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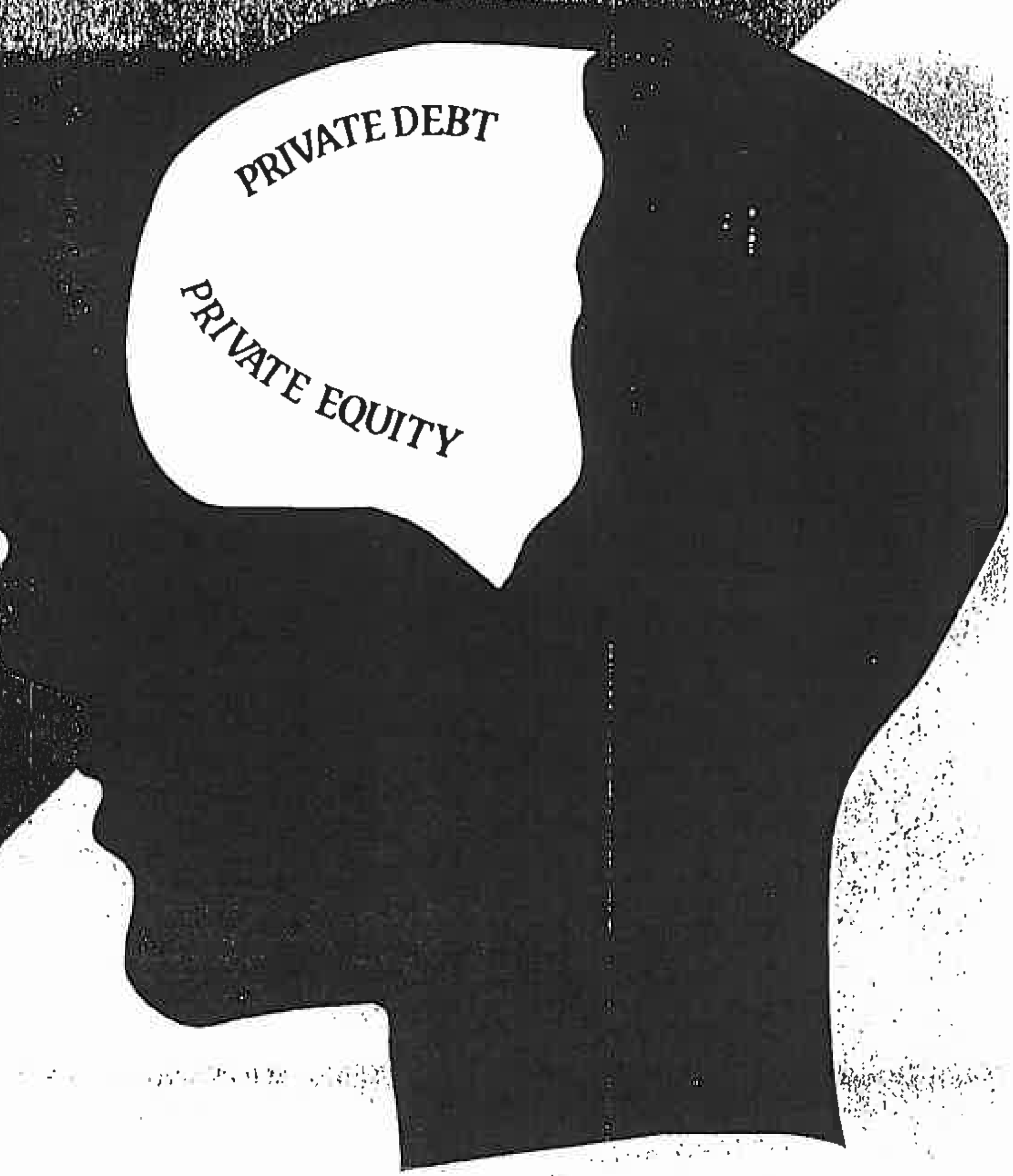
PENSION REAL ESTATE

The Pension Real Estate Business:

Of One Mind on the Four Quadrants?



Ex-official Reviews the RTC Experience

Peter H. Monroe, one of PREA's newest members, is president of Sembler Management, a division of The Sembler Company. Sembler is a real estate development and management company based in St. Petersburg, Florida.

