RESPONSE TO FDIC REQUEST FOR COMMENTS
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THE HOME BORROWERS RELIEF FUND
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The Home Borrowers Relief Fund is a potential bidder for single family residential mortgage loans. The following comments concern only these assets, and do not address land loan, construction loans, commercial loans or any other assets.

A. Question separate from the FDIC list.

Modification. If a bidder purchases a loan, what are the requirements to modify that loan. As an example, the borrower had the loan origination date documented income of $100,000. The DTI was 45%. The loan tape provides this information. The bidder buys the loan. The borrower has a new job, but only makes $25,000 per year. Is the bidder required to modify the loan down to 31% of this income? What if a 31% DTI of $25,000 is order of magnitudes less than the current property value? If this modification is required, should bidders set a price that is based on the worst case estimate for income?

B. Responses to selected questions posed by the FDIC.

1. Which asset categories should be eligible for sale through the LLP? Should the program initially focus only on legacy real estate assets or should any asset on bank balance sheets be eligible for sale? Are there specific portfolios where there would be more or less interest in selling through the LLP?

HBRF: It is our opinion that this program is suited to pools of single family residential mortgage loans, which are relatively homogenous and smaller principal value assets. Poorly underwritten residential loans are at the heart of the financial crisis. These loans are very expensive to sell individually, and the characteristics of a pool of SFR 1st lien loans allows for a uniform due diligence process, diversity because of the number of assets, and known resolution strategies. Creating a market for this narrow asset class will create price discovery that can flow up through MBS and CDOs. Furthermore, there is no current financing for this asset class.

It is absolutely critical that if the Participating Bank holds the related 2nd lien loans that they are offered in the same pool.

2. Should the initial investors be permitted to pledge, sell or transfer their interests in the PPIF? If so, how should the FDIC ensure that subsequent investors meet the program's criteria for investors?

HBRF: Any ability to pledge, sell or transfer interests will increase participation. On a slightly different note, investors should be able to sell or trade loans out of the pool as an alternative to modification or foreclosure. This will allow investors to concentrate on the assets within a pool with which it has the greatest experience.

3. What is the appropriate percentage of government equity participation which will maximize returns for taxpayers while assuring integrity in the pricing by private investors? How would a higher investment percentage on the part of the government impact private investment in PPIFs? Should the amount of the government's investment depend on the type of portfolio?

HBRF: The Treasury should state the minimum equity that is required. The term sheet stated the maximum, but the investor should be able to select a minimum level as well.

5. How can the FDIC best encourage a broad and diverse range of investment participation? How can the FDIC best structure the valuation and bidding process to motivate sellers to bring assets to the PPIF?

HBRF: Allow for small pools. The indication so far is that the pools will be multi-billion dollar sizes. Even with the PPIF financing, a billion dollar plus transaction size limits the number of investors and bidders to only a handful of major players due to capital and servicing restraints which a) will reduce the price and b) creates a public perception issue for the FDIC that once again Wall Street is the only entity that can participate. Furthermore the largest institutions have not proven that they are better than smaller firms at servicing non-performing loans.

Regarding servicing, since non-performing loans require an extremely high amount of work, it seems to me that the FDIC should want to incentivize as many participants to restructure these assets as possible and qualified. Furthermore whole loan trades in the industry are often sub $100 million and even sub $10 million. These sizes are not unusual.

The balance for the FDIC is to create a note that has a secondary market value. Therefore, the permitted leverage levels and the estimated pool values should be structured so that the note has a minimum value of approximately $50 million. There are agency and municipal bond issues of this size that suit a broad range of fixed income investors. Such amounts would create an issue of sufficient size to create a secondary market.

Requirements for bidders should include reasonable net worth and servicing experience requirements. The qualifications should be made public so that investors can organize their businesses to meet the requirements.

As for structuring the valuation and bidding processes, contracting with one or more of the major loan sale advisory firms e.g. Carlton Group and Mission Capital Partners to design and execute this process makes the most sense. Firms such as these, though not limited to them, have had significant successful experience in the sorts of skills required.

6. What type of auction process facilitates the broadest investor participation? Should we require investors to bid on the entire equity stake of a PPIF, or should we allow investors to bid on partial stakes in a PPIF? If the latter, would a Dutch auction process or some other structure provide the best mechanism for bridging the potential gap between what investors might bid and recoverable value? If multiple investors are allowed to bid through a Dutch auction, or similar process, how should asset management control be determined?

