only federal employees because, as a practical matter, RTC could not operate without the extensive use of contractors.

To ascertain whether contracting-out justifications for specific assets are developed, we reviewed RTC's authority to use private sector contractors. We also asked whether justifications are used by RTC officials who are responsible for deciding between hiring contractors and using RTC staff in 11 of 14 consolidated offices. Further, we discussed the decision-making process for contracting out with officials at RTC headquarters and the RTC Oversight Board. To identify examples of contracting-out decisions, we relied on the work of our other ongoing RTC contracting assignments.

We did our work from February through August 1991 in accordance with generally accepted government auditing standards.

RTC Needs to Use the Most Efficient Asset Disposition Approach

RTC does not justify decisions to hire private sector contractors on the basis of lower cost or higher returns from asset sales. RTC staff in all offices we contacted told us that justifications are not used because RTC directives require that contractors be used for asset management and disposition. This policy is based on FIRREA's authorization for RTC to use private sector contractors. This authorization does not require RTC to prepare justifications to support contracting-out decisions.

However, some RTC field staff have said that a more flexible approach for contracting-out decisions can be more effective than RTC's current policy. RTC staff has commented that, in some situations, assets can be more effectively managed and disposed of using RTC staff rather than a contractor. Generally, these are situations where RTC has developed expertise on a complex asset or package of assets, or where RTC expects that an asset could be sold through an RTC-sponsored bulk sale, auction, or other expedited selling technique.

RTC officials at two large conservatorships stated that contracting out certain types of assets, such as raw land, could be more costly and time consuming than using RTC staff. For example, RTC staff were hired from the private sector to monitor and manage a failed institution's large, complex land developments. After several months of developing expertise on one of the institution's land developments, RTC intended to place it with a private sector contractor. RTC staff stated that the contractor then would have to spend time developing the expertise already available within RTC. In an environment where selling the land may take several years, RTC staff questioned whether the cost of hiring a private sector manager would be offset through higher revenue or a faster sale.

In another RTC consolidated office, a senior official said that having RTC staff manage some assets temporarily may lower the cost of implementing some in-house sales policies. For example, under existing RTC sales policies, assets already in pending or issued asset management and disposition packages may also be offered for bulk sale or at auction. If the assets were sold by RTC staff through the bulk sale arrangement, RTC could owe the asset contractor up to approximately 2.7 percent of the asset's sales price in fees, although RTC staff had completed the sale. In fact, 2 months after placing an apartment complex with an asset management contractor, RTC paid $29,618 in disposition fees to the contractor after the property was sold by RTC staff through a bulk sale.

An official at one office in the western region recognized, in one case, that maintaining an ongoing staff to temporarily manage a performing loan portfolio was more efficient than hiring a contractor to provide the service. He stated that, as required by RTC policy, when the institution was sold, the loan portfolio's servicing would be contracted out for 6 months until it could be placed in a sales package or with a permanent manager. After the bids were received from the potential contractors, RTC staff recognized that the conservatorship's staff had provided high quality service and that about $75,000 per month could be saved by keeping the staff rather than contracting out. Although it is RTC's policy to contract out in lieu of hiring additional staff, the regional office approved the retention of the conservatorship staff rather than contracting out the function.

Conclusions

Unless RTC requires its staff to consider the overall benefits and costs of contracting out in relation to the costs of its employees' managing and disposing of specific assets or specific groups of assets, RTC cannot be certain that its decisions will result in the highest return for the assets. RTC has already made initial decisions about the mix of RTC staff and contractors needed to manage and dispose of overall categories of assets. Until December 1996, and possibly longer, RTC will be managing and disposing of assets and should have the flexibility to make decisions regarding how those particular assets should be handled.

Currently, RTC's contracting procedures do not authorize RTC staff to use other options, even when they recognize that an approach other than contracting out will be more practical and efficient. We believe RTC needs a more flexible policy that would allow RTC staff to deviate from RTC's basic policy of using contractors for the management and disposal of real estate, other assets, and problem loans when it can be justified as in the best economic interests of the government.

Recommendation

We recommend that RTC clarify its contracting-out policy so that its staff clearly understand that they have the flexibility to use their staff instead of private contractors when in their judgment an in-house approach would be more practical and efficient for a particular need or situation.

Agency Comments and GAO's Analysis

In an earlier draft of this report, we recommended that RTC review its policies and procedures to determine whether they should be revised to allow RTC offices more flexibility to use their staff instead of private contractors when in their judgment an in-house approach would be more practical and efficient. The RTC officials said they did not believe that the policy needed to be changed. They said that any contracting-out policy change would encourage deviation from RTC's use of the private sector for asset management and disposition, and would misdirect the RTC staff's attention. They also stated that without a change in policy, in unusual situations, RTC staff have justified managing and disposing of property without the use of contractors.

After considering RTC's comments, we continue to believe that at a minimum, RTC's policy needs to be clarified. We recognize that RTC will need to continue to contract out almost all of the services needed to manage and dispose of failed institutions' assets. However, RTC's current contracting-out policy is so restrictive that it may miss opportunities where it is clearly less expensive to use its own staff rather than contract out for such services. Earlier in this report, we identified an example where an in-house approach led to reduced costs.

We believe that with proper guidance and controls over what is done in-house, RTC could attain a more cost-effective mix between the use of contractors and its staff.

We will send copies of this report to RTC and to interested congressional committees. Copies will also be made available to others upon request.

This report was prepared under the direction of Gaston L. Gianni, Associate Director, Federal Management Issues. Other major contributors are listed in the appendix. Please contact me on (202) 275-8387 if you or your staff have any questions concerning this report.

Sincerely yours,

J. William Gadsby
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