Previously, he served as President of the Oversight Board of the Resolution Trust Corporation, making him the senior officer of a cabinet level Board during the Bush and Clinton administrations that oversaw the largest real estate liquidation program in history.

In that capacity, he was a leading advocate of the RTC's securitization program and other financial innovations.

He also has served as General Deputy Assistant Secretary of Housing at the U.S. Department of Housing and Urban Development (HUD) and General Deputy FHA Commissioner. At HUD, he led efforts to reform the agency in the wake of the "Robin HUD" abuses, including termination of the HUD, multi-family and co-insurance program. At the FHA, he served as chief operating officer.

Prior to these assignments, he held a number of private and public sector positions in the residential and commercial real estate areas.

He holds a law degree from Harvard, a master's degree from Oxford University and an undergraduate degree from Williams College.

QUARTERLY: As a backdrop, the RTC conducted the largest liquidation sale of real estate in history; it was the largest real estate company in history and it was an institutional company.

My first question is: were the numbers so large, the program requirements so contradictory, the public scrutiny so great and the time pressures so great that the job was impossible to do properly?

MONROE: Yes, according to normal business practices. First of all, you should understand what the RTC's handicaps were. It was more than just the quantity of assets. It was also their condition. They were often ill-conceived not just in the sense of over-building. They were typically poorly located, out in the boondocks. Due to inefficiency or fraud, adequate information on the assets was lacking. Due diligence often began from scratch. There was no proper business plan as PREA members know such a term.

QUARTERLY: Wow!

MONROE: For example, in 1990, neither systems nor monitored plans were available to tell the RTC whether money returned to it came from a sale or a pre-payment of a mortgage. How could they tell which programs worked and which didn't? The RTC had little time to develop their systems or business plans; however, when requested, the RTC, under Bill Seidman, was as responsive as conditions permitted.

I just had a two day retreat with my new company, The Sembler Company. It has taken them thirty years to develop excellent systems to handle a billion dollars of shopping centers. The RTC was a four hundred billion dollar operation, so this is four hundred times as many assets. I would say if the real estate systems of the RTC were rated a one or a two, the company I am with now is a nine or a ten. That's my plug. But it's also the truth. The RTC was also subject to many more regulatory and legislative constraints than there are when you simply develop or own property in the private sector — including requirements to keep information which were irrelevant to our key goal — making money for the taxpayer.

You are correct that many RTC program requirements were contradictory. What was our real mission? In the private sector you are supposed to maximize value. When you look at the legislation establishing the RTC, the agency's priorities jump off of the legislative pages — **maximize value.**

Yet, there was tremendous non-statutory Congressional pressure to sell assets quickly which usually was contrary to maximizing value. It is true that some assets were deteriorating so that a quick sale had some advantages. However, that problem was solvable by good management. One of the first portfolios - over $1.2 billion was managed and sold privately and successfully.

QUARTERLY: Wasn't there also the contradictory requirement of trying to maximize prices without disturbing real estate markets?

MONROE: Yes. However, when you have an excess of supply over demand in any market, prices naturally fall. Such effect is really not disturbing the market. Rather, it is the market working efficiently. While prices fell through normal market forces, I believe lack of good business practices often exacerbated the fall. Many people were learning big-time real estate on the job. The job itself was monumental, the scrutiny intense, and there was initially little inclination for planning and performance measurement. The result, as stated, was an obsession to sell assets quickly and provide minimal information to the Oversight Board, Congress and the public.

You are also right about public scrutiny — much of it is very hostile. Bureaucrats are afraid to act when under (often unfair) attack. You don't have that constraint in the private sector. In fact, fear of being perceived to make mistakes was probably one of the reasons why Congress and even a certain RTC CEO wanted to sell assets quickly — and shut down the agency prematurely to avoid the potential of something terrible being discovered on their watch.

QUARTERLY: Were there other problems?

MONROE: Yes. Another problem was that many leaders were in a state of denial as to how bad the markets really were. The real estate markets were terribly over built, and the condition of the financial markets indicated a clear credit crunch, which the Treasury and Federal Reserve didn't initially acknowledge. That is why my first act on the recommendation of my predecessors was to push for a $7 billion dollar financing program, so that sales prices were less impacted by liquidity. The RTC used only a small percentage of available seller financing, which I partly ascribe to bureaucratic fears that a loan would fail with adverse consequences for the originator.