HBRF: First, for clarification. I think that it would be clearer if investors bid on the pool, not the equity. As an example, if the bid package has $300 million UPB of loans and allowed for 4X leverage and 50% participation by the Treasury, it might be clearer if an investor bid $250 million for the pool (83.3% of UPB) and made it clear that it would invest $25 million, request $25 million from the Treasury and issue $200 million of debt. This would allow an investor in the bid the option of using less debt or taking less equity from the Treasury (if permitted). It would also allow for loan level pricing.

For a pool of non-performing residential loans, the most important aspect is the control of the asset post purchase. So the ability to bid on a portion of the equity would not give the investor control and would add complexity. I do not think that it would increase the purchase price. The better strategy is to create smaller pools.

For auction format, see #17 below.

7. What priorities (i.e., types of assets) should the FDIC consider in deciding which pools to set for the initial PPIF auctions?

HBRF: Initial sales priorities must focus on residential 1-4 unit whole loan pools of performing and non-performing loans. These asset classes are the most illiquid in the market today; enabling sales of them would free current investors to re-start extensions of credit.

8. What are the optimal size and characteristics of a pool for a PPIF?

HBRF: There is no optimal pool size, as different sizes fit different investors' needs. Minimum pool sizes of $50mm, however, will exclude undercapitalized players, while including smaller bidders of sound financial standing. See #5 above.

Very large portfolios should be split up to broaden the number of bidders, increase the bid prices, and diversify the risk for the FDIC and Treasury. The FDIC has a greater risk of poor performance is one investor has an extremely large pool, both from overpaying and from execution. This is especially relevant for non-performing whole loans which require tremendous servicing efforts.

Finally, even large funds might want to diversify their risk by making multiple smaller investments as opposed to one larger investment.

Characteristics:

In our opinion there are three major segments for a non-performing loan and these segments have distinct buyers:

1. Performing loans
2. Non-performing
3. REO

Segmenting pools into these groups might be advantageous.

Performing Loans: This segment has some level of cash flow. Valuing these loans requires fixed income investment expertise and assumptions. This class is available to foreign investors.

Non-Performing: This segment requires the most servicing and requires a different set of assumptions and investment expertise. This class includes everything from 60+ to loans in foreclosure. Loans that are near the end of the foreclosure process can be segmented into the “REO” group.

REO: This segment includes actual REO and loans that are in late stages of foreclosure (soon to be REO). This is primarily a liquidation valuation and attracts a different investor. This segment should be further divided geographically. Local investors will be able to pay the highest prices.
The other two segments would be better as geographically diverse pools.

9.  What parameters of the note and its rate structure would be essential for a potential private capital investor to know at the time of the equity auction to provide equity?

HBRF: For any non-performing asset pool, the note cannot have any fixed amortization schedule.  The note should have a repayment requirement based upon cash flow.  I would suggest no repayment during year one, and then semiannual payments thereafter based upon the prior period's cash flow. Accelerated payments should be permitted.  Possible term of 5-7 years.

The interest rate should be a set margin above a published Government debt instrument.  An investment bank can help you choose the best margin and "index."  The calculation of the rate should be fixed at the bid date. All parties will know exactly the value of the asset and the liability.  This eliminates interest rate risk during the bid to close period.

10.  Would it be preferable for the selling bank to take a note from the PPIF in exchange for the pool of loans and other assets that it sells? Alternatively, what would be the advantages and disadvantages of structuring the program so that the PPIF issues debt publicly in order to pay cash to the selling bank? Would a public issuance of debt by the PPIF limit its flexibility compared to the issuance of a note to a selling bank?

HBRF: Let the market develop.  I am sure that banks and other investors will step in to lend to PPIFs or underwrite the notes at the close, or purchase the note from the Participating Bank.  The FDIC can facilitate the development of this market by making the terms of the notes similar to other government agency debt.  Bidders can now make the decision based upon what is most attractive to sellers.  Participating Banks could signal what it desires and again the market will deliver it.

11.  In return for its guarantee of the debt of the PPIF, the FDIC will be paid an annual fee based on the amount of debt outstanding. Should the guarantee fee be adjusted based on the risk characteristics of the underlying pool or other criteria?

HBRF: Yes.  And the fee should be based upon the amount outstanding so the fee will decrease as the note balance decreases.

12.  Should the program include provisions under which the government would increase its participation in any investment returns that exceed a specified trigger level? If so, what would be the appropriate level and how should that participation be structured?

HBRF: Absolutely not. You want to incentivize the investors to maximize their returns. Furthermore, a deal is a deal. What scares investors the most is that the Government has the power to recast deals post closing. The uncertainty is too great.

