AUDIT OF RTC MORTGAGE TRUST 1994 S-6

Audit Report No. 99-046
December 16, 1999

OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

DATE: December 16, 1999

TO: Gail Patelunas
Deputy Director
Division of Resolutions and Receiverships

Sharon M. Smith

FROM: Sharon M. Smith
Assistant Inspector General

SUBJECT: *RTC Mortgage Trust 1994 S-6* (Audit Report No. 99-046)

This report presents the results of the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General's (OIG) audit of Resolution Trust Corporation's (RTC) Mortgage Trust 1994 S-6 (Trust). The Trust was created September 30, 1994 and consists of a Class A certificate holder (1994-S Dallas Associates Limited Partnership) and a Class B certificate holder (FDIC).[1] The OIG has audited other equity partnership trusts, but this is the first audit of this particular trust. We found that the Trust transactions were adequately supported and in compliance with the Deposit Trust Agreement, Assignment and Assumption of Assets Agreement, Indenture, and the Servicing Agreement (the Agreements).

BACKGROUND

The RTC had the authority to create a trust that sold, through a competitive bid sale, certificates representing a percentage of beneficial ownership in that trust. The 1994 S-6 Trust was organized as a special purpose Delaware business trust. The purpose of the Trust was to dispose of the assets purchased from the RTC as promptly as possible in a manner that maximized economic return. On September 30, 1994, the RTC entered into a Deposit Trust Agreement with Wilmington Trust Company. The RTC and Wilmington Trust Company also entered into an Assignment and Assumption of Assets Agreement in which the RTC transferred 125 mortgage loans to the Trust. These assets had a total principal balance of over $84 million.

In exchange for the assets that the RTC contributed to the Trust, Wilmington Trust Company provided the RTC with a controlling Class A certificate and a non-controlling Class B certificate. Through a competitive award, the RTC sold the Class A certificate to 1994-S Dallas Associates Limited Partnership and retained the Class B certificate. The Class A certificate holder paid about $12.5 million for a 49 percent undivided interest in the Trust's assets. The RTC, as the Class B

[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.

certificate holder, retained a 51 percent interest. The Trust, pursuant to an Indenture with State Street Bank and Trust (Bond Trustee), issued about $21 million of commercial loan-backed bonds to the RTC to provide operating funds to the Trust. The bonds were secured by a collateral assignment of the Trust assets to the Bond Trustee. Sales proceeds generated from the liquidation of assets were applied first to the retirement of bond debt and second to operating funds for the Trust. The bonds were retired in July 1995.

Under the terms of the Deposit Trust Agreement, the day-to-day management decisions regarding the Trust's operations were the responsibility of the Class A certificate holder. To facilitate the servicing of the Trust's assets, the Class A certificate holder entered into a Servicing Agreement with Quantum Capital, Inc., which performed asset servicing for the Trust from September 1994 through March 1996. Asset Recovery Fund, Inc., took over as the servicer in April 1996.

The FDIC's Division of Resolutions and Receiverships (DRR) is responsible for the oversight of the Trust. DRR contracted with Aldridge, Eastman, and Waltch (AEW) to assist in overseeing its interest as the Class B certificate holder. AEW's responsibilities included cash management, reporting, and asset management. To carry out the activity of the Trust, the servicer established a collection account and a deferred maintenance account. The servicer prepared reports that were sent to DRR and AEW showing activity in the collection and deferred maintenance accounts, property protection and property improvement expenses, liquidation proceeds, and servicing fees.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were to determine whether the servicer properly and accurately (1) reported collections, (2) claimed expenses, and (3) distributed equity to the Class A and Class B certificate holders. Our audit scope included transactions from the inception of the Trust on September 30, 1994 through April 30, 1999.

We interviewed oversight personnel from DRR's Equity Asset Group in Washington, D.C., and from AEW in Boston, Massachusetts, to gain a general understanding of the operations of RTC Mortgage Trust 1994 S-6. We also met with accounting and asset management personnel from Asset Recovery Fund, Inc., in Austin, Texas. Additionally, we reviewed the Deposit Trust Agreement, Assignment and Assumption of Assets Agreement, Indenture, and Servicing Agreement to understand the Trust's structure and purpose, as well as the servicer's role and responsibilities.

