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"The FDIC's practices, policies and philosophies in handling real estate":

AN ADDRESS BY

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Good Afternoon!

It is a pleasure to be here today addressing the members of the Urban Land Institute. While I am a liquidator I have not brought with me either a "Fire Sale" sign or a submachine gun, or even an attorney, the commonly thought of tools of the trade. Rather, I wish to discuss with you this afternoon the practices, policies, and philosophies of the FDIC in handling real estate that comes into our possession as a result of the failure of financial institutions.

As many of you are no doubt aware, the FDIC has been a very busy agency during the past several years. With the economic problems that have confronted our nation we saw record numbers of bank closings during the last three years. In 1986, 138 banks closed and 7 received FDIC assistance. In 1987, 184 banks were closed and the FDIC consumated assistance transactions with an additional 19 banks. Last year the numbers were similarly bleak with 200 banks closed. Thus far, in 1989, we have closed 71 banks, including the 20 MCorp banks that were closed in one evening. The transactions we have dealt with have ranged in size from the Hereford State Bank in Hereford, Colorado with $2.7 million in total assets to Continental Illinois, First Republic and First City Bankcorp.

As one would expect, the majority of the closings have been concentrated in those parts of the country that are experiencing economic difficulties. Particularly, the Southwest, and more recently Louisiana and Alaska. During the past several years we also saw a fairly significant number of bank failures in the Midwestern farm belt, and we are beginning to see some closings in the Northeast. With all of these bank failures the FDIC's liquidation portfolio grew to a peak with about 178,000 assets with a book value of $12.5 billion. As a result of changes in the way the FDIC handles failing institutions and revisions in our liquidation policies our portfolio has been reduced to about 100,000 assets with a book value of $10 billion. The liquidation of these assets is handled by a staff of 3,500 liquidation employees supported by several hundred in-house attorneys and accountants.

The assets the FDIC has acquired from failed banks have run the full gamut of anything that is conceivable in banking. We have had performing loans to operating businesses and installment loans to individuals as well as foreign debt and mortgage loans. More typically, we have acquired loans secured by anything from jewelry and rare coins to tankers. We have had loans secured by jet aircraft and race horses. Obviously, these types of credits have provided us with a wide range of collateral and, in turn, owned assets. As a result of the embezzlement by the owner of a bank who had a yen to be in the movie business we are currently the proud owners of a movie, set in Kentucky race horse country, starring Tab Hunter and Jose Ferrer. We have also owned a breeding stallion with syphilis, a mechanical gorilla and a collection of vintage wines. We recently had an interest in the largest container ships in the world as a result of the bankruptcy of U.S. Lines. With the downturn in the energy business and the failures of Penn Square and Continental Illinois we were directly or indirectly the largest owner of oil rigs in the United States. In addition, we have taken possession of producing oil and gas properties, as well as all types of collateral related to the energy business. As a further part of the deterioration in the economic conditions in the Southwest, we also acquired the entire inventory of a defunct Rolls Royce dealership in Midland, Texas. I might add, those cars sold quickly, as do most of the other vehicles we acquire.

Let me turn to our owned asset portfolio. Our portfolio of real estate has included the entire spectrum of real property interests. Our holdings have ranged from single family dwellings to farmland, from strip shopping centers to office buildings, hotels, undeveloped land and at one time included the entire undeveloped real estate in Snowmass, Colorado. We have owned most of the undeveloped property in Key Largo, Florida, as well as owning real properties that consist of restaurants sitting on barges that are permanently moored in San Francisco, brothels, and various other types of real property investments. FDIC has real property and real estate loans of about $3.2 billion and is financially responsible for an additional $3.1 billion at NCNB-Texas.

It is the FDIC's policy to sell real estate for fair market value as quickly as possible. All of our properties are for sale! We do not believe in dumping nor do we believe in holding. Rather, we believe that a property should be aggressively marketed, exposed to the market and sold for fair market value. If we do not get offers at fair market value, by definition, we will hold the property until we can generate appropriate sales. The practice of dumping implies that one is ratcheting-down real estate values by selling property at any price. The FDIC does not dispose of assets in this fashion!

We believe, however, that it is detrimental to the economic development of affected communities, and to real estate markets, to have the government warehouse real estate for future sales. The holding of large amounts of property off the market under the assumption that this is beneficial, either to the government, or to local economies is based on falacious reasoning. The mere fact that the government is holding substantial numbers of properties off the market, waiting for a price increase before selling, serves as a chilling deterent to outside investors seeking to enter a market and help spark economic recovery. The uncertainty surrounding the government's future actions is inconsistent with new investment. Moreover, markets cannot be fooled and the overhang will further reduce prices; having the opposite effect proponents of holding desire.

