Lessons Learned: Obtaining Value from Federal Asset Sales

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If the government decides to sell assets, how can it obtain full value? Four case studies provide valuable lessons: (1) sale of the Elk Hills oil field by the U.S. Department of Energy, (2) sales of loans and property by the Resolution Trust Corporation (RTC) after the savings and loan debacle, (3) loan asset sales by the Small Business Administration (SBA), and (4) excess property sales by the Defense Reutilization and Management Service (DRMS). The federal government should create an office to assist agencies that seek to develop effective asset sales programs.

INTRODUCTION

The federal government holds numerous assets, ranging from surplus military property to defaulted loans and foreclosed real estate, which could gain in value if placed into private hands. For those agencies that might find asset sales useful, a critical question must be addressed: how can the government assure that it obtains full value for any assets that it sells?

This question is important because of the likelihood that, in many cases, the government may not have experience selling some of the types of assets that it holds. This was true when the government sold the Elk Hills oil field in 1997. Indeed, if the government holds assets of a type that are unfamiliar to the market, then the government might need to develop the market before it can have a successful sale. This is true when the government sells portfolios of loans. The private market may be uncertain about the quality of such loans, compared to loans in the private sector. A successful asset sale

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must address the problem of market uncertainty if the government is to receive fair value for its assets. When bidders are uncertain about the quality of assets, they are likely to bid low, for fear of purchasing something that will not be profitable to hold or resell.

This study addresses the question of how to obtain full value, by presenting an overview of the federal government's experiences with several different types of asset sale and the lessons learned from those experiences. The purpose of this study is to provide an introduction for federal agencies that are beginning the process of policy planning for asset sales and would like to build on the lessons already learned by other agencies concerning ways to assure that the government receives good value for any assets it sells.

The four asset sales experiences reviewed here are (1) the sale of the Elk Hills oil field, a part of the Naval Petroleum Reserves of the U.S. Department of Energy, (2) the sale of loans and property by the Resolution Trust Corporation (RTC) in the aftermath of the savings and loan debacle, (3) the current loan asset sales program of the Small Business Administration (SBA), and (4) the sale of excess property by the Defense Reutilization and Management Service (DRMS) of the U.S. Department of Defense. These four cases represent successful large-scale asset sales programs. A fifth case study, loan sales by the Department of Housing and Urban Development, was not included here because of overlap of lessons with several of the other cases.[1] However, relevant lessons from the HUD experience will be mentioned.

The four case studies and the case of HUD each involved an end to the federal interest in the sold assets. In this regard, they differ from transactions in which there is a continuing federal interest, such as a sale-leaseback of military housing or utilities.[2] Asset sales can be complicated if the government seeks to retain an interest in the sold assets, because this removes the focus on the single goal of obtaining best value from the sale and substitutes a range of goals that the government may not be in a position to optimize.

From the four case studies and other experiences, a number of lessons can be learned. The first, and possibly most important, lesson relates to the value of the asset sale as a tool of government.[3] Asset sales have proved to be a cost-effective substitute for contracting out some program activities. For example, agencies such as the Federal

1. For information about HUD's experience with asset sales, see Thomas H. Stanton, "Using Loan Asset Sales to Improve the Management of Federal Credit Portfolios," *The Financier: Analyses of Capital and Money Market Transactions* 5, no. 1 (Spring 1998): 5–17; and Helen M. Dunlap, Deputy Assistant Secretary, Department of Housing and Urban Development, remarks at the Federal Credit Institute Workshop on Promising Practices for Federal Credit Agencies, October 3, 1996, *Proceedings* (Washington, DC, 1996), 3–46.

2. See, for example, George Cahlink and Shane Harris, "Power Play: Privatizing Utilities Has Proved to be Much Harder than the Military Services Expected," *Government Executive* 34, no. 7 (June 2002): 27–32.

3. Lester Salamon defines a tool of government as an instrument or means used to address public problems. Lester M. Salamon, ed., *The Tools of Government: A Guide to the New Governance* (New York: Oxford University Press, 2002). Chapter 12 briefly discusses loan asset sales. See Thomas H. Stanton, "Loans and Loan Guarantees," 394–395.

Housing Administration (FHA) spend considerable effort trying to oversee the activities of contractors that are supposed to manage and sell foreclosed properties. The FHA often lacks the tools to decide whether a contractor is performing well when it keeps a property under management rather than selling it.[4] Outright sale of such properties, preferably through a joint venture structure as will be discussed below, would seem to be a superior approach that could reduce the burden on the FHA of trying to supervise its contractors. This lesson is explored further in the case study concerning the Resolution Trust Corporation.

This relates to the second important lesson, which is the need to structure incentives well in any relationship of the government to private parties. The joint venture structure that the RTC developed for asset sales represented a deliberate effort to align the incentives of a private purchaser with those of the government. Once incentives are aligned, the government can dispense with much of the oversight burden that bedevils many public-private relationships. Conversely, if the incentives are not well aligned, even the most thorough supervisory mechanisms may not effectively address principal-agent problems.

The third lesson relates to the importance of information. For many federal programs, including the four case studies here, the government may find that it has higher quality information at the time of sale than was available at any other time in the life cycle of the program. Thus, to obtain a good sale price for Elk Hills, Department of Energy staff prepared an "Upside" report that explored and then disclosed to bidders much more information about the value of different kinds of oil and gas reserves than had been published before. Similarly, the RTC, HUD, and SBA have hired contractors to conduct so-called due diligence analysis to improve the quality of available information about the cash flows that bidders can expect from each loan pool that the government sells. Each asset sale involves tradeoffs between the expense of obtaining improved information for investors and the value of that information in improved bid prices.

The fourth lesson relates to the need to develop a market for the particular assets that the government seeks to sell. Some assets, such as automobiles or investment grade single-family home mortgages, are relatively easy to sell because a market exists that can readily value the assets and offer an appropriate purchase price. On the other hand, an agency such as the RTC must work hard to develop a market for assets without ready purchasers. The RTC was able to provide information over a series of sales so that a market emerged to purchase and deal in so-called subprime loans that are below investment grade. That market remains robust today, long after the RTC completed its work and left the scene.

Similarly, the SBA has had to work hard to develop a market for small business loans whose value was not clear to potential purchasers. The SBA guarantees loans to firms

4. See, for example, General Accounting Office, *Single-Family Housing: Current Information Systems Do Not Fully Support the Business Processes at HUD's Homeownership Centers*, GAO-02-44 (Washington, DC, October 2001).

that are not eligible to obtain credit on comparable terms in the commercial market. Also, most of the loans that the SBA was selling, especially in early sales, were nonperforming loans that lenders had put back to the SBA as a part of the process of making a claim on the SBA guarantee. The SBA and its financial advisers have carefully cultivated the market for such loans and have observed that pricing improves with each sale.

