

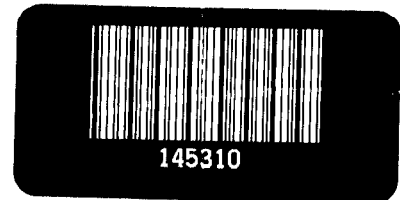
GAO

Report to the Honorable
Paul E. Kanjorski, House of
Representatives

October 1991

RESOLUTION TRUST CORPORATION

Effectiveness of Auction Sales Should Be Demonstrated



General Government Division

B-245598

October 31, 1991

The Honorable Paul E. Kanjorski
House of Representatives

Dear Mr. Kanjorski:

After the February 20, 1991, House Banking Committee hearing on Resolution Trust Corporation (RTC) performance, you asked for information on the national satellite auction that RTC canceled in September 1990. Specifically, you wanted to know how RTC can prevent future cancellations and make auctions a productive way to sell real estate. This letter gives our assessment of RTC's auction program design and recommends a method through which RTC can assure itself that the auction approach is an effective marketing strategy. As agreed with your office, this letter discusses only briefly the canceled national satellite auction because RTC's Office of the Inspector General already issued a report, which the Inspector General sent to you, on that subject.¹

Results in Brief

RTC's auction approach is conceptually sound. It contains elements that should provide an adequate foundation for ensuring that auctions are a productive way to sell assets. RTC believes auctions are an effective way to sell many types of real estate assets quickly and still get a good price. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) requires RTC to maximize returns from asset sales. However, there is widespread uncertainty about the viability of auctions because there has not been enough analysis to determine whether auctions are more effective in maximizing returns than the more commonly used brokered sales approach.²

RTC eventually intends to test the various disposition methods it uses to identify what works best. However, the results of these tests are needed now to support a decision to continue using auctions as a sales approach. These results could answer the question of whether returns are being maximized and could help RTC respond to criticism that brokered or other approaches work better than auctions because they produce higher returns.

¹Valuable Lessons to be Learned from Cancelled Real Estate Auction, RTC, Office of the Inspector General, Audit Report A91-001 (May 13, 1991).

²Brokered sales are handled through a real estate broker.

Background

FIRREA authorizes RTC to use the private sector to dispose of assets when services are available and when RTC determines that it is practical and efficient. FIRREA also identifies auctions as a marketing method. The unprecedented size and diversity of RTC's real estate inventory puts RTC in a unique position that allows it to try different disposition methods and learn what does and does not work. FIRREA requires RTC to maximize returns from the sale of assets of failed thrifts, and RTC is experimenting with different disposition methods—brokered sales, auctions, direct negotiated sales, and negotiated and competitive bid portfolio sales—to meet this requirement. For RTC, therefore, the success of the auction approach depends on whether auctions result in the highest possible return.

RTC has (1) decided to use the auction method extensively, (2) put a team in place to manage the effort, and (3) held several auctions. In May 1990, RTC began focusing on the use of auctions to sell real estate. It hired a firm to organize and carry out a national satellite auction involving as much as \$300 million in real estate in the fall of 1990. All properties to be auctioned were high-dollar value commercial properties. Although the auction drew a great deal of attention, RTC canceled it in September 1990 because of a contract dispute.

The RTC Inspector General reviewed the events leading up to the cancellation and issued a report in May 1991 that emphasized the need for better up-front planning for large auction events. In addition, the report revealed that some asset management and disposition policies and procedures were implemented after key decisions had been made, some contracting procedures were not followed, and some asset disposition and contracting procedures still needed to be developed. The report contained specific recommendations aimed at preventing future cancellations.

RTC is planning to hold another high-dollar value commercial property auction. This time, however, it will focus on far fewer properties and better planning of the event.

RTC has held auctions for lesser valued properties. It announced in October 1990 that it would hold a series of auctions for properties with book values of \$100,000 or less. Although there are a large number of such properties, they represent a very small percentage of the total RTC real estate inventory book value. Through June 30, 1991, RTC held a total of 67 auctions at which 4,603 properties were sold with gross proceeds of about \$117 million. RTC has continued to schedule auctions of

lesser valued properties. Also, in addition to real estate, RTC has auctioned nonperforming loans, furniture, fixtures, and equipment.

Although RTC used auctions extensively to recoup funds, there is much debate and uncertainty in the real estate community over whether auctions are the most effective tool for maximizing returns. Brokered sales still make up the majority of real estate transactions in the United States.

In addition, government entities, such as the Federal Deposit Insurance Corporation (FDIC) and the Department of Housing and Urban Development (HUD), along with several private-sector sellers, have used auctions only as a last resort after first attempting brokered sales. However, private-sector real estate experts we contacted, both brokers and auctioneers, agree that auctions are a viable and effective way to sell real estate. They told us that auctions are being used increasingly and are gaining acceptance as a viable sales method.

Arguments in support of auctions center around how auctions create open and competitive events at which a sufficient number of potential buyers able to purchase assets at market price are present. The success of the auction therefore depends on strong planning to raise buyer interest and effective management to achieve a high sales price.