Similarly, from the government's perspective the costs of holding are not insignificant. First there are the costs of managing the property, paying property taxes, and all of the other direct costs associated with holding property. Secondly, there are the not insignificant financial costs associated with the holding of the assets. Clearly, one would have to have very substantial increases in price, probably in excess of a doubling within five years to justify holding, using the Federal Government's cost of borrowing. If one were to factor in the risk of price changes into the discount rate, the appreciation rate would have to be significantly higher before it would make financial sense for the government to undertake these practices. The FDIC believes that it is inappropriate to hold assets off the market for the purpose of speculating on future price changes. Another argument frequently put forth in support of holding is to advance additional funds and enhance the value of the property. We do not believe it appropriate for the government to take on the role of developer by enhancing profits through entrepreneural developmental activities. Rather, the private sector should take these risks and reap the potential rewards.

In handling properties that we acquire from failed institutions, fair market value, and therefore our selling prices, are determined by the FDIC obtaining independent appraisals on properties. For smaller properties we require annual appraisals until the property is sold, with appraisals first being obtained when a loan goes into default. On larger properties, we will obtain two or three appraisals each year and average these to determine fair market value. While holding properties, the FDIC will utilize the services of independent property management firms. It is very rare that FDIC employees will handle these functions. We also, in extremely complex situations, have utilized the services of consultants on an asset or property specific basis to assist us in developing strategies and conducting negotiations. In some of our larger failed institutions we have contracted with the assuming institutions to manage the assets subject to FDIC oversight.

In disposing of real estate, we have traditionally used four approaches. (1), sale by liquidator; (2), sale by broker; (3), sealed bid sales and (4), auctions. Most of our smaller properties are typically marketed either by the liquidator or are listed with real estate brokers in the community in which the properties are located. In some communities, such as Southern California, where we have had larger quantities of residential real estate, we will actually operate a real estate office and co-op with local brokers on the same terms that are available to them if they sell another broker's listing. Larger properties are typically either marketed by brokers or are subject to sealed bid sales. We have found that sealed bids are particularly effective when we have several parties actively vying for a property and we wish to cut off a protracted multi-party negotiating process. Similarly, sealed bids are an effective selling tool, when, prior to our acquiring title, we have had significant interest in a property by several parties. Our sealed bid process involves placing ads in numerous papers and other publications, establishing a cut-off date, and inviting all interested parties to bid. The decision as to whether to accept the highest bid is tied to the appraised value of the property.

The fourth approach has been auction sales. We have found that the use of a skilled auction firm, accompanied by significant marketing, has yielded us large recoveries in certain areas of the country where we have large numbers of similar types of properties. On occasion we have sold some properties on an absolute basis, but these properties are typically small lots or homes with appraised values under $10,000 or are properties that have generated no interest during a several year holding period despite aggressive marketing. Let me emphasize however, that in all other cases we establish reserve prices that are tied to the appraised value of the property and in the event the price is not met, we do not sell the property.

Recently, as an experiment, we attempted to sell a number of our larger properties by combining the brokerage and auction approaches. We listed most of our larger properties with Cushman and Wakefield. They then exposed these properties to the market through aggressive brokering over a five month period culminating in an auction at Christie's in New York. The results of this combination of brokerage and auction proved very favorable. We sold half of the properties listed in the auction for $40 million, achieving approximately 100% of appraised value and had signed contracts with significant cash deposits within hours of the auction.

In handling the loans and real estate, as well as other assets we acquire as the result of the failure of FDIC insured financial institutions, we operate with a decentralized regional structure. We presently have six Regional Offices in Atlanta, Chicago, Dallas, Kansas City, New York, and San Francisco. These Regional Offices are responsible for the supervision of our Consolidated Liquidation Offices. Presently we have 16 Consolidated Offices that are housed at locations separate from our Regional Offices and four sites that are housed at our Regional Offices. We also, for a limited period of time, will operate liquidation offices at the location of the failed bank until such time as we can bring the assets into a consolidated site. No assets are worked out of the Washington, D.C. office. Rather, decision making is handled much in the same fashion as it would in a large bank holding company. Authorities are delegated by the FDIC's Board of Directors to the Division Director, who in turn re-delegates these authorities to Associate Directors and Regional Directors. The Regional Directors are permitted to delegate significant amounts of authority to the individual consolidated sites. As a result, only the largest transactions come to the Washington Office. For example, during 1988 the Liquidation Division took 28,100 actions requiring approval; of these, only 278 cases required approval by the Washington Office; less than 1% of the total. This decentralized approach, with reliance upon delegations of authority, allows us to more efficiently and expeditiously arrive at business decisions, achieve faster collections and better serve the public.