It is easier to develop a market if the agency sells assets without requiring private purchasers to adhere to government requirements that are unfamiliar to the private sector, such as special servicing procedures or unusual rights of borrowers whose loans are sold. These government requirements reflect public purposes that may be inappropriate when an asset goes into private hands. Asset sales work best when they are conducted with a focus on gaining economic value, with public purposes addressed through other means. The strategic planning process for asset sales must address these tradeoffs explicitly and develop ways to fulfill the public purposes of an agency or program without unnecessarily losing value for the government when the assets are sold.

The fifth lesson is that asset sales can create value by improving the servicing of assets. For example, when a loan is in private hands, it is serviced according to commercial standards. The same loan in government hands is subject to rules and requirements that the federal agency has developed over time, even if the applicable statute says that servicing should be done by commercial standards. It is important to add that the experience from numerous asset sales shows that more effective servicing does not involve harsh treatment of borrowers. It does involve enforcing legal rights against delinquent borrowers that the government may not have applied as diligently. A classic example in this regard came from HUD. In 1996, near the peak of the HUD asset sales program, Helen Dunlap, FHA deputy assistant secretary for operations, described the problems her office found with servicing of FHA-held mortgages:

> Recently we interviewed the purchasers of some of our single-family mortgages and, in essence, what we learned is that the credit reports on many of those borrowers are excellent with the exception of the payment of their [FHA] mortgage. Many of those borrowers have the capacity to pay their mortgage . . . I would say the borrower is responding to the expectations and requirements that are set before them. If nobody ever asks you for a monthly payment, you don't make a monthly payment after a certain point necessarily. We have borrowers that I suspect—in fact, I know—have the money in the bank for the monthly payment but they just simply haven't made it.[5]

Such servicing problems are now much less prevalent, both for FHA single-family mortgages and at many other federal credit agencies. However, the point remains that servicing of loans in private hands (or the exploitation of other assets such as the Elk Hills oil field) generally will result in increased value compared to servicing by the government.

5. Dunlap, 6.

A sixth lesson, not fully explored in the case studies below, relates to the larger context and impact of asset sales on the federal agency conducting the sales. Asset sales involve more than mere financial issues. Far more important to most federal officials at an agency are the organizational and people issues that accompany asset sales. An effective asset sales program needs to address directly the fact that asset sales may reduce an agency's workload. On the other hand, many agencies currently find themselves so short staffed that asset sales become the solution to a problem of excess workload. Also, as in the case of the sale of Elk Hills, much of the work may be done by contractors whose services can be terminated after the sale.

A well-planned asset sales program needs to pay attention to the legitimate needs of federal employees who may need to transfer or even leave the organization after working themselves out of a job. This is a matter both of fairness to the employees and of the best interests of government itself. Federal employees have shown a pattern of loyalty, even when their own jobs may be on the line. Thus, field offices at federal agencies have been supportive of asset sales, even at a time when it was not certain how they would fare once the work left their offices. Similarly, the civil servants of the Office of Naval Petroleum Reserves complied fully with the legislation that called for sale of the Elk Hills oil field. They generated reports and otherwise helped assure that the government received full value from the sale. If asset sales are to become more prevalent as a tool for rebalancing the federal workload, it would be appropriate to consider creating a special performance-based incentive system to reward federal employees who work themselves out of a job in a professional manner that benefits the government. If asset sales would result in downsizing an organization, it would be valuable to be able to share the benefits with the employees who help to make those savings possible.

The final section of the study suggests that the federal government would benefit from creation of a single office to assist federal agencies in developing effective asset sales programs. It is at the very beginning of the process that a federal agency most needs support in developing the capacity to design and implement a strategic plan that then can lead to hiring of staff and contractors to conduct the first sale. The ability to provide such support once existed in the Credit and Cash Management branch of the Office of Management and Budget, but was disbanded as a part of an OMB reorganization.

THE SALE OF THE ELK HILLS OIL FIELD: MUDDLING THROUGH TO SUCCESS

The Asset in Government Hands

The Elk Hills oil field in California is one of the ten largest domestic producing oil fields in the lower 48 states. By 1998, it had produced oil and natural gas amounting to an energy equivalent of over 1.4 billion barrels of oil. The federal government had held Elk

Hills as a petroleum reserve since President William Howard Taft created it by executive order in 1912 to provide a source of petroleum for the U.S. Navy.[6]

Production of oil from the reserve was complicated by the fact that the reserve included some land owned by Standard Oil of California (later Chevron USA) that was distributed in a checkerboard pattern. In the 1940s, the government and Standard Oil acted to rationalize the production of Elk Hills under a unit plan agreement between the two parties that allowed the government to control the quantity and rate of production and provided that operating costs and revenues would be shared between the parties, with 78 percent going to the government and 22 percent to Standard Oil.

Historically, the petroleum reserve was quite productive. In the years 1980–1985, when oil prices were high and production was at its peak, the Elk Hills field yielded almost $9 billion in revenues to the government, at a cost of less than $1 billion to produce those revenues.

Over the years, with the Navy assured of access to sufficient supplies of oil, the mission of the reserves changed. In 1976, in response to the OPEC oil embargo, the Congress changed the statutory mission of Elk Hills and the other Naval Petroleum Reserves to one of extracting oil and gas for sale, both to increase domestic production and to bring revenues into the treasury.

Although the Naval Petroleum Reserves had a mission of producing oil and gas for the commercial market, the administration of the reserves by the Department of Energy involved restrictions on the flexibility of the government to produce oil and gas in the most profitable manner. The major problem was that legal restrictions prevented the department from making cost-effective investments in the production of oil and gas from Elk Hills and other properties. One stumbling block was the annual appropriations process that applies to most government departments and agencies. A 1994 study by the National Academy of Public Administration (NAPA) found that it made no sense to subject a financially self-sustaining activity to the constraints of annual appropriations when reasonable investments could result in improved revenues.[7]

The NAPA study gave the example of delay in funding a cogeneration facility at Elk Hills that would pay for itself in only three years. Despite the substantial payback on the investment, congressional appropriations for the cogeneration plant were finally made available five years after the Naval Petroleum Reserves had made the initial request. The annual appropriations process can be exceedingly costly when applied to a producing

6. This account draws heavily on F. Jerome Hinkle's "U.S. Federal Asset Divestment: Politics and Policy," paper presented at the July 2001 annual conference of the International Association of Schools and Institutes of Administration, Athens, Greece, and F. Jerome Hinkle, "Selling Elk Hills—The Political Economy of Disinvestment," *Asian Journal of Public Administration* 21, no. 2 (December 1999): 246–248, based on a paper presented at the July 1999 annual conference of the International Association of Schools and Institutes of Administration, Birmingham, UK; and National Academy of Public Administration, *Restructuring the Naval Petroleum and Oil Shale Reserves: A Report for the Department of Energy* (Washington, DC, 1994).