Despite the logical arguments for the effectiveness of auctions, they are not used as frequently as brokered sales. One possible explanation is that the market has chosen brokered sales over auctions because of the perception that brokered sales result in higher returns.

However, some experts believe that auctions have suffered from a bad image in the United States and claim that they are used more extensively in other countries. For example, auctions in U.S. history are often associated with desperation, including post-Civil War auctions in the South; Great Depression-era bankruptcy auctions; and more recently, auctions during the farm crisis of the 1980s. Auctioneers claim that this unfavorable view can explain some lack of acceptance and the preference for brokered sales in the United States. They claim that auctions are becoming more widely accepted and are being used increasingly as their effectiveness becomes more widely known.

RTC has decided to use auctions extensively. It believes auctions will satisfy FIRREA's requirement to maximize returns and respond to the tremendous pressure from Congress and others to dispose of assets quickly.

Objectives, Scope, and Methodology

Our primary objectives were to (1) determine if the auction program design is conceptually sound; and (2) determine if RTC plans to assess whether auctions are a viable and effective method for selling real estate assets, in terms of ensuring that the use of auctions maximizes returns as mandated by FIRREA. As measures of conceptual soundness, we considered the quality of personnel hired to run the program, the communication lines within RTC and between RTC and the public, and RTC's outreach to the private sector. Several auction experts we spoke with believed that strength in these areas is essential to the soundness and eventual success of a program of this magnitude.

At the time of our review, RTC was still getting the program started and its results were only preliminary. We therefore felt it premature to address whether auction results at that point were acceptable or established policies and procedures were adequate and used properly and consistently. Although sealed bid formats—where bidding is closed and competitive—are sometimes referred to as auctions, for the purpose of this review we did not include these types of sales.

To evaluate the conceptual soundness of the program, we reviewed RTC auction directives and policies and interviewed RTC officials in Washington and at the Kansas City and Chicago sales centers. To determine whether selected attributes were present, we consulted with real estate experts and RTC auction contractors and discussed the auction program and its management with RTC officials. To assess whether auctions are a viable and effective sales method, we interviewed FDIC and HUD officials who use auctions, and we spoke with private-sector experts in both the auction and brokerage communities. In addition, we discussed with RTC officials steps they have taken to determine whether auctions will maximize returns.

We did our work between April and June 1991 in accordance with generally accepted government auditing standards.

Conceptual Foundation Is Sound

The characteristics of RTC's auction program mirror those characteristics that both auction experts and we see as essential to conceptual soundness. Although we did not review RTC's auction program in detail, we found that it included (1) hiring people with auction industry experience to run the program, (2) establishing communication lines within RTC and between RTC and the public, and (3) engaging in frequent and useful outreach to the private sector.

RTC auction specialists in both Washington and the field offices we visited have backgrounds in the real estate auction industry. RTC officials told us the auction specialists RTC has hired have auction industry experience, and RTC intends to continue hiring only experienced individuals for the auction program. For example, the RTC National Auction Marketing Specialist, who manages RTC's auction program nationwide, has extensive experience in the auction industry and is well respected among auction experts and auctioneers working for RTC. In addition, we reviewed some of the backgrounds of personnel hired to run the program and found them to have considerable auction industry experience. With such backgrounds, RTC staff monitoring and planning the events are better equipped to ensure that RTC auctions meet industry standards for effectiveness.

In some areas of expertise, RTC has been criticized for hiring people without the right backgrounds. However, in the auction area, RTC has hired specialists who have developed the program on the basis of their knowledge of and experience with auctions. The National Auction Marketing Specialist told us RTC will continue to hire people with auction industry backgrounds to monitor and guide the program.

RTC has designed and implemented practices for ensuring adequate communication about auctions within RTC and to the public. Within RTC, auction specialists in Washington meet regularly with regional staff to discuss program adjustments and implementation concerns. RTC has set up a toll-free auction hotline (1-800-348-1484) that prospective buyers can use to obtain information about specific properties to be auctioned. In addition, buyers can find out when different classes of properties will be auctioned nationwide. Publicizing auctions, both internally and to the public, is vital if RTC is to effectively experiment with the auction approach.

RTC has established a private-sector outreach effort for the auction program. Auctioneers and brokers have given feedback to RTC on auction

policies, and RTC has responded to their concerns. For example, top representatives of the auction and brokerage industries gave RTC comments on several auction policies and procedures as they were developed. In the past, RTC was criticized for not being receptive to the concerns of its private contractors. However, at the time of our review, auctioneers were generally pleased with the level of communication with RTC auction staff in Washington.

RTC Should Demonstrate That Auctions Are Effective

FIRREA requires RTC to maximize returns from the sale of assets. From RTC's point of view, determining how to ensure the highest returns involves formulating a selling strategy in which trade-offs are made among several considerations. For example, in the case of auctions versus brokered sales the prevailing concern is whether the net return to RTC through an auction will be better than that achieved using the brokered approach—taking into account the differences in holding costs.