There were also very significant ethnic and gender preferences which the Oversight Board, in my opinion, mistakenly had approved earlier in creating the RTC's strategic plan. Since we had created the preferences, it was politically awkward to undo them even though the Board, Treasury and Justice attorneys informally considered them unconstitutional. Our solution was to leave the preferences in place, which were in fact resulting in more balanced ethnic and gender participation, but hold the line against the Rainbow Coalition's demands for increased preferences as well as quotas with specific targets and timetables. We wanted to create a "level playing field" for all program participants.

QUARTERLY: Why do you think that Congress pressured you to accelerate asset sales?

MONROE: As I mentioned, one of the reasons why Congress wanted to sell fast was to make the problem go away. They hated to vote cash for the RTC in front of an angry electorate. I remember having to sign a $30 billion check! The loose term of the word "bailout" vs. "clean-up" made it look to the public as if Congress were looking to bail out stockholders. Exactly the opposite was true. Well informed congressmen and senators, Mack, Dodd, Pressler, Leach, Frank et al understood these issues and often spoke up. Over a thousand officers and directors served hard time; and no shareholders were "bailed out".

The way that the federal government accounts for its expenditures also didn't help our efforts. OMB doesn't use GAAP accounting. It looks at straight cash in and cash out. Everyone was focused on how to cut the deficit. If we could sell assets quickly, even if in the long run we got less money, we got quick cash and looked good on the deficit. I think that kind of thinking continues to hurt the taxpayer. I hope the presidential candidates hit these issues head on. We need a leader who understands management as well as rhetoric.

Furthermore, the RTC with all these problems, lacked a full-time CEO. I'm sure you recall that Bill Seidman was the CEO not only for the RTC but also for the FDIC.

QUARTERLY: What do you think about the RTC's bulk sales program? Its auctions? When should large institutions use such techniques vs. more normal asset sales techniques?

MONROE: From 1989 through 1991, very few financial institutions were using bulk sales. The RTC thought the bulk sales program was manna from heaven. There is no question the bulk sales program accelerated the pace of asset sales program. Even though it was done through private contractors, the individual asset sales program was slow and burdensome — the so-called "SAMDA" program. Contracting procedures were overly complex. The big players began to give up trying to do business with the RTC. This was very unfortunate because the individual asset programs: auctions, negotiations, etc. brought the highest asset prices notwithstanding RTC's convoluted studies trying to support bulk sales.

To worsen matters, the RTC often was not managing assets -- allowing them to deteriorate. Contributing to the problem was the fact that S & L's in, let's say, Arizona, often owned property in Florida. Thus, the Arizona RTC became responsible for assets thousands of miles away in Florida. I don't believe that problem was ever fully corrected.

From a cynical and bureaucratic point of view, the RTC liked the bulk sales program because, if you sold a bunch of assets all at once, nobody could ever figure out what price you sold an individual asset for. That way, if somebody took that asset; flipped it and made some money on it, you would never know.

I personally saw deals where assets were grossly under priced. The bulk sales advocates would argue that even though the assets were improperly priced, competition would assure a premium for the undervalued asset.

But there is no question that one of the big reasons for the bulk sales program was as a way to hide the pea. I saw and was informed of many examples of that and they were very disturbing — yet very difficult to prove. I know the RTC Inspector General and the U.S. Comptroller General had difficulty in such proof, however, the Chairman of the National Advisory Board, Philip Searle, a former private sector CEO, conducted extensive interviews which revealed the private sector's opinion that the RTC was being ripped off by the bulk sales program.

QUARTERLY: Did the RTC ever balance its books?

MONROE: In a broad sense the RTC balanced its books. That is in the sense that the GAO finally gave a clean opinion that the RTC's reported losses, as a whole, were correct. The Executive Director, David Cooke, was the one who really made that happen — although others take credit for it. I don't understand why the RTC as of my departure in June, 1993, hadn't balanced and

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audited more than a handful of receivership books. I received information that basically the RTC just plugged the numbers which is completely contrary to good business practice. It truly amazes me that the RTC got away with it. The Inspector General and I both complained — to no avail. You recall, I was at HUD with Jack Kemp. We would never have discovered "Robin HUD" if we did not have some way of balancing the books. But just one more thing on bulk sales, if I could...

QUARTERLY: Sure.

