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To: LLPComments
Subject: Legacy Loans Program

Comments to the Legacy Loans Program

We are commercial real estate lawyers representing private equity and investment companies that acquire real estate secured debt and commercial real estate assets. We have the following comments in response to your questions posted:

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?**

The LLP should focus on any class of commercial real estate backed mortgage loans to draw the broadest supply and demand, creating as free a market as possible. Loan pools should be separated by asset class, including multifamily, hotel, retail, office, condominium, industrial, and residential development etc.

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?**

Yes, investors should have a means of exit as well as entry during the life of the investment. To create the most liquid market, the FDIC should permit investors the right to pledge, sell or transfer *non-controlling/non-voting* interests in the PPIF. Liquidity is critical to get broad investor adoption to the program and create the best possible pricing from demand. If the loan pools initially are very large, facilitating a secondary market will be critical to success of the program.

If the FDIC wants to ensure that a subsequent investor meets the program's criteria, then for a valid transfer of a controlling or voting partnership interest, the criteria should be embedded in the PPIF partner documents with a representation in the subscription agreement for the sale of the PPIF interest referencing the same. <u>This comment assumes that the FDIC / Treasury continue to guarantee the debt by the PPIF for the original acquisition of loan assets.</u>

Transfers should be permitted based on, at most, the reasonable consent of the Treasury. Otherwise restrictions on transfer should be left up to the private investor sponsors.

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?

The government's equity participation should range no higher than 50%, with a provision that private investors can make their own risk assessment relative to the equity participation sought from the government. Again the objective here is to entice a greater diversity of private investors.

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

Transparency is critical to the success of a government sponsored program. However, FDIC should consider making the underlying transaction agreements available to the public with redacted names of the private investor groups and their partners and principals. Recorded documents (deed of trust, mortgage, assignment of mortgage) relating to the transaction are public records in the county/jurisdiction where the underlying asset is located. The public will have the same access to information as with any real property transaction. I think publishing information about the investor groups will serve no greater public purpose and could 1) create an opportunity for irreparable harm to a private investor, and 2) inhibit participation from certain groups. In all respects, individual names participating in private investor group entities should never be disclosed.

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?**

The size of an offered loan pool is going to dictate who can get involved, combined with assembling pools by asset class (as stated in #1 above). For investors, FDIC should endeavor to offer pool sizes ranging from, by way of example only, $75,000,000 and higher. The size of pools will affect the administrative (cost) burden on the government and taxpayers. While "smaller" pools will create more work for FDIC, the benefit will be investor adoption increasing the likelihood that transactions get done and pricing reflects true value.

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?**

A private sealed bid auction process similar to those established by DebtEx, Eastdil Secured et al, will be the most effective. It is what private investors are used to and the process usually works. FDIC needs to bear in mind that due diligence costs are very high for multi loan pools and therefore permitting the selling bank the ability to pull the loans if they do not hit unknown reserves will chill investors from participating. Permitting private investor groups to aggregate resources and conduct joint bids, will likely result in those agreements also pre-determining control and asset management.

It was unclear from the FDIC materials if the selling documents will be negotiable between the parties. Investors should be able to condition their bids on reasonable modifications to the sale agreement. The selling documents must be equitable, and provide customary provisions including sufficient representations and warranties regarding the loan assets. Selling institutions must represent that they have disclosed everything in their possession material to the value of the loan asset(s), as well as some or all of the following:

(1) Seller is in compliance with the LLP provisions for selling institutions, can sell the loan and all action/resolutions have/ has been taken by seller to do so

(2) Seller will not be in violation of any other contract by selling the loan

(3) A representation as to the exact loan balances and escrows

(4) The collateral real property is not cross-collateralized or cross-defaulted with any other asset/relationship

(5) Except as provided in a schedule attached to the sale agreement, there are no required future advances and all disbursements under the loan have been made

(6) Servicing has been handled in compliance with law

(7) There are no other leases and contracts relating to the property that have not been disclosed in the loan file

(8) There are no environmental or hazardous material issues

(9) No brokers fees are due except what has been disclosed

(10) There are no known claims made by borrower or any third party against lender regarding the asset

(11) There is no known litigation with respect to the asset except as disclosed on an attached exhibit

Related Covenants. For non-performing loans, the sale documentation should provide a narration as to the status of any pending foreclosure, deed in lieu or judicial action as we as an and assignment of the same.

The due diligence process is critical to the success of this program, and must provide for:

- A sufficient time period for the investor group to complete and economic and legal underwriting

- A requirement that selling institutions will disclose all information, both business and legal documents, relative to a loan asset including without limitation all servicing records, correspondence with borrower (critical for sub performing and non performing assets).

- Investors should have direct access to the due diligence information and not be required to rely on government contractors to complete due diligence for investors. Then greater the access and confidence that a private investor has in the information reviewed, will allow for the best pricing, increasing the likelihood that investors will participate and deals will get closed.

- All aspects of the program must be disclosed to private investors at the outset, in plain English.

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

Given the current market conditions, all classes of sub or non-performing real estate loan assets should be high priority.

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

The optimal size and characteristic of a pool for a PPIF will vary depending what size investors are participating. It is important for FDIC to consider small and large pools. Pool sizes ranging as low as $75,000,000, or less, in size will permit many well qualified private investment groups to participate. Pools should be created based on asset class, and further categorized by performing, sub-performing and non-performing loans. We are lawyers, and principal investors will provide better comments on economics of the loan pool. We see suggestions ranging – current yield 7-9%, with a likelihood of yielding 20% overall within 7-8 years.

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?

No comment.

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?

From an investor’s perspective, more available financing options will increase the number of possible investors and improve the likelihood that transactions close. Public issuance of debt creates liquidity but will increase complexity and cost due to disclosure requirements. The best case scenario is making public issuance of debt one option, along with a note to the Seller as another option.

Third party lending (with foreign banks allowed to participate) should be permitted as well, increasing liquidity for participating /selling institutions. Third party lending should also be permitted for asset management issues.

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?**

Perhaps, if risk criteria can be standardized. If the loans were not individually rated (and in the LLP program they are likely not rated), then a rating system may be required to develop a basis for variation of the FDIC fee.

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?**

If the Treasury were willing to subordinate its return of capital and investment return to that of the private investor, then Treasury could be entitled to a greater share of the return on investment. The PPIF could be set up with a series of tranches with varying levels of return based on subordination of return of investment capital.

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?**

Yes, to increase the incentive for smaller banks to participate and clean up their balance sheets. Banks of all sizes should be able to and encouraged to participate for the benefit of not just the overall economy but local economies as well.

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?**

Conflicts may arise as certain investor groups are formed to participate. What is more important is the procedure and documentation to handle those conflicts. Standard entity and customary partnership documentation should address conflicts between the managing member/partner and passive investors, including providing for remedies in the event of a breach in the managing members duties to the limited/passive partners.

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?**

The private sector/ private managing partner should be in control of the asset manager selection as well as operational oversight of the asset manager. Private managing investors will have the expertise to make the process efficient. Certain ground rules regarding selection can be provided by FDIC so long as they are disclosed at the outset of the program.

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?**

The transaction documents should provide for servicing released to buyer with no separate consideration required. Servicing rights should not be separately valued. The PPIF should determine who it retains as servicer.

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?**

All data from the independent valuation consultant must be shared with both sellers and investors prior to the bid. The biggest challenge to this program is the concept that an investor can bid on a pool after extensive due diligence and related expense only for the selling bank to pull the bid. That feature must be modified so that investors can bid with confidence that if they are the highest bid, they will acquire the loan assets. Otherwise many investors will stay on the sidelines.

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