From: chris@milancap.com [mailto:chris@milancap.com]
Sent: Friday, April 10, 2009 8:24 AM
To: LLPComments
Cc: chrisnyuri@earthlink.net
Subject: Legacy Loans Program

To Whom it May Concern:

Milan Capital Management, Incorporated is a privately-held real estate investment company that specializes in the purchase, development, and management of multi-family and commercial properties throughout southern California and several other western states. We are interested in participating as private investors with the United States Treasury in the Public Private Investment Partnership program and the Legacy Loan Program, and could bring significant expertise as an asset manager, as well as significant capital as an investor to insure the program's success both as an investment for the taxpayers and as a vehicle for helping banks through the liquidity crisis. At the end of this letter, we propose a mechanism to get more banks to participate in this program. Without meaningful participation by institutions of various sizes and capital structures, the program will not achieve its objectives. After discussing the program with several member banks, we have formulated a proposal that will encourage this participation. In addition to making this proposal, we have carefully considered all of the other questions on which you are seeking public comment and have formulated a response for each:

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?

While obviously there remain significant issues with the residential loan portfolio of many FDIC member banks and thrifts, and of course such pools should be eligible, the next major wave of defaults will likely come from the commercial real estate portfolio of regional and national banks, many of whom have large concentrations of this type of asset. If the FDIC and treasury can help provide liquidity to some of these institutions, and in a meaningful way reduce or eliminate the specter of possible future write downs, the institutions might again be able to attract private capital. In some cases, the combination of asset sales and capital injections, either through the government's Capital Purchase Program or through new private equity investment, might be enough to prevent receivership and therefore further hits to the FDIC's Deposit Insurance Fund.

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?

Initial investors should be permitted to pledge, sell, or transfer their interests in the PPIF, because all of these features will make investments in PPIF's more liquid and thus more attractive, which will insure the best pricing for institutions, making the program more effective. I cannot find anywhere on your website what the program's criteria for investors is—it seems quite broad, and intended to get diverse participation—but a simple rule that requires buyers or creditors and other transferees to certify as to their eligibility should help to insure that they do qualify.

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?

I don't believe having the government participate in more than 50% of the equity would be wise for three reasons. First, I think it would diminish the incentive for realistic pricing if private investors were risking less than 1/14th of the capital stack in a loan pool purchase. Secondly, I believe the public would not approve of the government allowing private investors to take less risk than was initially indicated in the program's first announcement. Third, because of the second reason, I believe private investors would be less willing to participate in a PPIF with a greater than 50% equity stake, given the recent ex post facto tax increase on bonuses paid to TARP and other government assistance program recipients that is working its way through the legislative process.

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

Individual investors in funds that invest as part of a PPIF should not be disclosed. If they were, it might prevent large private equity funds and hedge funds from being able to participate. The funds themselves should be made public.

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?

If minimum pool sizes were set at $100M, thus enabling private investors to participate in tranches as small as $7M, the FDIC would insure broad and diverse investor participation. In order to encourage sellers to bring assets to the PPIF program, the FDIC should permit "stalking horse" bidders to work in concert with the institution and its regulators in setting minimum pricing for pools. In this way, sellers would not have the fear that they would bring assets to the PPIF, go through the process of price discovery, and then be forced or at least pressured to take a hit to their capital because the "discovered" marks were lower than the price at which they would be willing to sell.

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?

We believe investors should bid on the entire equity stake of a PPIF, and that investors should have full asset management control over the PPIF, with the government as silent partner. Reducing minimum pool sizes to $50M or $100M would mean that you would be opening up the bidding to the widest possible but administratively practical range of bidders.

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

Commercial and Residential real estate loans should be the highest priority items.

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

We believe that the smaller the better, but understand that from a practical standpoint, administering more than a few thousand of these pool sales will be difficult. Thus we recommend that minimum pool sizes be set at $100M. Many banks will do larger pools, but at $100M, it should be possible for all but the very smallest institutions to participate in a meaningful way. Pools should be organized by geography, and should generally not mix commercial and single family residential real estate loans.

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?

I think notes should be priced on a fixed rate basis indexed to treasuries, with a 200-400 basis point spread, depending on the risk characteristics of the pool. The particular treasury to index over would depend on the average term remaining on the loans placed into the pool. If the average maturity was 2.2 years remaining, for example, then we should use the three year T-Bill, so that the maturity on the pool financing exceeds the expected maturity on the underlying loans. The pool financing should come with some rights to extend, also, to give pool buyers time to be flexible with workouts, extensions, and potential bridge financing in place in the event of foreclosure. The extension rights should be based on the three, six, or twelve month T-Bill, at Borrower's option, and should float with the same spread. Structuring the notes this way would potentially enable banks to sell these guaranteed notes at a profit, and investors would know that essentially they were getting government guaranteed obligations at a discount to the applicable risk free rate. Borrowers should be charged a yield maintenance premium for early prepayment, and ½ point per year for the extension fees.