7. National Academy of Public Administration, 19.

commercial enterprise such as the Elk Hills oil field. The government lost an estimated $45 million due to the delay in installing the cogeneration facility.

The NAPA study also reported on problems caused by a "non–value added government burden" at the Naval Petroleum Reserves. The small office that administered the Naval Petroleum Reserves needed significant extra staff, as well as contract staff, to meet departmental requirements that added little or no value to the operations. These included application of environmental, safety, and health requirements that the department applied uniformly to nuclear sites and the petroleum reserves, despite the inapplicability of many of the nuclear protections to an oil and gas field. Naval Petroleum staff estimated that compliance activities required the filing of over 200 reports, most of which were irrelevant to the management of a producing oil field. The result was a shift of resources from operations into compliance activities and overstaffing of both the small federal workforce and the much larger contractor presence.

After reviewing these issues, and especially the diminished value of Elk Hills and the other parts of the Naval Petroleum Reserves in government hands, the NAPA study recommended that the Naval Petroleum Reserves be converted into a wholly owned government corporation that operated on the basis of its own revenues rather than annual appropriations. That structure would allow the Naval Petroleum Reserves to make cost-effective investments, adopt more appropriate environmental and other compliance requirements, and generally increase the value of the reserves. The study concluded, "Establishment of a wholly owned government corporation is clearly preferable to the other options and is best suited to achieve the goals of maximizing the value of the reserves as a national asset, increasing net revenues to the U.S. Treasury, and reducing operational costs."[8]

The senior authors of the NAPA study testified before Congress and spelled out the corollary to this proposition: once a new government corporation realized maximum value from the Elk Hills field and the other Naval Petroleum Reserves, the government would have much more complete knowledge of the value of the assets if it sought to sell them.[9] By exploiting the reserves in a commercial manner, the government corporation could generate improved information about the value of the reserves and thereby obtain a better purchase price. Without this knowledge, and with oil and gas production at suboptimal levels, investors likely would underprice the asset in their bids.

The Asset Sale

The 1996 National Defense Authorization Act[10] authorized and directed the Department of Energy to dispose of its interests in the Elk Hills Reserve of the Naval Petroleum

8. Ibid., 29.

9. Statement of Harold Seidman before the Subcommittee on Military Readiness, Committee on National Security, U.S. House of Representatives, 22 March 1995.

10. See U.S. House of Representatives, National Defense Authorization Act for Fiscal Year 1996, Conference Report to Accompany S. 1124, House Report No. 104-450 (Washington, DC, January 22, 1996), 461–467. The legislation became law on February 10, 1996.

Reserves, known as NPR-1. The legislation attempted to assure that the government maximized its proceeds from the sale of this asset. To this end, the statute required an arm's length appraisal by five independent petroleum experts and review by OMB of the financial value of the final sales transaction. These and other protective features of the law acquired special importance because of earlier published reports that expressed concern about the possibility that the government would not receive full value from the disposition.[11]

The executive branch manifested differing opinions concerning the sale. On the one hand, the Office of Management and Budget had long advocated selling, or at least leasing, Elk Hills. OMB variously projected that a sale would yield from $1.6 billion to $2.6 billion for the government. Regardless of the selling price, it appeared as if OMB favored a sale as a matter of principle: if there was no further public purpose for Elk Hills to serve, then the asset belonged in the private sector and not in the Department of Energy.

On the other hand, Department of Energy staff with responsibility for the Naval Petroleum Reserves feared that the pressure to sell Elk Hills could result in a significant loss for the government. An assessment by an independent financial advisor in 1988, Shearson Lehman Brothers, had concluded that it could sell Elk Hills to an industry buyer for between $3.4 and $4 billion. Program staff had watched over the years as the revenues from Elk Hills showed that that estimate of value had been too low. The program staff worked with the Elk Hills contractor to publish a so-called "Upside" report in 1997 that took account of ways that a private owner could increase the value of Elk Hills through operating efficiencies, improved investments, and more thorough exploitation of the field for both oil and gas. The Upside report estimated the value of Elk Hills at $6.8 billion and provided geologic and engineering information about the reserves that would be of considerable value to prospective purchasers.

In addition to a variety of federal government perspectives, one major private actor was making its influence felt in the decision process. Chevron USA, owner of an undivided interest of 22 per cent of Elk Hills, worked actively to persuade the Congress to enact legislation for a sale. In 1995, Chevron estimated that the government might receive between $800 million and $1.4 billion from the sale of Elk Hills. As the owner of a 22 percent share of the oil field, Chevron was in a superior position to other potential bidders for the field who would not have Chevron's detailed knowledge of its value.[12]

The information developed and published in the Upside report appears to have played a significant role in persuading both the government's investment advisor and bidders of the value of Elk Hills. The report achieved wide distribution before the sale. The government sold Elk Hills in a single sealed bid auction. The winning bid was $3.65

11. See, for example, Daniel Southerland, "Proposed Sale of California Oil Field Assailed as Government Giveaway," *The Washington Post*, 7 August 1995, A17.

12. Andy Pasztor, "Legislation on Sale of Navy Oil Field Is Seen by Many as Favoring Chevron," *The Wall Street Journal*, 24 July 1995.

billion, from Occidental Petroleum. Additional value will accrue to the government from its final equity settlement with Chevron, now underway, which may net another $700 million, for a total sale value of $4.35 billion—resulting in an estimated net sale value (after deducting estimated transaction costs) of $3.8 billion.[13]

F. Jerome Hinkle, an official responsible for overseeing the writing of the Upside report, summarizes Occidental's next steps. In one year after acquiring Elk Hills, Occidental quickly implemented Upside planning, and elements of the staff's earlier government corporation plan, including:

- building new oil and natural gas pipelines to remove bottlenecks in the flows to commercial infrastructure in the San Joaquin Valley that greatly expanded their marketing opportunities to demand centers in Los Angeles and San Francisco
- dramatically increasing drilling investments, proving considerable new reserves
- creating new balancing agreements with regional natural gas distributors, allowing three to four times the gas to be sold, to a wider variety of customers
- shrinking operating costs and streamlining management for quicker decisions

As Mr. Hinkle observes, "This was largely accomplished in months, even against the backdrop of steadily declining oil prices that had dropped a third over when they purchased Elk Hills in October 1997."[14]

Lessons Learned

The sale of Elk Hills reveals a number of useful lessons. First, when the government announces an asset sale, it will take systematic effort for the government to receive full value from the sale. Pressure to sell Elk Hills as a matter of principle came from OMB and a number of quarters in Congress. Although the 1996 law did specify a minimally acceptable price, that price was set so low as to be largely irrelevant as a source of protection of the interests of the government in achieving suitable value.

