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INTRODUCTION

On September 9, 1998 the Office of Inspector General (OIG) Hotline received a call from Ms. Pearlene Hamler, President, Board of Directors, Central Piedmont Economic Association Inc. (CPEA). [1] According to the documentation provided by the Hotline, Ms. Hamler alleged that the Federal Deposit Insurance Corporation (FDIC): (1) was not fair in considering her proposal requesting that the Corporation donate a building (the Coreast Savings Bank, FSB building commonly known as the River Ridge Branch) to CPEA, and (2) did not honor an agreement to donate the building to CPEA if CPEA acquired the grounds on which the building was standing. Ms. Hamler believed that FDIC did not follow fair and appropriate business practices, and the Corporation took actions that were based on racial bias. On September 28, 1998, the OIG Hotline forwarded the allegation to the Office of Congressional Relations and Evaluations for review.

BACKGROUND

Description of Events Leading to FDIC Having Interest in the Building and the Parties Involved in the Lease

In 1979, American Federal Savings and Loan Association (American Fed) and River Ridge, Ltd. entered into a 25-year ground lease agreement (lease). [2] Under the original lease, American Fed was responsible for constructing a building suitable for use as a branch facility of its savings and loan association. The original lease also required American Fed to pay rent for the land upon which the building was built, taxes and assessments, utilities, maintenance and upkeep.

Section 17 of the lease provides that the lessee cannot transfer the premises without the consent of the landlord. Under the terms of the lease, any transfers of the building, whether by sale or donation, could only be accomplished with the approval of the landlord. Thus, the lessee could not sell, or otherwise transfer, the building without the approval of the lessor of the property upon which the building was located. The landlord also agreed not to unreasonably withhold its approval if the transferee had the requisite experience and financial resources and expertise to assume the lease. However, in order to obtain the landlord's approval, a transferee had to establish, among other things, the financial ability to pay on the lease.

The lease states that the use of the land was for the purpose of establishing a branch office of a specific institution, American Fed, and for the business purposes in which

[1] According to their 1998-99 funding request, CPEA was founded by a group of citizens whose mission is to plan and implement economic development projects for low-income and minority communities. CPEA is a member of, and has been in contact with, the National Federation of Community Development Credit Unions to begin the process of organizing a community development credit union for low-income citizens in central Virginia.

[2] In 1979, River Ridge, Ltd. entered into the lease with American Fed. Shortly thereafter, River Ridge Ltd., became River Ridge Limited Partnership. A lease memorandum, which commenced on October 24, 1980, was entered into with River Ridge Limited Partnership and American Fed. However, the lease assignment dated June 24, 1981 was entered into under the name of River Ridge, Ltd.

savings and loans are engaged. The lease is further conditioned on the lessor obtaining appropriate approvals of the "Federal Savings and Loan Board."

Coreast Savings Bank, FSB (Coreast) became successor in interest to American Fed. On March 6, 1992, Coreast was taken over by the Resolution Trust Corporation (RTC). Once RTC acquired the building, it elected not to repudiate the lease and assigned management and disposition responsibilities for the building to Graimark Realty Advisors Incorporated (Graimark). Graimark's contract was in place from December 1991 through November 1996 and included the River Ridge Branch as well as other assets. During its contract term, Graimark attempted to terminate the lease, modify the lease, lease the building and dispose of the building on behalf of RTC/FDIC. The building was advertised in local real estate magazines and newspapers, and placed in auctions for sale. However, the lease was neither terminated nor modified, and the building was not leased or disposed of.

FDIC assumed RTC's position as successor in interest at the sunset of RTC on December 31, 1995. River Ridge, Ltd. continued to be the grounds owner, as a fee simple estate, and FDIC became the building owner, as a leasehold estate.[3] FDIC continued to pay the grounds rent, taxes, and ground maintenance expenses through August 1998.

Applicable Policies and Procedures

The applicable policies and procedures for RTC to manage and dispose of acquired assets were contained in the Asset Management and Disposition Manual (AMDM). The AMDM provided policy guidelines and mandatory directives, which were designed to accomplish RTC's asset management and disposition in an effective and efficient manner. The applicable policies and procedures for FDIC to manage and dispose of acquired assets are contained in the Asset Disposition Manual (ADM). The ADM was developed for the purpose of providing policy, a comprehensive reference guideline, applicable delegations of authority, and statutes and regulations.