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?

We believe that if the selling bank takes a note from the PPIF it would potentially create even more liquidity for the selling bank for the reasons outlined in our response to #9 above.

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?

The risk is hard to quantify on a per pool basis—and assessing a higher fee on the pool is likely to drive down the pricing on that particular pool. The FDIC will, it is our understanding, determine how much debt that they are willing to guarantee, and that determination should be based taking into account the guarantee fee that they will earn for extending this credit enhancement. I think the fee should be standard, and that the FDIC should come up with a risk based model so that they feel that actuarially, the fee more than compensates for the risk of guaranteeing the amount that the FDIC is willing to guarantee.

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?

We believe that for 50% of the equity in a deal, the government should be entitled to 50% of the upside. You will discourage private investor participation with a different structure.

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?

Multiple institutions should be allowed to pool assets, but only those institutions whose total asset book value is below $1.5B. Investors could submit a unit price on each asset to derive their total price, and the proceeds could be allocated accordingly.

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?

Since we are proposing a “stalking horse” bidder arrangement, along with potential cooperation with selling institutions in finding and arranging new equity investments for them, we think conflicts might be minimized because essentially many of the sales would be striving for a win-win-win result.

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?

One of the qualifications of an investor or investor group should be that they have an asset manager in place with extensive knowledge of the underlying collateral type, and a business plan in place for the workouts or the potential taking of possession of the underlying collateral. The asset manager should be incentivized in such a way that the most significant portion of their compensation should be derived from the performance of the partnership from an investment standpoint, after certain minimum returns are met both for the public and the private investors. The hedge fund or private equity fund model of 20% after a 6%-8% or so hurdle, plus 1-2% of the equity as a fee per year, should work well for this. I would recommend, however, that no promotes (i.e. the 20%) be paid until the partners have received in cash distributions all of their capital back plus the 6-8% return.

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?

Servicing rights should be left at the discretion of the PPIF. Although there is certainly value in the servicing rights, that value should come with the pool.

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?

I believe that data used by the independent valuation consultant and that consultant's analysis should be part of the package made available to potential bidders, and it should also be made available to potential sellers prior to their decision to submit assets to bid. The more clarity and transparency there is in markets, the better they function. As a final point: We believe that while the leverage and equity participation afforded by the PPIP program as proposed will help to spark investor interest in buying the legacy loans, we have talked to several member banks and they are afraid to participate without knowing where the potential bids might be. In addition to this, they worry that selling, even at prices 50% higher than they would have been without the leverage provided by the FDIC guaranteed debt, might create such a hit to their capital that they still might not be able to function. This concern was also expressed openly by bankers during your conference call concerning the program, as noted in the transcript on your website:*FDIC STAFF MEMBER: And just to add to what George French was saying, the proposal from the FASB deals with securities, and this program, at least initially, is going to be focusing on loans. And the help for investment loan portfolios isn't subject to mark-to-market accounting right now, and if you only sold some of your loans out of the Help for Investment portfolio, that wouldn't trigger any change in the accounting per se for the remaining loans in the portfolio. The market indicators of the price, if they are extremely low, that may have some bearing on what the market view of credit quality is, which could affect judgments going forward about loan loss allowances, but there wouldn't be any automatic marking-to-market for the rest of the Help for Investment loan portfolio solely because you sold a pool out of that portfolio.MR. ACKERS: No, but you would still -- if you took a discount greater than your reserves, you would still have a hole in your capital, still put a hole in your capital.FDIS STAFF MEMBER: That's right. On the actual sale transaction itself there -- depending on how you are carrying those loans vis-à-vis the sale price, you'd have a loss that would reduce your capital.MR. ACKER: Thank you very much.* Banks haven't taken appropriate reserves against many of these loans, because their capital would be too hard hit. Milan is interested in working with some of these banks on a selective basis to function as a stalking horse bidder for their legacy loans, and then analyzing the capital of each bank taking into account the effects of a potential bulk note sale at a discount greater than current loan loss reserves. If it is possible, we would like to work in conjunction with regulators, private equity sources, and potentially the government's capital purchase program to backfill the “hole” in an institution’s capital with new equity capital.

We believe that without this element, it might be very difficult to get banks to participate in the legacy loan program, and many more banks than necessary will be forced into failure.

Thank you.

Sincerely,

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