Public Private Investment Program
Legacy Loan Purchase Program
Comments from Merrick Road Properties Management LLC

Background on Merrick Road:

Merrick Road Properties Management was created in June of 2008 with the goal of purchasing bulk portfolios of foreclosed single family residential homes (REO) in the U.S. This was a response to the increased foreclosure rates and the distressed state of the banking system which will cause institutions in search of liquidity to dump assets at discount prices into the marketplace. Although many distressed funds have been active in trading and investing in the asset-backed securities and the whole loan markets, very few players are willing to "get their hands dirty" in owning the underlying asset, nor willing to build the administrative capabilities necessary for managing bulk portfolios of vacant homes. In this regard, Merrick Road is led by our COO, Chris Ryan, who has over 18 years of residential real estate experience. Merrick Road has a team of eleven people and the systems in place to handle a significant amount of foreclosed homes.

General Comments:

The biggest concern that we have with the program is that it appears skewed to the benefit of the sellers of legacy assets. While it remains unclear which banking institutions will participate as sellers of assets, and we certainly hope that any bank that has received TARP money will be compelled to participate, it is even more unclear if those participating will actually sell any assets. Under the terms that have been set forth to date**, it seems that the selling banks will be able to reject the highest bid rendered in an auction process if they deem it inadequate.** Therefore, there seems to be a large risk that buyers and sellers will never meet on price and the goals of the program will not be met.

Currently, banks with legacy assets have been unwilling to dump them into the marketplace as they have not been able to find a willing buyer and/or they believe there has been too great of a liquidity discount placed on a bid due to the lack of buyers. This is evidenced by the fact that, so far, few banks have been able to meaningfully rid their balance sheets of these toxic assets. While this program has clearly been put in place to provide the incentives (via the equity match and the FDIC-backed financing) for more buyers to bid at higher prices for the assets, there is still no guarantee that the two sides meet on price. Unfortunately, the power to say "yeah or nay to a potential deal" rests with the sellers, and therefore the structure favors the sellers to the detriment of the buyers/taxpayers. Surely, this is in direct conflict with another goal of the government's Financial Stability Act which is to make sure that the taxpayer does not overpay for assets.

Ideally, we would like to have all participating banks be **required** to sell the assets they have included in the program to the highest bidder. At a minimum, we would like to see a more even process that will result in a deal being reached by bidder and seller. Specifically, **there should be a floor price (possibly established by an independent valuation firm) that if reached during the auction process, must be accepted by the seller.** This will insure that the auction will succeed in taking the legacy assets off of the banks' balance sheets at a price that has been determined by the market.

We also feel strongly that any institution (or any of its subsidiaries) that is selling assets not be allowed to bid on any assets, particularly their own. The idea behind the program is to improve the balance sheets of the banking institutions by having private/government money purchase the bad assets from the banks. Allowing selling banks to use government money to buy more legacy loans may improve their balance sheets, but only because it allows them to buy assets at a discount and enabling them to put only 6% of their own money down. These banks should not reap rewards from this program given their poor behavior in the past. More importantly, if a seller bank can bid on its own assets it can "game" the system by putting in the highest bid (though at a lower price than where they have marked the assets) and pay for them with money that is majority government-backed. Again, in order to meet the goals of the program, it is best to keep any selling institution out of the bidding process.

In order to attract the broadest level of bidders, the pools of assets should vary by size and asset type. For example, there should be pools for small investors ($5 million-$25 million on a fully levered basis); medium-sized investors ($25 million - $100 million) and large investors ($100 million +). Likewise, investors may specialize in a particular asset class. While we expect the program to be confined to residential and commercial real estate assets, there are numerous types of assets that fall under that umbrella and it may make sense to segregate the pools by type of asset. This will also prevent a seller from dumping questionable assets in larger sized, very diverse pool of assets. In any case, bidders must be provided with a term sheet of the exact size and type of asset that they will be bidding on.