General Management and Disposition Goals

The following general goals for marketing RTC assets apply to the circumstances surrounding the River Ridge Branch:

- produce timely sales at the highest possible price;
- provide adequate exposure to the market for all available properties;
- provide accurate and current information to the market to all available properties; and

[3] According to an appraisal received January 12, 1998 the definition of a Fee Simple Estate is absolute ownership unencumbered by any interest or estate, subject to only the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat. The appraisal defines a Leasehold Estate as the interest held by the lessee through a lease conveying the rights of use and occupancy for a stated term under certain conditions.

- educate, inform, and motivate the regional and local real estate communities regarding RTC assets and the sales process.

The following general management and disposition goals for FDIC owned real estate apply to the circumstances surrounding the River Ridge Branch:

- timely sales which maximize financial recovery to FDIC on a net present value basis;
- adequate exposure of all properties to targeted markets;
- fair and consistent treatment of the public in the marketing and disposition of assets; and
- continued education of brokerage community and general public on the acquisition of FDIC properties.

<u>Lease Buyout and Leasehold Estate</u>

Neither the AMDM nor the ADM contain specific guidelines for a lease buyout or management and disposition of a leasehold estate that would apply to RTC and FDIC efforts to manage and dispose of the building.

<u>Donation of properties with nominal value</u>

An asset donation policy was in place at RTC and exists at FDIC. The RTC policy stated that promotional items, or items determined to have nominal value after attempts to market and sell the items have been unsuccessful, should be donated to non-profit organizations.

With regard to FDIC, the ADM states that assets can be disposed of under the nominal value guidelines [donated] if they have no reasonable recovery value and meet one or more of the characteristics described below:

- The estimated market value of the property shown by the appraisal, or other valuation method, is very low.
- The property has been marketed for an extended time (12-18 months), with no reasonable offer.
- Holding costs for the property are high compared to its anticipated recovery value.

The ADM provides that, once a property has been identified as being eligible for the donation program, the Office of Real Estate Account Officer will contact local charities, non-profit organizations, and public agencies, or advertise the property via media to determine if there is a mutual interest. Every office should maintain a list of properties available under the program.

Proposals for donation of FDIC properties should be submitted from an eligible public agency or non-profit or charitable organization with an application approved by the governing body in the area of the property. More specifically, each proposal must contain:

- a completed application form;
- certification by the applicant that the information in the proposal is accurate;
- a letter of approval from local governing body;
- the applicant's proof of non-profit status and the required current year Internal Revenue Service letter;
- a duly authorized corporate or board of directors resolution approving submission of the request;
- a description of intended public use and a statement demonstrating that the asset is being conveyed for public good;
- written commitment from the applicant stating the proposed public use for a specified period;
- a statement of experience and capability of applicant to manage, operate, and develop the property;
- proof of funding availability for operation, rehabilitation, or construction, to include (if applicable) letters of funding commitment; and
- a written agreement by the applicant to accept the property in its existing condition (meaning no additional costs are to be incurred by FDIC with the negotiated disposal of a given property under this program), to use it for the purposes outlined in the proposal to FDIC, and to release and hold FDIC harmless from all liability arising at any time after the conveyance and incurred from or in connection with the property.

If only one proposal is submitted for conveyance of the property at no cost, FDIC may accept that proposal provided it is a feasible and beneficial use of the property. Additionally, FDIC may reject any and all proposals for donation. If an interested public agency or non-profit entity cannot be found, the local taxing authorities should be approached regarding simply deeding the property to them in lieu of paying taxes.