Some real estate experts and RTC claim that auctions are an effective way to dispose of assets quickly and maximize returns. RTC decisions regarding the use of auctions thus far have been based on the knowledge and experience of RTC auction specialists and input from auctioneers. Arguments presented to support the use of auctions include the efficiency of selling in volume at well-planned and well-executed auctions at which a sufficient number of potential buyers able to purchase assets at market price are present.

Despite logical arguments for the effectiveness of auctions, RTC has not yet demonstrated through a comparison of returns from auctions versus returns from brokered sales that auctions maximize returns. Furthermore, the auction industry has not documented the extent to which auctions actually outperform brokered sales for similar properties under similar market conditions.

Although RTC is generally satisfied with the results of its auctions thus far, it has no way of knowing whether brokered sales would have achieved a higher return. RTC statistics on completed sales are not completely reliable for determining which sales method is better. Comparing percentages of appraised value is one method that is often used to compare different sales methods. However, variations in the characteristics, conditions, and geographic locations of the properties, along with market conditions at the time of purchase, make comparing percentages

of appraised values unreliable. In addition, holding costs are often not considered.

As RTC proceeds to experiment with the auction approach, a valid and reliable comparison of sales results showing auctions to be viable and effective would strengthen RTC's case for their continued use. Such data would help RTC demonstrate to Congress and taxpayers that auctions are viable and effective and that returns are being maximized as required by FIRREA. In addition, such evidence could help guard against accusations that RTC is selling too quickly and that brokered sales would have produced higher returns.

RTC officials told us they eventually plan to compare the results realized using different sales methods when their information systems are more advanced. However, manual collection and tracking of data on a reasonably sized sample of assets could be done now. One way to design such a comparison would be to select groups of similar properties in different markets and get appraisals. Properties in each group could then be randomly assigned to auctioneers and brokers, and sales results could be compared with holding costs and other factors affecting return taken into account.

Conclusions

RTC's auction program has a number of positive attributes that should enable RTC to effectively test the auction approach. Staff with auction industry experience are managing the program. Communication lines within RTC and between RTC and the public have been established. Auctioneers have given RTC input on the program, and RTC has addressed their concerns.

Although the program is conceptually sound and arguments for the efficiency of auctions are logical, a comparison of the effectiveness of auctions with other sales methods would be useful to RTC. Such a comparison would either support or discourage further use of auctions for different property types. To the extent that auction results meet or exceed the results of other sales methods, auctions would be shown to be a viable strategy for maximizing returns from real estate sales and would also help RTC respond to criticism that other marketing approaches would produce higher returns.

Recommendations

We recommend that RTC determine the effectiveness of auctions used to sell its real estate by comparing a sample of the results of auction sales

with results realized on various other sales methods, particularly sales by brokers.

Agency Comments

In July we discussed the results of our work and the recommendation being considered with the RTC Auction Program Manager. She agreed with our conclusions and strongly supported the potential recommendation. In September, after we completed drafting the report, we invited RTC officials to comment. They told us that they felt the report was accurate and fairly presented the issues, that the conclusions were valid, and that the recommendation was appropriate and useful. They agreed that the recommended comparison would provide them with the statistical data they need in their decisionmaking process.

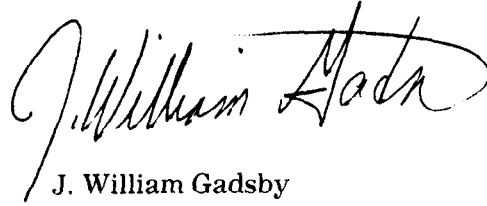
They also advised us that they were taking steps to implement our recommendation. Through their market impact program, they plan to study, compare, and contrast the results, effectiveness, and impact of RTC real estate sales activities, including auctions, for single family residential properties priced at \$100,000 or less. The planned study is to review RTC assets sold in North Carolina during the period January through June 1991. They said they were currently in the process of selecting a contractor for the study.

RTC officials said they are planning an ongoing evaluation effort to compare, as we recommend, the results of brokered sales with those sales made through auctions and sealed bids. They said they also plan to focus their analysis on different types of property because one sales method may work better for some types of property than others. They emphasized that their analysis and interpretation of sales results would be continual because several comparisons over time should lead to the most reliable and useful information.

As agreed with your office, we plan no further distribution of this report until 5 days from the date of this letter unless you publicly announce its contents earlier. At that time, we will give this report to RTC and interested congressional committees. We will also make copies available to others upon request.

This report was prepared under the direction of Gaston Gianni, and 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,

A handwritten signature in cursive script that reads "J. William Gadsby". The signature is written in black ink and is positioned above the printed name.

J. William Gadsby
Director, Federal
Management Issues

Major Contributors to This Report

General Government
Division, Washington,
D.C.

Ronald L. King, Assistant Director, Federal Management Issues
David E. Sausville, Evaluator-in-Charge
Carolyn S. Ikeda, Advisor

Office of the Chief
Economist,
Washington, D.C.

James R. White, Senior Economist

Ordering Information

The first copy of each GAO report is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20877

Orders may also be placed by calling (202) 275-6241.

United States
General Accounting Office
Washington, D.C. 20548

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use \$300