One of the attractions for investors (bidders) is the financing (up to 6:1 leverage) that they are able to obtain in buying assets as it dramatically improves the expected returns. The plan gives the FDIC the responsibility for determining the amount of leverage acceptable for each pool of assets, with riskier pools receiving less leverage and safer pools greater leverage. The FDIC is expected to receive a fee for guaranteeing this financing. In general, the fee should be reflected in the rate being charged which should be commensurate with the risk of the pool of assets. As it may take time to monetize the assets that investors purchase, the term of the loan should be at least five years. Assuming that the program will feature rolling auctions over time, it may be helpful to have the FDIC financing be in the form of a line of credit so that investors have the ability to reuse the FDIC-backed financing once we have liquidated a given pool of assets.

Having Treasury match the investors' equity and share the profits 50:50 is clearly a provision put in place to compensate taxpayers for the risk that they will be taking. From an investor standpoint, it does change the economics as Treasury is putting up half of the equity and reaping half of the profits. Therefore, as long as the investor is able to charge a servicing fee and performance fee on the Treasury funds (and its leverage) investor's should not care. As for the warrants, there is no need for such an instrument as the government is already sharing in the profits. Besides, structuring warrants would be problematic as unlike TARP, which provided for warrants in publicly traded companies, the PPIP will likely have many private investment entities participating.

Comments Specific to Merrick Road as an Investor in PPIP:

Merrick Road has raised money to purchase foreclosed single family homes (REO properties) from selling banking institutions. It is our understanding that REO will be included in the assets that sellers will contribute to the program. **We feel strongly that REO should be one of the highest priorities for the PPIP for several reasons.** First, in order to stabilize the entire housing market decline, which has underpinned the severe recession facing the country, there must be a mechanism to take out the ever-increasing supply of foreclosed homes, and thereby finally establishing a floor on home prices. Second, banks, to date, have been unwilling to sell these assets in the quantity that would be needed to significantly improve their balance sheets. And finally, incorporating REO into the legacy loan program will help stabilize local neighborhoods across the country by reducing the number of foreclosed homes in the area. These homes are often uninhabited and not properly maintained. Our plan is to purchase and rehab the homes so that they can quickly be occupied, thus increasing the overall value of other homes in the neighborhood, and also improving the safety of the community. Clearly, incorporating REO into the PPIP will help achieve some of the more critical housing goals of the federal, state, and local governments.

The marketplace for purchasing portfolios of REO properties is very different from the marketplace for purchasing a pool of loans. In particular, geographic, appraisal, and due diligence issues exist with purchasing hard assets such as homes. Each of these are somewhat related. The timing for performing due diligence on a portfolio of REO homes is long and costly, particularly when the homes are located in disparate parts of the country. Investors will not want to spend money on due diligence unless they know that they have won the asset being bid on. It may be necessary to have the bids based on recent broker price opinions (BPOs) of the properties provided by the seller, but have any bid be subject to a due diligence period post bid. Generally, in the REO marketplace, bidders are afforded several weeks to perform due diligence on the portfolio to allow the investor to inspect the properties which have been left vacant for several weeks/months and to perform proper comparable analysis. For this reason, it makes sense for individual portfolios of REO properties to be in similar geographic regions of the country (i.e., Southeast, Southwest, Northeast), if not by state or county.

Representatives of Merrick Road would welcome an opportunity to discuss the unique aspects of investing in REO properties with the Treasury/FDIC at any time, in an effort to have this important asset class properly included in the PPIP.

Merrick Road Answers to Comment Questions:

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?

   We believe foreclosed single family homes held by banks (REO) should be one of the first asset classes that should be sold. These assets for the most part are uncared for (uncut lawns, broken windows, littered with garbage) and are blight on many communities across the United States. (see comments above)

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?

   No opinion.

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?

   We believe that the current 50:50 equity participation by the Treasury is appropriate making tax payers equal partners with private investors and sharing equally in the upside of the program. However, managers should be able to charge a servicing fee and success fee on this equity for managing the investment. Additionally, we do not believe that Treasury equity should get any additional upside, such as warrants, other than the 50:50 split.

4. Is there any reason that investors' identities should not be made publicly available?

No opinion.

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?