Case Memorandum Procedures

RTC and FDIC policy requirements for case preparation are very similar. They state that a case memorandum should be a persuasive written document used to request and obtain authority to act with respect to an asset. More specifically, cases should:

- seek authority to act from the proper individual or committee; and
- create a permanent record of RTC/FDIC's actions taken to conform to its fiduciary responsibilities. Each case should include:

    (a) Appropriate address
    (b) Proposal section
    (c) Signature lines
    (d) Description of assets
    (e) Brief background
    (f) Financial highlights
    (g) Alternatives and recommendations
    (h) Substantiation

Delegations of Authority

Authority is delegated to various FDIC officials to conduct and expend funds for asset management and disposition functions on behalf of the Corporation. Delegations and redelegations of authority are granted to the appropriate person or committee to allow decisions to be made at the appropriate level in the organization. The redelegations of authority used to approve the August 1998 River Ridge Branch lease buyout expenditure case were Expend/Extend Loans (C-3) and Write-off (C-25) dated September 15, 1997.[4]

- C-3 allows the ORE Management Manager, in the Asset Management Branch to "…authorize disbursements of sums in an amount not to exceed $3 million net of projected income, per calendar year for the protection of any asset or for such other expenditures as may be required in connection with any particular asset liquidation…" The redelegation allows the expenditure of up to $1.5 million.
- C-25 allows the ORE Management Manager, of the Asset Management Branch, "To write off any asset which is categorized as non-discretionary as defined in the Division of Resolutions and Receiverships asset disposition procedures manual, or any other asset with a book value of $15 million or less." The redelegation is unlimited for non-discretionary assets, $5 million for discretionary.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives for this review were to determine whether:

- RTC/FDIC handled Ms. Hamler's request and the disposition of the building in accordance with applicable policies and procedures; and
- there was any evidence to suggest that FDIC's actions were based on racial bias.

To accomplish our objectives we:

- obtained an opinion from OIG Counsel that confirmed our analysis of RTC/FDIC's rights and obligations under the lease agreement;
- interviewed Ms. Hamler with the assistance of a criminal investigator from the OIG Office of Investigations;
- conducted interviews of cognizant Division of Resolutions and Receiverships (DRR) officials, the leaseholder, and the leaseholder's counsel;
- reviewed relevant RTC/FDIC policies and procedures;
- reviewed the asset file, the case prepared in June 1995, and the case file and case prepared in August 1998, relative to the disposition of the building; and
- reviewed other pertinent documentation relative to the building, the lease, and Ms. Hamler's request.

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[4] DRR delegations of authority were revised and effective July 1998. However, because the revision did not affect the field office redelagations, there was no need to reissue redelagations of authority.

RESULTS OF REVIEW

Chronology of Events Surrounding the Management and Disposition of the River Ridge Branch

In March 1992, RTC acquired Coreast and assumed responsibility for building maintenance and upkeep, taxes, and monthly payments on the lease. Rather than exercising its right to repudiate the lease, RTC assumed the obligations of the ground lease believing it would retain value and be easily sold, subleased or assigned. Accordingly, RTC assigned the marketing and management responsibilities for the building to Graimark. The building was marketed and attempts were made to terminate the lease agreement through the end of Graimark's contract term. After Graimark's contract expired on November 11, 1996, it appears that the building was not aggressively marketed or maintained. The only disposition activities associated with the building appeared to be Ms. Hamler's inquiries and the Corporation's responses to those inquiries until August 1998, when the building was going to be placed in an auction and negotiations for lease termination resumed.

Ms. Hamler's first written inquiry, on behalf of CPEA, was February 17, 1995. She submitted an offer of $80,000 "…for the lease agreement…" to Graimark on March 3, 1995. Both RTC and the landlord accepted the proposal. However, on August 30, 1995, the landlord rejected the proposal stating that they were not satisfied with the financial capability of CPEA to meet its obligations under the lease. We found no formal written communication of the rejection to Ms. Hamler in the files we reviewed. Subsequent to the landlord's rejection of CPEA's proposal, FDIC staff researched to determine if there were any government programs for minority banks (financial institutions). The documentation suggests that RTC's Office of Minority and Women Owned Business would be contacted once additional information was received from Ms. Hamler. Additional documentation located in the file suggested that FDIC had been willing to work with Ms. Hamler in her effort to obtain use of the building.