Second, when government sells a unique asset such as Elk Hills without adequate information to provide to prospective purchasers, it can expect to sell at too low a price. This makes it important to include in the sale some form of recapture of some of the extra value that the asset gains from being in private hands. Mr. Hinkle points out that the Department of Interior recommended a royalty arrangement;[15] other profit-sharing arrangements also would have been effective in returning value to the government.

Third, asset sales often involve a contest among competing interests that may favor a sale, as in the case of Chevron USA and Elk Hills, or that may potentially oppose a sale in a manner that would give the government full value. The government needs to create a well-designed and well-marketed sales process that assures all prospective bidders that

13. Hinkle, "Selling Elk Hills," 16 (endnotes omitted).
14. Ibid., pp. 22–23. See also Hinkle, "U.S. Federal Asset Divestment," 8–9.
15. Hinkle, "U.S. Federal Asset Divestment," 12.

the government is serious about receiving full value. In the case of Elk Hills, as Jerome Hinkle concludes, the government achieved success largely by "muddling through,"[16] and by having an investment advisor that took the Upside report seriously.

Fourth, transparency helps the sales process. The publication of the Upside report helped to place all bidders on a more equal footing than would have been possible otherwise. The danger of having one bidder much better informed than the others was that this would discourage realistic bids by the other firms.

Fifth, it is important to create incentives that help to align the interests of federal employees with the goal of a successful sale. As was seen in the publication of the Upside report, federal employees who know the asset may be able to contribute significantly to obtaining value.

Sixth, the sale of Elk Hills resulted in a substantial increase in value when the asset went into private hands. Occidental Petroleum, the winning bidder, was able rapidly to take a number of steps to reduce operating costs, make needed investments, and otherwise to increase the exploitation of the commercial value of the Elk Hills field. Unless the government had adopted the government corporation model, which it declined to do, such steps were not possible while the field remained in government hands.

THE RESOLUTION TRUST CORPORATION: LEARNING BY DOING

While Elk Hills involved the sale of a single large piece of producing commercial real estate that the government had operated for years, the experience of the Resolution Trust Corporation involved a much more massive process of disposition of many smaller assets, mostly loans, securities, and real estate, which had suddenly come into government possession from the private sector. These assets had been held by the many federally insured savings and loan associations (i.e., "thrift" institutions—a remarkable misnomer in this context) that failed in the 1980s.

The Assets in Government Hands

In 1989, the government created the Resolution Trust Corporation as a temporary federal agency to reorganize or wind up hundreds of failed thrift institutions, pay off insured depositors, and sell the recovered assets to private investors. The RTC was a federal corporation with a statutory charter that expired on December 31, 1995. It operated under a mandate to sell assets without a federal guarantee or other recourse to the federal government.

The RTC did a remarkable job. In roughly six years of operation, the agency disposed of assets with a book value of $455 billion, leaving some $8 billion (book value) in its

16. Hinkle, "Selling Elk Hills," 24.

inventory, plus another $6 billion in credit reserves. Recoveries from sales and collections averaged 87 percent of book value and totaled about $395 billion.[17] The RTC sold most of its assets, including whole loans, through competitive sales; the RTC also sold some $42.4 billion of real estate loans as asset-backed securities.

Selling the Assets

The sheer volume of assets involved in the failure of thousands of savings and loan associations was immense. The RTC was able to sell the most marketable mortgage-backed securities and loan assets in bulk sales. For the lower quality assets, the RTC embarked upon a process of experimentation, beginning with familiar techniques such as contracting out asset management and disposition responsibilities.

As loans, real estate, and other assets came into RTC hands from failed savings and loan institutions, the RTC at first hired numerous asset managers to hold the assets and try to sell them. The problem was that, once the asset managers sold the most saleable assets, they collected a monthly fee for overseeing the rest of the assets that remained government property. This monthly fee discouraged contractors from making special efforts to sell the more difficult properties. The conflicting interests of the RTC and its asset managers meant that the RTC had to try to supervise its asset managers to assure their compliance with their contract with the government, known as the Standard Asset Management Disposition Agreement (SAMDA). This supervision imposed great demands upon the agency's institutional capacity. Moreover, government officials often were tempted to substitute their own judgments for those of the private asset managers. Sometimes the results could be quite burdensome.

RTC officials soon realized that traditional approaches were inadequate to deal with the huge number of difficult assets in RTC hands. They saw how some private purchasers made considerable money by securitizing pools of RTC assets, and decided to securitize low-quality assets themselves. In a securitization, the seller places a pool of assets into a trust and sells securities to private investors that assure the purchaser the right to the cash flows that come from the assets. In the case of securitized loans, the security purchasers receive an undivided interest in the flow of payments of principal and interest by the borrowers on the loans. Cash flows also result when the private owner of the trust sells loans out of the pool and distributes the proceeds to security holders.

The RTC structured its securitizations so that it sold ownership of the trust to private investors who would actually dispose of the assets in return for a specified percentage of the cash flows. The remainder would be distributed to security holders who had purchased the right to receive them. Many of the loans of failed S&Ls were delinquent or in default. To achieve a high investment grade rating on debt securities backed by pools of such nonperforming loans, the RTC created a sizeable reserve fund that could be used

17. Resolution Trust Corporation, *Statistical Abstract August 1989/September 1995*, Office of Planning Research and Statistics (Washington, DC), 17.

to pay investors if the loans did not yield sufficient returns. The investment grade rating reduced the uncertainty of the bidders about the value of the securities and thus induced them to pay higher purchase prices.

The investors who purchased ownership of the trusts found that they could increase their returns by disposing of the assets much more quickly than anyone had expected. This meant that the RTC's asset-backed securities paid off very quickly. Because of the high cost of underwriting and rating securities, securitization seemed expensive for assets that paid off within perhaps two or three years.