To determine whether the servicer properly reported cash collections, we reviewed the collections on a judgmentally selected sample of 16 assets. The collections on the sampled assets totaled $29.1 million (44.7 percent) of $65.1 million collected by the trust. The primary sources of cash collection included owned real estate sales, loan sales, settlements with the debtor, loan payoffs, and net operating income. We obtained the sales closing statement or signed settlement agreement and identified the date the asset was disposed of and the amount of proceeds from the disposition. We then traced this information to the Trust's bank account to ensure the Trust received the correct amount of proceeds. For collections of net operating income, we obtained the property management statements and copies of remittance checks from the property manager. We matched the amount of net income to the property management statements and traced the deposit of the funds to the Trust's bank account.

We reviewed servicing fees, property protection expenses, and bond payments to determine whether the servicer claimed only allowable expenses. Specifically, we examined servicing fees paid on a judgmentally selected sample of 32 assets. The sample represented $518,000 (62.5 percent) of $829,000 in total servicing fees paid by the Trust. We obtained a schedule of monthly servicing fees paid and verified the amount with the Servicing Agreement's guidelines for the calculation of the servicing fee.

Additionally, we judgmentally selected a sample of 97 property protection expenses representing $4.9 million (75.4 percent) of $6.5 million paid by the Trust. The primary types of property protection expenses were payments for lien obligations, legal fees, property taxes, and insurance. The sample included one expense of about $2 million to pay off the first lien on one of the Trust's assets. We then traced these sample items to supporting documentation such as vendor invoices, property tax statements, and contracts. We also ensured that the expenses complied with the Servicing Agreement's definition of a property protection expense. We then determined whether the amount of the expense agreed with the amount shown in the Trust's bank statement.

We also reviewed all principal and interest paid on the bond. The Trust paid $21 million in principal and $900,000 in interest. We reviewed the Indenture to determine the appropriate interest rate and scheduled bond payment dates. We recalculated the bond interest to ensure that the servicer calculated it in accordance with the Indenture. We also traced the disbursements for bond payments to the Trust's bank account.

To determine whether the servicer made equity distributions accurately, timely, and in accordance with the Deposit Trust Agreement, we reviewed all equity distributions through April 1999. The Trust had disbursed a total of $38.6 million to Wilmington Trust Company who in turn was responsible for remitting the funds to the Class A and Class B certificate holders. We identified each distribution and calculated amounts that should have been distributed to the certificate holders. We also analyzed the cash available to the Trust at various points in time to determine the timeliness of the distributions.

We did not perform a comprehensive review of the servicer's internal controls because we concluded that the audit objectives could be met more effectively by conducting substantive testing rather than by placing reliance on internal controls. Accordingly, we do not express an opinion on internal controls. We performed the audit from May 17, 1999 to July 1, 1999 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

The FDIC has the responsibility to protect its investment in equity partnerships by requiring efficient and economic use of the Trust's funds. DRR, with the assistance of AEW, manages and conducts the FDIC's trust oversight function. Our audit determined that the servicer properly and accurately reported collections, claimed only allowable expenses (including property protection expenses and servicing fees), and properly distributed equity to the certificate holders.

For types of transactions in which we selected a judgmental sample, all items reviewed were adequately supported and in compliance with the Agreements. Specifically, the servicer properly and accurately reported collections of $29.1 million. These collections were primarily cash from owned real estate sales, loan sales, and net operating income. In addition, the Trust's payments for servicing fees of $518,000 and property protection expenses of $4.9 million were adequately supported and allowable under the Agreements. We have no reason to believe that collections and expenses not included in the sample were inaccurate or not adequately supported.

Our review of all transactions involving bond payments and equity distributions indicated they were correct and in compliance with the Agreements. The servicer paid allowable bond principal of $21 million and bond interest of $900,000. Additionally, the servicer made accurate and timely equity distributions of $38.6 million to the certificate holders.

Because the Trust transactions were adequately supported and in compliance with the Agreements, we made no recommendations requiring a management response.

CORPORATION COMMENTS AND OIG EVALUATION

On December 8, 1999, the Deputy Director, DRR, provided a written response to a draft of this report. The response stated that DRR had reviewed the report and had no comments.

CORPORATION COMMENTS

FDIC

Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429

Division of Resolutions and Receiverships

December 8, 1999

TO: Sharon M. Smith
Assistant Inspector General

FROM: Gail Patelunas
Deputy Director

SUBJECT: Draft Report: RTC Mortgage Trust 1994 S-6

The audit found that the servicer properly and accurately reported collections, claimed only allowable expenses, and properly distributed equity to the certificate holders; and, made no recommendations. We have reviewed the draft report and have no comments.

We appreciate your audit of the servicer for the 1994 S-6 Trust.

Cc: Doug Stinchcum
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Dean Eisenberg