In May 1996, Graimark sent a letter to River Ridge, Ltd., expressing FDIC's interest in renegotiating or terminating the lease. On July 16, 1996, Faison sent the landlord's written offer to accept $147,469 from FDIC, to terminate the lease.[5] In light of Faison's offer, Graimark requested that fee counsel for FDIC submit an opinion letter regarding the FDIC's lease obligation. On September 10, 1996, the fee counsel provided a written opinion which advised FDIC "…to provide notice of its intent to cease payments under the lease and advise the landlord of its rights to administrative relief, providing guidelines for how and when to file an objection to the FDIC's decision." Counsel also noted that any damages, which would likely be incurred by FDIC, would not be more than $147,469. However, FDIC neither ceased lease payments nor pursued negotiations with River Ridge Ltd. to terminate the lease.

[5]River Ridge, a development of Faison Associates, is the landlord and property manager for the leased premises and performs day-to-day property management responsibilities. Lynchburg Associates is the general partner of River Ridge, Ltd. and Henry J. Faison is the general partner of Lynchburg Associates.

The FDIC Atlanta Office assumed responsibility for the building after Graimark's contract expired in November 1996. On November 19, 1996, Ms. Hamler sent a written request for FDIC to donate the lease to CPEA. Although it appears that FDIC was willing to work with her at the time, there was no evidence of a written response to her November 1996 request. According to Ms. Hamler, in January 1997, someone orally promised her that FDIC would donate the building to her organization. We found no evidence of that promise, nor could Ms. Hamler identify for Dallas Office staff the individual who had made the promise.

On February 18, 1997, Ms. Hamler sent an offer of $350,000 to Faison to acquire the grounds lease and the building. Faison did not accept the offer. The only documented response in FDIC's records to Ms. Hamler's offer was a letter dated February 16, 1998 from Faison. The letter stated that the building was under the control of FDIC, but all rights of assignment and subletting resided with the control of the landlord. Additionally, the letter indicated that any offers would have to be sent in the form of a purchase offer for the grounds.

As part of FDIC's downsizing and realignment, responsibilities for the building were transferred from the Atlanta Office to the Dallas Office in July 1997. Management of the building was assigned to the Dallas Office of Owned Real Estate (ORE), Property Management, while marketing and sale of the building was assigned to ORE, Sales. In September 1997, Faison made another offer to buy out the grounds lease, and again, FDIC took no action.

Dallas ORE, Sales requested an appraisal for the building on October 10, 1997 and a title commitment on December 5, 1997. Ms. Hamler called Dallas ORE, Sales in October 1997 to inquire about her previous request for FDIC's donation of the building. Dallas ORE, Sales was not aware of her previous donation request and told her to send in another request. Her second request was dated January 21, 1998. In the meantime, on February 27, 1998, Ms. Hamler sent another letter to Faison requesting that Faison respond to CPEA's request for donation of the grounds and stating that CPEA was prepared to offer $234,000 for the grounds. However, there was no evidence in FDIC's files of a response from Faison to her request.

In April 1998, Ms. Hamler received a response from FDIC relative to her inquiry about the donation, as a result of a congressional inquiry she made to determine the status of her request. The April 1998 response to Ms. Hamler outlined her responsibilities to obtain possession of the building. The letter stated that she must: 1) obtain the landlord's written approval and 2) have the landlord release the FDIC of all liability under the lease. However, it does not appear that FDIC's donation policy or requirements for donation were included in the response.

In August 1998, ORE's Mass Sales Department notified ORE, Sales that the building would be included in an upcoming auction. Knowing approval from the landlord was necessary for any assignment of the lease, ORE, Sales requested that ORE, Property Management secure an outside property manager with leasing authority to try to locate a tenant for the building prior to the auction. However, rather than obtaining a tenant, ORE determined that it would be in the best interest of FDIC to terminate the lease. Staff within ORE, Property Management prepared an Expenditure Case to expend no more than $105,000 to buy out the existing ground lease and write off the building. Management within ORE, Property Management approved the Expenditure Case on August 25, 1998 and negotiated a lease buyout with the landlord for $104,045 effective August 31, 1998. The termination agreement included the tenant's (FDIC) surrender of the demised premises (the building) to the landlord. During this time frame, ORE, Property Management stated that they had no knowledge of Ms. Hamler, CPEA, or Ms. Hamler's requests for donation. Further, ORE, Sales did not recall having any communication with Ms. Hamler between the April 1998 letter, telling her what she needed to do for the FDIC to consider donating the building to her, and the time the case was approved to buy out the remainder of the lease on August 25, 1998. We found no additional documentation of communication between Ms. Hamler and FDIC between April 1998 and August 1998.