RTC officials then experimented with so-called equity partnerships. In 1994 and 1995 transactions, the RTC divided the securities backing a pool of assets into two parts. Private parties bid competitively for the right to manage the pool and received class "A" securities that entitled them to receive a specified percentage of the cash flows. The RTC retained class "B" securities for itself and reserved the right to sell these to investors at a later date. In effect, the RTC provided seller financing by keeping a large ownership stake in the pool of assets. The equity partnership thus kept the form of a securitization but altered its substance. Again, the structure enhanced bidder confidence, this time by using the class "B" securities that the government kept, to absorb losses from the most risky parts of the loan pool.

The RTC established fairly rigorous standards for the qualification of bidders, including a performance track record and capital requirements. The winning bidder became the general partner and the holder of a class "A" certificate that represented a specified (often 49 percent) equity interest in the partnership. The winning bidder was compensated through its share of returns from the sale of assets or income from the assets and, usually, a servicing fee of 1 percent of the principal balance of assets remaining in the trust.

The final step in the evolution of the RTC's approaches to asset disposition was the joint venture partnership. The joint venture partnership was designed to give the private partner a significant minority share of the cash flows from the sale of the assets, but to strip out any other interests of the private partner that could complicate the incentive structure. The partnership agreement permitted payment of no servicing fee and also limited any ability of the private partner to receive tax advantages from the transaction. The private partner became the general partner with all rights and responsibilities to manage and sell the pool of assets. The RTC was the limited partner, with rights to receive a proportionate share of the cash flows and a proper accounting of all transactions, but essentially in a passive role.

The RTC created some 40–45 partnerships to dispose of about $16 billion of assets. The RTC successfully used the joint venture structure to sell a broad range of assets, including real estate and real estate loans, nonperforming loans, and even some extremely low-quality assets that consisted of judgments, deficiencies, and collections.

The elegant structure of these joint ventures can be understood as follows. In the usual asset sale, the government had sold assets and then watched as the private purchaser turned around and resold them at a profit. In the joint venture structure, the government essentially sold the right to a private purchaser to sell the assets out of the trust. When the private purchaser sold the assets at a profit, the government received a proportionate amount, often half of those profits, and the private partner received the other half. Sometimes the government received a higher share of the profits, up to 80 percent, with the private partner receiving the rest. The private bidders would factor this percentage into the bid price. Figure 1 summarizes some forms of asset sale that the RTC used.

As the RTC disposed of its assets, the market began to develop. RTC officials could watch the range of competitive bids become tighter as an increasing number of private investors perceived the value of assets that were below investment grade and sought to purchase RTC assets. Private bidders also began to appreciate the structure of RTC transactions and to bid more competitively for the right to become the equity partner and dispose of RTC pools. By aligning the incentives of the private equity partner with those of the government, the RTC was able to harness the efforts of the private partner to provide value to the government as well. This was a very efficient structure that required much less oversight than the original SAMDA process and some of the other structures that the RTC had tried.

Today, as direct consequence of the RTC's work, the private market has become increasingly efficient at trading so-called "B" and "C" quality, that is, below investment grade, residential mortgages. The RTC's work also helped lead to a competitive market for the Department of Housing and Urban Development when it began to sell delinquent and defaulted single-family and multifamily mortgages in the early 1990s.

Lessons Learned

The activities of the RTC are relevant to federal agencies on several levels. First, the RTC provides an impressive example of an organization that learned from its experiences and constantly evolved improved processes and programs. In only 6 years, the RTC moved from use of asset managers, under the SAMDA program, to a much more efficient process of asset disposition that increased value to the government and reduced administrative burdens. The Department of Housing and Urban Development, the Small Business Administration, and the Defense Marketing and Reutilization Service all have conducted asset sales programs that benefited extensively from the RTC experience. One of the most important lessons for HUD and the SBA was that they should create a deliberate learning process so that they could examine the strengths and weaknesses of each of their sales and make appropriate improvements.

Second, the RTC used increasingly effective structures for asset disposition that show clearly the benefits of sound design for ease of implementation and enhanced value to the government. The joint venture partnerships and some of the other sales structures allowed the government to sell assets that, until the RTC, had been considered to be difficult to sell for a reasonable price. The private partners could make generous returns

FIGURE 1
Alternative Forms of Loan Asset Sale

	Advantages	Disadvantages	Comments
Sales of whole loans	Good for assets that can be valued by investors in a typical due diligence environment; easiest to execute	The agency retains no ability to participate in improved loan performance; complexities of servicing for public purposes may be more difficult or costly to achieve	RTC and HUD started with these transactions; SBA sells pools of whole loans
Loan sales/government retains subordinated debt (i.e., takes first losses)	Good when the market would underprice because of inadequate financial data	Transactions costs can be high; investors often require "AAA" rating on the debt they buy; not user friendly for the small investor	Publishing the payment experience on the subordinated debt can improve pricing on later deals
Securitization/government keeps some equity and sells some equity and possibly debt	Good when the market would underprice because of inadequate financial data; creates a marketable, transferable liquid instrument; government can get cash immediately and also participate in gains, for example, from improved servicing	High transactions costs; must maintain credit enhancement; RTC found securities may retire so quickly that securitization does not pay	HUD has refined this structure to serve nonfinancial public purposes
Equity partnership	Good for below investment grade portfolios; government can get cash immediately and also participate in gains, for example, from improved servicing; easy for the government to monitor	Not user-friendly for the smaller investor; perception may be that the agency remains involved with the assets	Not as cost-effective for investment-grade portfolios as whole-loan sales
Joint venture (JV)	Aligns incentives of purchaser with those of the government; efficient at realizing value for the government; easy to monitor; adaptable for sale of many different kinds of assets	Tends to favor larger bidders, even with a bid optimization program	SBA declined to use the JV structure because of the perception that smaller investors have greater access to whole-loan sales

on their investments. However, because the structure of these partnerships aligned the incentives of the purchaser with those of the government, the government also profited as the returns increased for its private partner.

Third, the RTC devised joint venture partnerships that provide an excellent model for other agencies that are considering asset sales. HUD used the joint venture model extensively in its asset sales program in the 1990s. The RTC experience allowed HUD to skip some of the less useful approaches such as securitizations of its pools of delinquent and defaulted loans. More recently, the DRMS has developed an extremely successful adaptation of the joint venture structure to sell quite different types of assets, as will be discussed below.

Finally, the RTC left behind a cadre of government officials and private contractors who had extensive experience with asset sales. These people have helped agencies such as HUD, SBA, and DRMS to launch and manage their successful asset sales programs.

THE SMALL BUSINESS ADMINISTRATION: BUILDING ON LESSONS FROM THE RTC AND HUD

The Loan Assets in Government Hands

The Small Business Administration faced a serious problem: staff size was dropping, from nearly 4,000 in 1988 to just over 3,000 in 1996. Meanwhile, the size of SBA loan programs was growing. Loan approvals in the main SBA business loan program, the Section 7(a) guaranteed loan program, rose from 18,000 in 1988 to 52,000 in 1996. The SBA was being asked to do much more with far fewer staff.

