

Industrial Revenue Bond Partnership TEJV-1, L.P.

Audit Report No. 00-004
March 3, 2000




OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

DATE: March 3, 2000

TO: Mitchell Glassman, Director
Division of Resolutions and Receiverships



FROM: Sharon M. Smith
Assistant Inspector General

SUBJECT: *Industrial Revenue Bond Partnership TEJV-1, L.P.*
(Audit Report No. 00-004)

This report presents the results of the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General's (OIG) audit of TEJV-1, L.P., a partnership where the FDIC holds an 80 percent limited partnership interest. The Resolution Trust Corporation (RTC)¹ created the partnership to eliminate its financial exposure and recover the collateral related to industrial revenue bonds (IRB). Our limited tests did not identify any problems with the income, expenses, or distributions reported to the FDIC by the general partner.

BACKGROUND

State and local governments issued IRBs to provide low-interest, tax-exempt financing to real estate developers for socially beneficial projects. These projects included low- to moderate-income housing and nursing homes, and industrial and retail developments. Thrift institutions played an important role in these projects by providing collateral to secure the bondholders and ensuring reliable cash flows to the bondholders with letters of credit. In the early 1990s, the RTC assumed the liabilities for these IRBs from failed thrift institutions and for those institutions' associated collateral.

When the IRBs were issued, the bond agreements required the institutions to deposit collateral with bond trustees to protect bondholders from the risk of default by the developer. To ensure a reliable cash flow to the bondholders, the institutions provided the trustees with letters of credit that the trustees would draw upon to make periodic bondholder interest payments. The institutions, in turn, received payments from the real estate developers to cover these letter of credit draws. The institutions profited from this arrangement through letter of credit origination fees paid by the developers, earnings on the collateral, and interest earned on the letters of credit.

When the RTC assumed responsibility for resolving the institutions, the RTC realized the real estate collateral underlying the IRBs was insufficient to pay off the bondholders in full.

¹ In accordance with the RTC Completion Act of 1993, the RTC ceased to exist on December 31, 1995. Responsibility for all RTC-related work was transferred to the FDIC as of that date.

Therefore, the RTC developed a partnership plan to encourage developer refinancing. The refinancing proceeds and, if necessary, the collateral would then be used to pay off the bondholders, thus avoiding the legal costs and uncertainties inherent in future foreclosure litigation against the developers.

The general partner, CMC TEJV-1, L.L.C. (CMC), purchased its 20 percent interest from the RTC for approximately \$35.8 million effective December 28, 1995. The partnership agreement calls for the partnership to continue until December 31, 2016, or the final disposition of the partnership assets, whichever occurs first. At the inception of the partnership, the RTC transferred 40 IRB assets with a book value of \$280.3 million and a fair market value of \$179.0 million to the partnership. By December 1997, CMC had recovered \$132.4 million, or 74 percent of the fair market value of the assets. By December 1998, the partnership's accounting records showed that it had \$12.5 million of partnership assets remaining.

The partnership agreement granted CMC wide latitude to resolve the IRBs and incur partnership expenses. The partnership agreement also allowed CMC to charge the partnership a monthly management and servicing fee based on the value of the outstanding IRBs. The partnership paid CMC almost \$3 million during the 3 years ended December 31, 1998.

For those 3 years ended December 31, 1998, the partnership received \$237.4 million, which is comprised of proceeds from pledged collateral of \$176.2 million, proceeds from bond sales of \$23.3 million, interest income of \$27.6 million, and other income of \$10.3 million. For this 3-year period, expenses totaling \$6.4 million consisted of servicing fees of \$2.9 million, property protection expenses (mainly legal fees and taxes) of \$2.9 million, and other expenses of \$572,000.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our audit was to determine whether TEJV-1, L.P.'s general partner, CMC, accurately reported income, expenses, and distributions in accordance with the partnership agreement. To address this objective, we obtained information on CMC's accounting and reporting systems and controls by reviewing documentation and interviewing responsible FDIC and CMC representatives. Our audit scope included the liquidation efforts of the general partner from January 1, 1997 through December 31, 1998.

We interviewed FDIC personnel from the Division of Resolutions and Receiverships (DRR) and Division of Finance (DOF) as well as managers representing CMC and its loan servicer to obtain background on the partnership. Additionally, we reviewed the partnership agreement to understand its terms and conditions. Also, for 1996, 1997, and 1998, we obtained and reviewed the independent auditor's reports on TEJV-1, L.P.'s annual financial statements to determine whether the partnership's independent auditors had identified any material problems.

We judgmentally selected two IRB liquidations to verify whether CMC accurately reported proceeds and expenses and whether transactions complied with the partnership agreement. The two assets we selected for testing were Park Plaza and Sunwest. We selected these assets because both incurred a large amount of liquidation expenses compared to other partnership assets.

For the two assets we selected, we tested income of \$15.2 million, or 11 percent of \$140.1 million in total income and expenses of \$263,000, or 12 percent of \$2.2 million in total expenses incurred, during the 2-year audit period. We confirmed receipt of the sales proceeds by reviewing supporting documentation such as purchase agreements, statements from title companies, closing statements, and bank statements to determine whether the partnership received all the funds due at the asset's closing. In addition, for expenses greater than \$1,000 paid during the 2 years ended December 31, 1998 (excluding management and servicing fees), we tested whether CMC made payments accurately and in accordance with the partnership agreement by reviewing invoices, payment vouchers, and bank statements.

Management and servicing fees paid to CMC represented the largest expense line item totaling \$1.3 million for all assets for the 2 years ended December 31, 1998. To determine whether CMC properly calculated these monthly fees, we checked the arithmetic accuracy of the December 1997 and December 1998 monthly fee payments and recalculated the fee payments for Park Plaza and Sunwest for the month the assets were resolved.

We also judgmentally selected 2 months (June and July 1997) to determine whether CMC made distributions to the FDIC accurately and in accordance with the partnership agreement. To test this, we examined \$8.8 million of the \$125.9 million (7 percent) paid to the FDIC in 1997 and 1998 by comparing the available cash and the amounts distributed at the end of each month to the minimum distribution required by the partnership agreement. We also confirmed that CMC wired the \$8.8 million to the FDIC.

We did not perform a comprehensive review of CMC's internal controls because we concluded that the audit objectives could be met more efficiently by conducting substantive tests rather than by placing reliance on internal controls. Accordingly, we do not express an opinion on internal controls. We conducted the audit from October 14, 1999 through December 10, 1999 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

Our audit of TEJV-1, L.P., found that CMC accurately reported income and expenses for the two assets we reviewed and that income and expense transactions complied with the partnership agreement. Further, for the 2 months we examined, CMC made distributions accurately and in accordance with the partnership agreement. Specifically, we found that CMC accurately reported the \$15.2 million in income and \$263,000 in expenses we examined. Also, we examined selected management and servicing fees and found that CMC accurately calculated those fees. Finally, we confirmed that CMC made \$8.8 million in partnership distributions to the FDIC accurately and in accordance with the partnership agreement.

As our tests were limited, we do not express an opinion on other partnership assets and distributions not reviewed. Because the partnership's income, expenses, and distributions were accurately reported and complied with the partnership agreement for the items tested, we are making no recommendations in this report.

CORPORATION COMMENTS AND OIG EVALUATION

On February 29, 2000, DRR management informed us that they had no comments on the draft report.