OIG Assessment

Ms. Hamler had numerous contacts with RTC and FDIC staff from 1995 to 1998 regarding the River Ridge Branch. We believe that RTC and FDIC officials could have better handled these inquiries through improved communication. For instance:

- It was not clear that Ms. Hamler was apprised of the lease restrictions that prevented RTC and FDIC from unilaterally selling or donating the building or the lease payments to her when she first contacted Graimark. The first written document provided to Ms. Hamler from FDIC, which discusses the actions necessary for Ms. Hamler to take in order for her to obtain possession of the building, was the April 1998 letter from Dallas ORE, Sales.
- Ms. Hamler was apparently not formally informed by RTC of the landlord's rejection of the lease assignment relative to her $80,000 offer for the building in February 1995.
- It appears that FDIC officials did not provide Ms. Hamler with complete information regarding the requisite documentation for the Donation Program that was available in the ADM.
- When the building and the lease were transferred from FDIC's Atlanta Office to its Dallas Office, it does not appear that Dallas ORE was familiar with the events surrounding Ms. Hamler's previous proposals and inquiries.

RTC and FDIC expended funds (approximately $200,000 for rent, taxes, and maintenance) for 6 years to maintain a vacant building, for which the estimated market value had diminished to zero dollars according to a February 1996 appraisal. FDIC did not attempt to terminate the lease, lease the space, or otherwise dispose of the building from the time Graimark's contract expired in November 1996 until Dallas ORE contemplated placing it in an auction in August 1998. As a result, FDIC expended funds for 2 of the 6 years with only a remote prospect that those funds would be recovered.

Notwithstanding the above issues, RTC and FDIC officials followed applicable policy, procedures, and delegations in ultimately disposing of the lease (although, in hindsight, the lease should have been terminated sooner). Specifically, the August 1998 expenditure case:

- substantiated that the lease termination was maximizing the financial recovery to FDIC at that time;
- generally contained each of the elements required by the ADM; and
- was approved within the proper delegated authority.

RTC/FDIC's actions in response to Ms. Hamler's inquiries did not amount to a commitment to CPEA to go forward with a donation of the property. Even assuming Ms. Hamler's understanding that someone told her that FDIC would donate the property is correct, under FDIC's policies, such a donation must be approved by the Regional Director, and it was not so approved. In addition, the policies state that the recipient had to agree that FDIC would have no further financial obligations with respect to the property. Because of FDIC's continuing obligations under the lease, CPEA could not so certify. In fact, one of the proposals expressly included a provision that FDIC pay on the lease for a period of 2 years after the transfer, which is inconsistent with FDIC policy.

Further, while the lease did not require that a financial institution occupy the site, the intended use for the property clearly contemplated that a specific federally-regulated savings and loan would occupy the space. A credit union, with appropriate federal regulatory approvals, could arguably have occupied the premises. However, we have no evidence that CPEA had acquired such approvals for a credit union, or even that it was a legal entity. Because the credit union appears to have been in the developmental stages, not an actual business, there is no basis to evaluate financial capability or experience as contemplated by the transfer provisions of the lease.

Allegations of Racial Bias

Chapter II-B of the ADM contains guiding principles of FDIC's Division of Depositor and Asset Services strategic plan, one of which is the promotion of a high standard of integrity and professionalism. Chapter XI-E of the manual provides as a general disposition goal the fair and consistent treatment of the public in the marketing and disposition of ORE assets. According to Ms. Hamler, FDIC did not follow those general principles in handling those inquiries, and to a lesser degree, FDIC took actions that were based on racial bias. More specifically, she believed that FDIC and Faison were aware that CPEA was an African American organization. For that reason, she believes they terminated the lease agreement to preclude CPEA from acquiring the building, which is on the grounds of a mall that has allegedly not leased space to African American businesses. According to legal counsel for Faison, Ms. Hamler's initial proposal was not accepted because of CPEA's lack of creditworthiness. Faison's legal counsel also told us that the grounds were not for sale. Finally, in response to Ms. Hamler's request to purchase the grounds and the building, Faison stated in correspondence to Ms. Hamler that it did not have control over the use and occupancy of the building.