Loan asset sales provided an immediate answer to this problem.[18] When a borrower defaulted on a Section 7(a) loan, the lender was allowed to put the loan back to SBA. Many of these loans were time consuming to service. It was difficult to work with defaulted borrowers, either to come back into repayment or else to foreclose and try to dispose of the business property that backed the loan. An internal SBA study found that the agency expended an average of five times as much in administrative costs to liquidate a Section 7(a) loan as it cost to make a new Section 7(a) loan. If the SBA could sell its defaulted loans to private companies, then SBA staff could be freed to concentrate on the front end of the loan process and try to make SBA loans more available to the small business community.

In 1997, the SBA began a two year strategic planning process to sell loans on a large scale. The SBA looked closely at the experiences of the RTC and HUD in their asset sales programs. As the program shifted into implementation, the SBA hired several

18. A longer term answer to the problem of understaffing came in a statutory change that now requires lenders to liquidate defaulted SBA-guaranteed Section 7(a) business loans, rather than putting them back to the SBA for disposition.

former RTC staffers with experience in asset sales. The SBA adapted approaches, policies, and documentation that RTC and HUD had developed.[19]

By early 2002, the SBA had conducted five asset sales involving almost 110,000 loans with a combined unpaid principal balance (UPB) of $4.5 billion. The sales returned $2.7 billion in gross proceeds, with sales costs amounting to about $124 million, or 4.6 percent of gross proceeds. At this writing, a sixth sale is underway with a bid date of August 6, 2002, to sell 32,000 loans with a UPB of $670 million. Implementation of three further sales is also underway. SBA is selling not only Section 7(a) loans, but also other types of loans, including disaster loans.

Selling the Assets

The SBA asset sales program consists of a series of individual loan sales, scheduled at a rate of approximately two per year. Bidders purchase both performing and nonperforming SBA loans. They purchase the latter because of their expectations that they can bring many of them into repayment and, for loans that remain in default, can foreclose on the properties that secure the loans.

During the strategic planning process, the SBA decided to sell loans through competitive auctions, rather than utilizing a joint venture structure. While the joint venture might yield somewhat higher returns than a competitive auction, the SBA felt that the auction would allow smaller investment banking firms to have more of an opportunity to bid successfully for groups of loans. Access for smaller investors was believed to be consistent with the SBA's public mission of supporting smaller businesses. The SBA also believed that active attention to developing a market for SBA loans would help to increase returns to the government.

Several features of the SBA program deserve special mention. First, the agency and its contractors work hard to enhance the value that the government receives from each sale. The loans in a sale will be separated into groupings that reflect characteristics that the SBA knows will appeal to particular types of investors. Investors may seek to purchase blocks of residential loans, or commercial loans of various types, for example. The blocks are large enough to appeal to larger bidders that seek economies of scale from large purchases.

Second, the SBA also has taken steps to assure that smaller firms will be able to purchase loans. The SBA subdivides larger blocks of loans into pools of loans that are of a size that smaller bidders can afford to purchase. The SBA also sets aside so-called "designated pools" of loans that must be bid individually rather than as a part of a larger bid.

Third, the SBA is careful to protect the public purposes of its loan programs. Section 7(a) business loans are supposed to be serviced according to commercial standards. SBA

19. This section draws upon a number of SBA documents prepared with respect to the asset sales program. Extensive information about the SBA asset sales program is available from: *http://www.sba.gov/assets.html*.

sets standards for bidders and post-sale servicing requirements to assure that private purchasers will service loans according to accepted private sector servicing and collection standards. Entities that are debarred or suspended from doing business with a government agency are not eligible to bid on SBA loans. SBA disaster loans have somewhat different public policy objectives from Section 7(a) business loans. In the case of disaster loans, the SBA declines to sell any loans that are less than two years old, as a way of giving borrowers time to recover from the natural or economic disaster before they are subject to commercial servicing standards on their loans.

Fourth, following the examples of the RTC and HUD, the SBA has created a process for continual improvement of the asset sales process. The agency requires each of its contractors to record its experiences and potential improvements. At the end of the sale, the contractors produce a "Lessons Learned" document that identifies areas for future improvement. The documents include surveys of winning bidders, unsuccessful bidders, and firms and individuals that obtained bid packages or performed due diligence, but did not submit an actual bid.

The SBA takes seriously the process of learning from each sale. Thus, when investors indicated that they sought a more rapid settlement, to limit risk on open bids before the sale transaction was actually consummated, the SBA instituted a process of online bids and faster response time. In sales three through five, the SBA created a process of high-speed remote access to due diligence documents to reduce the burden on bidders of coming to Washington to view documents. As a result, few people now take the trouble to visit the Washington, DC, due diligence facility. Every document is imaged electronically, with bidder access available around the clock. Sale number six plans to use the Internet to provide access to the due diligence documents.

The SBA points with justifiable pride at a number of indicators of success. Richard Blewett, the asset sales program director, came to the SBA after extensive experience with the RTC. He notes that the series of SBA sales has become routine. Bidders regularly return to bid on subsequent sales. Investors view SBA loans as a commoditized product. There is a broad bidder base with robust competition. The pricing continues to improve, indicating that the SBA has succeeded in making a market for its loans among investors. The government is receiving value from this process.

Lessons Learned

The SBA program offers a number of useful lessons, in terms of practical implementation as well as policy. First, SBA ran a very tight process for procuring services of the different types of contractors that were needed to help implement the asset sales program. Asset sales involve considerable amounts of money, both in the sold assets themselves and in the cost of hiring contractors. Perceived irregularities in parts of the HUD asset sales program made effective procurement imperative for SBA when it launched its program. Procurement was made more efficient by the availability at the General Services Administration (GSA) of a new set of "supply schedules," that is, rosters of contractors that the GSA deemed sufficiently qualified to be listed as available for use by other federal agencies. The GSA supply schedule includes firms that are eligible to be program financial advisors, transaction financial advisors, due diligence contractors, outside legal counsel, and credit reform contractors for asset sales programs. HUD officials helped to create this GSA program; had it been available earlier, HUD might have avoided problems with its own asset sales procurements.