13. Should the program permit multiple selling banks to pool assets for sale? If so, what constraints should be applied to such pooling arrangements? How can the PPIF structure equitably accommodate participation by smaller institutions? Under what process would proceeds be allocated to selling banks if they pool assets?

HBRF: Yes. One way is for the FDIC to combine loans from different Participating Sellers and then offer in a single bid package without identifying which seller has contributed which loans. Require that bids are made with loan level prices. With this format, the proceeds from the winning bid can be allocated based upon the bid price for each loan. The notes could be divided based on the same formula or for these transactions the notes could be underwritten or held by a trust and sold within some agreed upon time frame.

Alternatively, they can set up in the same manner as are whole loan conduits. A conduit is set up and loans are contributed to the conduit. The FDIC packages the assets into various whole loan pools and offers the pools. This approach permits smaller sellers to participate in part of the program by selling into the conduit, increases the availability of assets on offer, and permits the conduit to structure new whole loan or MBS pools to the specifications of investors.

The conduit approached worked very well for almost 30 years; it only fell apart due to the poor/unknown credit qualities of assets on offer. The new conduit would perform sufficient loan-by-loan due diligence to permit prospective bidders to bid with reasonable amounts of asset quality knowledge.

15. What should the relative role of the government and private sector be in the selection and oversight of asset managers? How can the FDIC most effectively oversee asset management to protect the government's investment, while providing flexibility for working assets in a way which promotes profitability for both public and private investors?

HBRF: Private investors should have the sole right to select the asset managers. The equity investment assures that the private investor group is going to act in a way to maximize its investment. As the past two years have shown, even those that were perceived to be the best asset managers in the business failed to manage well. The best way to protect the Government is through diversification. Oversight firms, such as Clayton and Boston Portfolio, should be retained by the FDIC to monitor assets managers' performances.

16. How should on-going servicing requirements of underlying assets be sold to a PPIF and paid for? Should value be separately attributed to control of the servicing rights?

HBRF: For non-performing loans, the loans should be sold servicing released with an interim servicing agreement. The servicing should not be sold separately and separate valuations do not serve any purpose. The servicing for a non-performing SFR loan must be owned and controlled by the investor. Separating servicing would not generate any meaningful bid value increases and would only add uncertainty.

17. Should data used by the independent valuation consultant, as well as results of such consultant's analysis, be made available to potential bidders? Should it be made available to potential sellers prior to their decision to submit assets to bid?

HBRF: The FDIC should provide the investors with a standardized loan tape that should have as much information as the seller has available. All loan information made available to the FDIC should be made available to the bidders. The order and format of the tapes should be consistent for all sellers. This information should be checked by the FDIC due diligence / valuation firm prior to sending out the tape and the data should be consistent (e.g. LTV should always be calculated on the original appraisal and the original loan balance). Inconsistent, incorrect and incomplete information is a major impediment to selling assets without significant discounts.

Unless an investor can rely on the consultants analysis, this information should not be provided.

Most importantly, the valuation consultant should provide current BPO appraisal value figures in the loan tale for each loan (preferably dated within 2 weeks of the bid package). The BPOs themselves can be provided electronically. A current BPO value enables the FDIC to conduct an auction without an appraisal based bid price adjustment and get the highest price. This will greatly simplify the closing. (Note that there must be the provision for purchase price adjustment base upon loan file due diligence issues), though these should be minimal since it sounds like the FDIC will conduct a due diligence process prior to releasing the bid package).

The loan tape should include the following data:

Original loan amount, UPB, data date, original FICO, loan documentation type (Full, stated, no doc, etc.), DTI, reported gross income, performing status (performing, non-performing, foreclosure, bankruptcy, etc.), delinquency (days delinquent), payment history (with an explanation of the code), foreclosure start date, foreclosure sale date, PMI %, PMI provider, loan type, loan purpose (purchase, refinance, cash out refinance), lien, existence of 2nd lien loan, closing date of loan, maturity date, term, amortization term, original note rate, current note rate, interest only, interest only months, reset index, reset margin, initial cap, periodic cap, life cap, first reset date, fixed period (years), reset frequency (months), original P&I, current P&I, T&I, PITI, property type (SFR, condo, multi-family, etc.), city, state, zip code, occupancy (owner, second home, investment, vacant, etc.), original appraisal value, LTV, CLTV, current BPO, BPO date, tax escrow balance (will this be deducted from the bid price?), 2nd lien UPB, 2nd lien rate, 2nd lien P&I, 2nd lien term.

The loan tape should not include borrower personal information, including name, telephone, social security, street address, or any other information that would reveal the identity of the borrower.