OIG Assessment

As discussed previously, both RTC and FDIC could have communicated better with Ms. Hamler. In particular, there did not seem to be a clear understanding on the part of Ms. Hamler as to FDIC's restricted ability to donate or sell the lease to CPEA. This lease term was key to RTC's and FDIC's ability to manage and dispose of the asset. Further, FDIC's failure to contact Ms. Hamler before it bought out the remaining term of the lease, given her continued interest for close to 3½ years, was not good business practice. These factors, coupled with Ms. Hamler's knowledge that FDIC was continuing to pay rent, taxes, and maintenance for a vacant building, could have given her the impression that FDIC was motivated by other than its basic principle of maximizing return on assets. However, all of the individuals we interviewed stated that the lease buyout was a business decision. In addition, during our review of relevant documentation, nothing came to our attention to suggest that FDIC's actions were based on racial bias.

CORPORATION COMMENTS AND OIG EVALUATION

On March 18, 1999, the Assistant Director, DRR, provided comments to a draft of this report. The response is presented as an Appendix to this report. DRR concurred with our assessments presented in the report.

DRR agreed with our statement that RTC and FDIC officials could have better handled Ms. Hamler's inquiries through improved communication. In order to improve communications with the public, the Government and Public Relations Group at the Dallas Field Operations Branch is developing a formal program to reinforce good communication and customer service practices. The program will focus on treating customers with respect and courtesy and responding to inquiries in a professional manner.

The draft report further stated that neither the AMDM nor the ADM contain specific guidelines for a lease buyout or management and disposition of a leasehold estate that would apply to RTC and FDIC efforts to manage and dispose of the building. According to its response, DRR periodically reviews and updates its Asset Disposition Manual and this matter has been referred to DRR's Asset Management Branch for review and consideration.

The Corporation's response adequately addressed the information and issues we raised in this report. Nevertheless, we are providing a copy of the report to the Department of Housing and Urban Development because representatives of that agency indicated to us that this matter might fall under its jurisdiction of fair housing and equal opportunity for nonprofit entities. We are also providing a copy of the report to FDIC's Office of Diversity and Equal Opportunity for its information and consideration because of the issues the report addresses.

APPENDIX

CORPORATION COMMENTS

Holmes-Gilbert, Dawn A.

From: Ivie, Stanley R.
Sent: Thursday, March 18, 1999 2:24 PM
To: Beard, Stephen; Holmes-Gilbert, Dawn A.
Cc: Forrestal, Jim; Ostermiller, William R.; Patelunas, Gail; Recchia, Giovanni; Spaid, Mike; Brooks, Gail; Coyle, Greg
Subject: River Ridge Ranch

The Division of Resolutions and Receiverships (DRR) appreciates the opportunity to review the draft report on the River Ridge Branch asset and concurs that applicable policies and procedures were followed in buying out the lease, and that there was no documented evidence of racial bias. DRR also concurs with your suggestion that Ms. Pearlene Hamler's inquiries could have been handled better through improved communications.

To improve communications with the public, the Government and Public Relations Group at our Dallas Field Operations Branch is developing a formal program to reinforce good communication and customer service practices. The program will focus on treating customers with respect and courtesy and responding to inquiries in a professional manner. A communications "Do's and Don'ts" tip sheet is also being developed in conjunction with this effort.

Additionally, the draft report noted a material weakness in that DRR's Asset Disposition Manual does not contain specific guidelines for lease buyouts or management and disposition of leasehold estates. DRR periodically reviews and updates its Asset Disposition Manual and this matter has been referred to DRR's Asset Management Branch for review and consideration.

Again, DRR appreciates the opportunity to review the draft report.

Stan Ivie
Assistant Director