Second, SBA dealt with its public policy objectives in a sophisticated way that helped to further the agency's public mission without detracting significantly from the value received from asset sales. Thus, the SBA was sensitive to the need to maximize opportunities for small and disadvantaged businesses. Procurement of due diligence contractors was set aside for competition among small and disadvantaged businesses participating in the SBA's own "8(a)" program. Due diligence is one area where small businesses can compete effectively to provide services. The SBA also encouraged other sales advisors to team up with smaller contractors. The SBA chose the competitive auction process rather than the joint venture structure as a way to help small businesses compete and took steps to designate smaller loan pools in each sale so that smaller investors could bid. Finally, in the servicing area, the SBA addressed the special needs of disaster loan borrowers by holding disaster loans back from sale for at least two years before they are selected for sale.

Perhaps the most important lesson here is that agencies must be explicit about their public policy objectives in structuring an asset sales program. That way the agency can weigh the necessary tradeoffs between financial returns on the one hand and public policy objectives on the other and can make sound decisions on how to proceed.

Third, SBA studied the lessons of earlier asset sales, both at the RTC and at HUD, and built its program accordingly. Following the practices of those two earlier programs, the SBA built a process of continuous improvement into its own practices. Similar to HUD, the SBA uses a program financial advisor (PFA) to oversee each individual sale and assure that each sale fits the SBA's larger asset sales program goals. A transaction financial advisor (TFA) conducts each sale, but the PFA is responsible for learning lessons from each sale and assuring that they are incorporated into future sales.

Also following HUD's example, the SBA has created an asset sales design book that it provides to contractors at the start of each sale. The SBA updates the design book after each sale to incorporate new lessons learned. Given that the SBA has chosen to proceed through a series of competitive auctions, market development is especially important to achieving value. The SBA's surveys of successful bidders, unsuccessful bidders, and firms that decided not to bid are key to staying close to the needs of the market. A review of Lessons Learned documents from the first five sales reveals a broad range of recommendations relating to issues such as project management, marketing and advertising, field office coordination, the bidder information package, the loan sale agreement, investor outreach, due diligence, and bid procedures.

Fourth, the SBA used asset sales as a solution to the pressing problem of declining staff size to administer the increasing size of its major loan programs. Except perhaps, for a temporary agency such as the RTC, asset sales are more than a mere financial matter for a government agency. The sale of assets will change the nature of work and the workload of many people, both at headquarters and in the field. The SBA's leadership took care to articulate the importance of asset sales to assuring the agency's ability to deal with its workload and continue to provide support for America's small businesses.

THE DEFENSE REUTILIZATION AND MARKETING SERVICE: APPLYING THE JOINT VENTURE STRUCTURE TO NEW TYPES OF ASSET

Excess Military Property in Government Hands

The Defense Reutilization and Marketing Service (DRMS)[20] is in the business of selling excess military property. DRMS faces a similar problem to that of the SBA, that is, the need to carry out its mission with a declining workforce. In 1993, the Office of the Secretary of Defense identified DRMS as a candidate for privatization. With that impetus, DRMS explored various privatization options, with the goal of improving the efficiency of excess property sales. DRMS now is in the process of reducing its staffing by 50 percent in five years, from October 2000 through September 2005, and cannot afford to conduct its sales in the traditional manner. DRMS looked at the RTC's joint venture concept and found an answer to the need to provide improved service with fewer staff.[21]

DRMS is responsible for disposing of property that the Defense Department considers to be excess for reasons such as changing technologies or priorities, outdated inventory, or closure or downsizing of military installations. Under the law, excess DOD property first is subject to reutilization within the department, then for transfer to other federal agencies, and finally for donation to state and local governments or eligible nonprofit organizations. In fiscal year 2000, DOD distributed about $4 billion of excess property through reutilization, transfer, or donation.

Property that remains is considered surplus and is sold by DRMS. Such property is either sold for scrap or, if usable, to private purchasers. Some of the larger groups of property types include machine tools, hardware, bearings, electrical and electronics equipment, material handling equipment, and service trade equipment. Other categories include aircraft parts, vehicles, clothing and textiles, medical items, furniture, commercial kitchen equipment, and many other kinds of property. Traditionally, DRMS conducted hundreds of surplus property sales monthly at more than 100 sites throughout the country.

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20. See the DRMS web site at: *http://www.drms.dla.mil*.

21. Information in this section is taken from the DRMS website, from a DRMS publication, "Surplus Commercial Property: Invitation for Bids, No. 99-0001" (Washington, DC, March 2001), and from interviews in March 2002 with Roger Kormendi and Cyrus Gardner, principals of Kormendi/Gardner Partners, Inc., financial advisors and developers of the commercial venture structure that DRMS currently uses to dispose of surplus property.

Selling the Assets

DRMS turned to the RTC joint venture structure to provide the basis for designing a more efficient sales process that would yield better returns with less administrative burden on the shrinking agency. Financial advisors helped DRMS to adapt the joint venture structure to DRMS's unusual needs. The RTC had used the joint venture to sell pools of assets that were specified in advance and that the purchasers could examine before making their bids to become the RTC's joint venture partners. By contrast, DRMS does not know what kinds of military property might become surplus and available for sale at any particular time. DRMS needs to sell a future flow of assets rather than fixed pools. Thus, DRMS adapted the RTC joint venture structure to create the first "pipeline" sale of a future asset flow.

DRMS created a new asset sales structure, called the commercial venture (CV). In the commercial venture, DRMS finds a private purchaser who precommits to purchase all usable property that becomes surplus in designated locations over a specified period of time. To help bidders decide how much to bid, DRMS segregates property by category and publishes information on past sales of each type of property. It turns out that the average sales price of surplus usable property may be perhaps 1 to 2 percent of the acquisition value. The winning bidder is expected to sell the property that it purchases. The firm is required to form a "stand alone" corporation whose sole business is the processing of DRMS property. All costs directly associated with that processing, such as transportation, storage, refurbishment, and marketing, are paid from resale proceeds. The government then receives 80 percent of the net resale proceeds and the CV firm receives 20 percent.

DRMS conducts a two-step sealed bid process to find its commercial venture partner. In the first step, DRMS solicits proposals that demonstrate the bidders' qualifications to sell large volumes of surplus property. In the second step, DRMS solicits the qualified bidders to bid the price at which they will precommit to purchase the flow of assets over the term of the contract.