MONROE: The reason why bulk sales often makes some sense for banks is that solvent banks generally have good information about their assets — much better information than the RTC had. So, if the ingredient for a successful sale is good information about what you are selling, so that buyers have confidence in your due diligence, and full exposure of an asset to the market, it makes much more sense to do bulk sales. In addition, with massive capital flowing into the real estate markets through REITS, and other public vehicles, I believe that bulk sales have become more effective. In fact, I have seen many instances of REITS overpaying for assets.

QUARTERLY: What lessons did you take from your HUD and RTC experiences and how does it apply to the private sector?

MONROE: I learned the best way to sell real estate assets is one by one with good information and good competition. Its mind boggling to contrast the attitude of the RTC sales people with the people who sell assets in the private sector. Our Company's emphasis is to go beyond asset management and marketing to add value through changing the tenant mix and through renovation, demolition and even expansion of properties. The RTC was truly a different world and I think people should be very careful about taking too many lessons from the RTC and applying them to their own institutions. Securitization of performing assets is an entirely different matter which I will address below.

QUARTERLY: That brings up a philosophical question that applies both to the RTC and to the pension real estate business. Some people contend that real estate at its very essence is an entrepreneurial business and its just the entrepreneurs that make money. The idea is that institutions are always going to be outgunned by smarter, entrepreneurs. There are other people who think that institutions have a role not only in the process but also in the profit. What do you think?

MONROE: There were many excellent people at RTC; many of whom were from the private sector. Well over half of the employees at RTC were from the private real estate sector. But there were very sharp career civil servants from the FDIC and the scrapped Federal Savings and Loan Insurance Corporation "FSLIC". So, as a general proposition I don't think person-for-person that the RTC was so outgunned but the procedures of the RTC and the leadership were often harmful to the field troops. As I said earlier, a healthy proportion of the RTC leadership was learning on the job.

QUARTERLY: You put much emphasis at the Oversight Board on the RTC improving its business plan. Why did you consider that so important and was it in fact improved?

MONROE: Well, without a plan, no one had any priorities, nor benchmarks to measure performance and adjust toward policies that made money and away from the losers.

When I got there, the business plan was a three month plan. And the primary results being measured were the number of thrifts being closed and the gross book value of assets disposed of, i.e. the goals were not related to saving taxpayer dollars. You can sell anything for a nickel.

What we tried to do was to get the RTC to measure performance. You can't measure performance without a plan - and the plan should reflect the mission of the agency rather than being some alien instrument as it was when we first got there.

It's too bad that the RTC wasn't more forthright with the Oversight Board which had stellar members who understood business from Alan Greenspan and Nick Brady, Tim Ryan, and Bill Taylor, to one of the country's top real estate experts Bob Larson, and a successful former mortgage banker and Federal Reserve Governor, Phil Jackson. Jack Kemp was also an excellent board member, until in a late night reorganization, his position was unfortunately eliminated. The Treasury Secretary was backed by people like John Robson, former President of Searle, and Bob Glauber, a nationally known management consultant and business professor at Harvard. Greenspan had the support of people like Federal Reserve Governor John LaWare, the former head of Shawmut Bank; David Mullins and many more of the best business minds.

QUARTERLY: Bill Seidman credits your role as being important in encouraging the securitization of RTC Mortgages...

MONROE: First, may I try one more time to emphasize the importance of good management in government.

QUARTERLY: Go right ahead.

MONROE: If Republican Stanley Tate (Clinton nominee to head the RTC, who withdrew before confirmation) had been confirmed, things would have improved. He's a guy who knew real estate, knew receiverships and he's one of those persons who takes his cot and sleeps in his office until he totally understands what's going on. If you want to talk about something that was terrifying to bureaucrats over at RTC, it was Stanley Tate. And the bureaucrats skillfully scuttled his nomination.

Roger Altman was also very good but Altman was both Deputy Secretary of the Treasury and the RTC CEO. Altman deserves much more credit than he received.The same goes for Frank Newman, the former Vice Chairman of the Bank of America. At least, Newman got the respect he deserved. The Oversight Board, if I may say so myself, also had a terrific staff — led by a former senior engagement manager, from a top management consulting firm, and an experienced general counsel who was a former law review editor-in-chief.

But to answer your question: The securitization program was the area where we were both the smartest and the luckiest.