On a broader scale our view on how the process favors sellers has been addressed above. However, specific to REO we would add the following;

REO, as a hard asset class, presents specific problems and challenges when purchasing and managing. The time and cost of due diligence can be substantial. Additionally, there are issues related to the spread of the assets across the country, vacancy issues and title issues that could prevent bidder participation. Many of these issues are addressed in the current market place for bulk portfolios of foreclosed homes. This should serve as a guide to how the bidding and auction process should be structured.

In the current market place for REO not only do sellers offer pools of homes they are looking to sell, but buyers can request of sellers specifics of what they are looking for and what price they are willing to pay. For example, if I have $25 million of private capital to invest this grows to $50 million with the Treasury's equity participation and to $350 million with FDIC guarantee (assuming 6x leverage). Investors should be able to request a pool with the following characteristics; all single family homes or condos, in Florida and the Tri State area of NYC, mostly light rehab, average home value of $200,000, all or mostly vacant, no raw land and a desire to pay 45% of current BPO valuation, thereby creating a pool whose total value is above $700 million. Sellers can then create pools that meet these characteristics and begin negotiating with specific buyers. This type of process allows a broad range of investors of different size, location, preferences and capabilities to participate, and levels the playing field between buyers and sellers.

The current market place also can offer advice on the structure of the auction and due diligence processes for REO. Specifically, the process needs to take into account the costs associate with the type of due diligence that is needed in order to close on portfolios. After a buyer and purchaser agree on the purchase and sale of a specific pool of assets, whether originated by the seller or the buyer, a due diligence period should then ensue. This will allow the buyer to conduct third party appraisals on each home and to execute customary title searches. It also will afford the buyers the ability to assess the extent of rehabilitation each home will need. After the due diligence period, as is customary per Asset Purchase Agreements, a value adjustment may be needed on the portfolio. Typically, whenever there is a dispute on the valuation of a specific home, an independent third party appraisal is obtained, and either the price is negotiated down, the home is removed from the pool, and/or the home is replaced with a similar home.

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?

   Answered above.

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

   Already answered.

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

   When dealing with REO the pool size should vary so that different sized bidders can participate. Additionally, sellers may be willing to take deeper discounts for larger pools, thereby helping buyers and sellers to meet on price. As addressed earlier the characteristics of pools should take into consideration geography, average value, vacancy, offer price, type of dwelling, and concentration. As discussed above, allowing bidders to set criteria of a pool with their specific needs and presenting it to the sellers via an intermediary such as the FDIC will help facilitate pools that meet bidder's needs.

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?

   For REO the note should carry a minimum term of 5 years and have an interest rate reflective of the FDIC guarantee.

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?

    The selling bank **should** have to take a note from the PPIF in exchange for the assets. It then should have the right to resell this debt into the open market raising cash. Many participants will not have the capability of selling notes to the public and may be unwilling to take on the costs of doing so. It would also put the success of any PPIF into the hands of the investment banks who would be needed to underwrite the notes.

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?

    No opinion.

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?

    No, the government should receive 50% of the returns reflecting its 50% investment. No more and no less.

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?

    For REO, we believe selling banks should pool assets for sale allowing them to meet specific needs and request from buyers.

14. What are the potential conflicts which could arise among LLP participants? What structural arrangements and safeguards should the FDIC put into place to address or mitigate those concerns?

    There should not be any conflicts between participants as long as the manager is allowed to control the assets and is paid a servicing fee for both private and public money. This, in conjunction of FDIC oversight, should mitigate any potential conflicts.

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?

For REO, managers of varying size should be allowed to participate. As long as they have minimum required capital to invest and can demonstrate experience in the market place that they will be actively involved. The FDIC should then ensure that the owner of the asset is acting in a responsible fiduciary capacity and is carrying out the stated objectives.

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?

    Third party servicing rights is not relevant to REO. The manager of the pools of REO needs to be able to charge a servicing fee for the portfolio and a success fee based on return.

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?

    For REO, a recent third party valuation of all the properties will be necessary. However, a third party chosen by the seller will not be acceptable to buyers who would then need to conduct there own third party valuations.