Let me turn, for a moment, to the pending legislation and the S&L crisis. As we meet this afternoon, the legislation is clearly evolving and none of us can give you a definitive picture of what will emerge. However, based on the bill that passed the Senate, there are several things that appear clear. One is, that it is the Senate's intent that FSLIC be merged into the FDIC. Second, that FADA be dissolved. And third, that the disposition of the S&Ls currently in conservatorship, and under the management of the FDIC, as well as future S&L failures for the next three years be handled by a new entity, the Resolution Trust Corporation. The huge amounts of real estate that you will hear talked about coming out of the S&L industry will be handled by this separate entity. The Resolution Trust Corporation will be overseen by a Board of Directors made up of the Secretary of the Treasury, the Chairman of the Federal Reserve Board and the Attorney General. It will have its own Chief Executive Officer appointed by that board. It will have the ability to contract with the FDIC, private parties or have its own staff. The role that will be played by the FDIC is not yet apparent.

Nevertheless, if the FDIC is to assume responsibility for the FSLIC portfolio, we clearly will be dealing with a larger amount of real estate assets than we have in the past. The basic policies and philosophies that I have enunciated will continue to be the approach that we will use. However, we recognize that the increase in the volume of real estate, as well as its concentrations in certain markets, where financing is not readily available, will require us to pursue more aggressive policies if we wish to sell for fair market value. Let me be somewhat more specific. We intend to continue to operate under a regional structure. However, we will probably augment this structure with regional real estate sales and management offices to deal with the larger commercial properties and loans. We will also establish a national marketing staff in one or more money center cities to serve the national investment community.

Another practice in which we have previously engaged, albeit selectively, will be the willingness to provide financing in conjunction with the sales. Let me be more explicit. Recent evidence has indicated to us that in certain markets in the Southwest, it is virtually impossible for a purchaser to obtain conventional mortgage financing on commercial real estate. In these situations we have sold properties requiring 20% cash down and have provided financing at traditional market rates, with secondary market acceptable documentation, assignment of rents, and all of the other protections a lender would be seeking. In evaluating a sale where the FDIC provides the financing, we will clearly factor into the business decision any concessions that are provided in the financing terms and expect these to be reflected in the price. We view the sale of property with FDIC financing on a net present value basis.

When we provide financing, we do not intend to hold the paper for the long-term. Rather, we have been successful, as part of our asset marketing/bulk sales activities in selling this paper to investors who are interested in holding it but are not interested in originating loans. Specifically, I am referring to financial institutions who lack the expertise to do their own originations, such as pension funds and other types of institutional investors. I anticipate, that with a significant increase in the volume of larger real estate, and in particular land, we will have to be even more flexible in providing financing.

One of the questions that is frequently raised is: "how does one go about doing a deal and how does the FDIC react to proposals?" As I mentioned to you a few moments ago, we operate with a decentralized structure. What that means is that buyers or borrowers must deal with the local office handling the asset. In most instances these offices are able to make their own business decision and react accordingly. If the deal is of a magnitude that they cannot, they will have to prepare a proposal and forward it to their Regional Office. In many instances we will have established approved minimum sale prices at the time the property is placed on the market. This enables our offices to consumate a deal almost immediately. Clearly, the more creative a deal is, or the larger it is, the greater the number of levels of review. However, we have the ability, with our delegations and the support of our Board, to react quickly. And let me assure you, the better the deal for the FDIC, the faster we can react.

Let me conclude by addressing an often expressed fear, namely that several hundred billions of dollars of real estate will suddenly descend upon the market place when the President signs the pending legislation. This clearly is not going to be the case. From experience I can tell you that many of the problem assets are still in the loan stage and it will take a number of years before the entity having responsibility for disposing of real estate will have clear title to those properties; and be in a position to bring them to market. The legal process, alone, will serve to stagger the real estate coming to market. Moreover, the FDIC has been fairly successful in attempting to bulk sale loans. I expect we will expand this effort and will endeavor to tranfer as many problem real estate loans to the private sector as possible; thereby avoiding taking title to the collateral and having to dispose of it. Clearly, our sales price must be consistent with our goal of maximizing the net present value of the assets.

As we go forward with this endeavor there will be a need for new ideas and creative thoughts. I urge those of you in the private sector to provide us with your thoughts and ideas on how we can best deal with the problems that confront us all. Private sector firms, whether they be appraisers, brokers, managers, will clearly be called upon to provide support to this effort. As developers, there will clearly be opportunities for you to acquire properties that are distressed, in need of completion, or a whole new concept in order to make them profitable. I urge you not to overlook this large body of real estate that will be available. Lastly, it is clear to me that there will be a need for greater securitization of real estate. I urge you to consider combining your professional talents together with those of investment bankers. Come up with new vehicles. Privatize the real estate holdings of the Federal Goverment and give individual investors the opportunity to share in the upside by combining your professional talent with their capital.

Thank you for your attention, I look forward to answering any questions you might have.