I was out in Dallas and discovered that performing mortgages that had never failed were being sold at seventy-five cents on the dollar. I also found a specific case where commercial mortgages, medical mortgages where doctors were on the hook, were selling for 67 cents on the dollar and not one of these mortgages had missed a payment. Anybody who knows anything about real estate knows that if you have a recourse mortgage with a doctor you are probably going to get paid off.

Since we couldn't get the kind of information we wanted from the RTC, we often had to base recommendations on examples like this. I found people would write me and tell me horror stories. I accept the old adage, "if it ain't broke, don't fix it". However, if it is clearly broke, action is mandated. It was recommended by a former Board President that we take a good look at securitization. We clearly weren't achieving what the taxpayer wanted.

My view was that the smartest thing we could do was to adopt a "hold" strategy for performing mortgages, which is really what you are doing with securitization. It looked to Congress like we were selling them because we got cash, but we were really holding them at a slightly higher cost than if we had simply borrowed from the Treasury, except it was just off budget. Federal accounting made it look like a sale, (for once, the federal accounting rules were helpful), but if anybody ever takes a good look, the reps and warranties of the securities were backed by the full faith and credit of the United States. One warranty was that the mortgage was originally prudently underwritten, another that it had been serviced properly from day one. How would you like to defend a Lincoln mortgage on those grounds?

Most importantly, the success at the Fed in reducing interest rates at a critical time, caused loan repayments to come rolling in and resulted in billions of taxpayer savings.

QUARTERLY: How do you compare and contrast the securitization program of the RTC with the securitization in general that's occurring now in the private sector?

MONROE: The RTC had no choice but to securitize because we were so inept at selling commercial mortgages on a bulk basis and everyone was pushing us to convert the assets to cash. So we had to do it with minimal information and maximum reps and warranties. The motivation for insurance companies and banks is different. They are securitizing mortgages for business reasons such as risk-based capital rules and interest rate risk. This is similar to Fannie Mae and Freddie Mac on the residential side, which hold only a minority of their mortgages. It's a way to allow banks to keep their client relationship and satisfy them by giving them a commercial mortgage while at the same time getting it off their books. The business is up front. You get the client relationship. You probably get servicing, but you get rid of the actual loans the same way mortgage brokers get rid of residential mortgages and you proceed on to the next one. You don't have to carry a lot of capital.

The RTC's securitization program for performing commercial mortgages was one of the RTC's finest legacies. It legitimized the secondary market method of taking out commercial mortgages which, unlike residential mortgages, are much less uniform and, therefore, harder to securitize. It developed such innovative methods as the use of Libor rates to reconcile the variety of interest rate formats of the underlying mortgages. The program's success is underlined by Wall Street's difficulty for many years in securitizing such mortgages prior to the RTC.

The solid performance of these instruments, (e.g. no Fitch downgrades through July, 1994) despite the uniquely difficult nature of underlying RTC assets, gave comfort to pension funds, foreign investors and other non-traditional investors in commercial mortgage securitization.

In 1994, the RTC's securitization efforts was reduced. The slack was taken up by the private sector whose activities have more than replaced the RTC.

QUARTERLY: So if I understand — you are basically saying in the case of RTC securitization, the issuer was forced into doing it. The issuer gave maximum representations and warranties.

MONROE: Yes. We gave the maximum reps and warranties to people that trusted us and rightfully so.

QUARTERLY: And you had relatively poor information yourself about the mortgages, whereas private issuers act voluntarily to capitalize on an opportunity with maximum information?

MONROE: Yes. But the commercial securitization program holds great promise and the real estate and finance organizations, notably The National Realty Committee, are continuing to improve the process.

In my opinion, the securitization program got off track when it was applied to non-performing mortgages.

These programs were much like bulk sales. They were known as the "N Series", "MIF", and Patriot programs. In these programs, the RTC did not keep the upside but sold a portion of it with very little knowledge and competition I remember one deal for $750 million that had only two bidders.

In the long run, I believe the RTC will be given credit for its creativity in developing the true securitization program; as well as innovative auction approaches and the foundation for a private contractor program. Less credit should be given for its bulk sales and non-performing mortgage securitization initiatives.

After all is said, the country was better served by the RTC doing this massive program than the myriad of other federal agencies I have witnessed.

QUARTERLY: Thank you. ■