DRMS made its first CV contract award in July 1998 and its second contract, for a period of seven years, in June 2001. The agency expects that some $23 billion in equipment (the acquisition value, not the sales price) should flow through the new CV contract over its seven year term. DRMS estimates that it has saved millions of dollars a year in sales costs from the existing CV, besides the savings that resulted from a reduction in the agency's administrative burdens so that it can carry out its mission despite the downsizing of its staff. As DRMS stated in a press release,

> In privatizing DRMS's day-to-day sales functions through the CV initiative, DRMS will be able to concentrate its remaining workforce on doing those functions that cannot be shifted to the private sector, such as hazardous waste disposal oversight.[22]

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22. DRMS, "FAQ—Commercial Venture," available from: *http://www.drms.dla.mil/pubaff/html/faq-commercial_venture.html.*

Lessons Learned

The first, and perhaps most striking, lesson learned from the DRMS experience is the robust nature of the joint venture concept. At the time the RTC went out of business, few could have imagined that an agency could adapt the joint venture concept to deal with a flow of property of uncertain type or price. The strength of the joint venture concept, as shown by the experience of the RTC, HUD, and DRMS, is that it aligns the incentives of the private partner with those of the government. When the private partner makes money, the government does too. Essentially, the joint venture concept is that the government benefits from selling the right to sell assets, rather than selling the assets themselves directly.[23]

Second, there is no one right model for selling all kinds of assets. The government and its financial advisors need to study the particular market carefully to determine which features will align incentives best between the private partner and the government. DRMS refined the joint venture concept in a number of ways. For example, the splitting of net proceeds between the private partner and the government in a 20–80 percent ratio helps to protect the private partner against the risk that, while most assets will sell at a profit, some will not. Also, in contrast to many RTC joint ventures, expenses of the private partner in preparing DRMS property for sale are completely deducted from the sales price before dividing the net sales proceeds between the private partner and the government. This kind of technical detail is important in helping to build value for the government.

Third, as in the SBA case, a well-designed asset sales program can bring good value to the government in the sales price. Perhaps even more important in many cases, a sound program can allow an agency to allocate its scarce workforce to more important functions than those of asset management and disposition. Especially after September 11, it is likely that many agencies will face pressure to downsize and to concentrate the efforts of their diminishing workforce on matters other than management of assets that they might be able to sell without loss of public purpose or public value.

CONCLUSION: PRESERVING AND BUILDING THE GOVERNMENT'S CAPACITY TO DESIGN AND IMPLEMENT ASSET SALES PROGRAMS THAT CREATE VALUE

Asset sales are not appropriate for every agency and program. However, for those that would benefit from asset sales, it is important to assure that the sales process is designed

23. For a discussion of the applicability of the joint venture concept to the sale of the Elk Hills Naval Petroleum Reserve, see Thomas H. Stanton, "Institutional Considerations Affecting the Government's Ability to Receive Maximum Value from the Disposition of the Elk Hills Reserve: Lessons from the Experience of the Resolution Trust Corporation (RTC)," prepared for the Office of Naval Petroleum and Oil Shale Reserves, U.S. Department of Energy, 1996.

well and with an eye to gaining full value for the government. Currently, a loose network of specialists and experts exists to help a federal agency design or improve an asset sales program. These consist of people with experience at the RTC and FDIC, disposing of assets of failed S&Ls, at HUD, selling defaulted residential mortgage loans, and, more recently, at the SBA, selling business and disaster loans. When an agency taps into this network of government officials and private contractors, it can gain access to considerable expertise.

The government formerly possessed an institutional focus for knowledge about asset sales, which reported to the deputy director for management of the Office of Management and Budget. This was the Credit and Cash Management branch, a small staff of seven people that provided support to federal credit agencies on a variety of management issues, including loan asset sales. The branch helped several agencies—HUD, the Veterans Administration, the Department of Agriculture, and the Department of Education—to conduct asset sales in the late 1980s.

OMB abolished the office in 1995. A single person, the senior adviser for credit and cash management, continued to provide an institutional focus for agencies seeking support in enhancing their credit management practices. In 1996, he was able to help enact the Debt Collection Improvements Act that encouraged agencies to conduct asset sales and also revised the budget rules to allow them to pay for the expenses of a sale out of the proceeds. Also, working with the Financial Management Service of the Treasury Department, he was instrumental in obtaining contractor support to assist the SBA in developing and implementing the strategic planning process for its asset sales program in the late 1990s. It is at the beginning, when an agency views asset sales as foreign and potentially threatening, that such external support is most needed. The senior adviser for credit and cash management retired two years ago and the position has gone unfilled at OMB.

The OMB budget examiners for each agency that seeks to sell assets also play important roles, both in devising the scoring for the sale and for accommodating the agency's budget to the changed circumstances that result from the sale. In the case of federal loans, the OMB Budget Review and Concepts division plays an important role in applying the rules of the Credit Reform Act of 1990 to proposed sales.

One lesson emerges quickly from this survey of ways to add value for the federal government from asset sales. A small office within the federal government, possibly reporting to the OMB deputy director for management or else located in the Financial Management Service of the Treasury Department, would be helpful in supporting today's loose network of government officials and private contractors who are experienced in asset sales. That office would have the responsibility for maintaining touch with government agencies and the private sector and could provide an institutional source of information about design and implementation of an effective asset sales program. The office also would coordinate with the officials in OMB who help to score the budget implications of any sale. The small costs of such an office would pay for themselves quickly, probably in a single asset sale.

Another lesson relates to the linkage between the federal budget and asset sales. Especially for federal credit agencies, budget rules may preclude the government from making economically beneficial decisions, such as selling performing direct student loans. When the government sells nonperforming loans, such as in HUD or SBA asset sales, considerable gains in value are possible from placing the loan assets into private hands. On the other hand, performing loans are current in their payments and therefore will not show the kind of gains in value that are possible from nonperforming loans. Even though sales of direct student loans would save the Department of Education an immense administrative burden, larger scale sales may not be possible without a change in budget scoring rules.

The problem is that, because the government and private sectors keep their books quite differently, loan asset sales that may be quite cost effective from a management perspective may give the appearance of lost value. If the government is serious about including loan asset sales in the repertoire of management tools available to federal credit agencies, then it would be good to consider changing the credit reform rules to permit use of a private sector discount rate in calculating the value of loans in government hands (the so-called "hold" value) so that the value of loan assets can be measured by a comparable yardstick when the government seeks to transfer them across the boundary between the public and private sectors. OMB might also revisit the decision made at the inception of credit reform to separate the calculations of credit subsidies from administrative costs. Combining those two accounts would allow agencies to include their savings in administrative costs in estimating the benefits of loan asset sales. These two changes would help to bring credit budget rules into better alignment with the economic realities of loan asset sales.

Finally, asset sales are a management tool that, in appropriate circumstances, can help federal agencies to carry out their missions more effectively. Asset sales can strengthen agencies' capacity to manage their programs, can shed risk that the government is not well equipped to manage, can shed particular functions such as servicing of large loan portfolios, and can help to dispose of unneeded property. When properly designed and executed, as these case studies illustrate, the government also can obtain significant value from such sales.

NOTES

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