RECRA

**Real Estate Capital Recovery Association**

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April 10, 2009

**VIA EMAIL AND FIRST CLASS MAIL**
Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
LLPComments@FDIC.gov

Re: Comments Regarding Legacy Loan Program

Dear Mr. Feldman:

These comments are being submitted by the Real Estate Capital Recovery Association ("RECRA"), a national non-profit trade association comprised of firms expert in the evaluation, management and workout of distressed real estate related assets. RECRA represented most of the asset management firms (sometimes termed "special servicers") who assisted the RTC and FDIC in the '90s as asset managers and equity partners in their respective programs to liquidate real estate-related assets. Recently, RECRA has been reactivated to represent that community in their efforts to contribute to solutions to the current crisis.

Asset managers are professionals with a business-focus on working out distressed assets, and have expertise in matters ranging from managing, re-positioning, and marketing real estate, to litigation and bankruptcy. The quality of asset management has an enormous impact on the recovery that will be extracted from a distressed asset portfolio. We think it is of paramount importance to Government that PPIF pools be serviced by professional asset management firms with a demonstrated track record, so as to help ensure that FDIC-guarantied loans are repaid and Treasury's equity investment is maximized. Accordingly, we recommend that FDIC establish standards and procedures to prequalify asset managers, and require PPIF bids to designate prequalified asset managers who would be used. There are a variety of factors that FDIC should consider in determining the qualification and eligibility of asset managers, including the asset manager's prior experience as a contractor or equity partner with FDIC or other governmental entities.

To the extent practicable, RECRA believes FDIC should strive for uniformity in the program, including the use of standard transaction structures and standard documentation.

For example, there should be a standard asset management agreement for servicing a PPIF portfolio with a standard fee structure. If each contributing institution designated its own documents and structure, the result would be an enormous learning curve burden on participants for each sales event, and certain important issues (such as, for instance, those pertaining to the indemnification of asset managers – an important issue in the creations of the RTC's standard asset management agreement) would have to be repeatedly addressed – perhaps with different results from deal to deal. We believe this may deter participation in the program by some of the most qualified firms. In addition, the details of the transaction documents are of critical importance to prospective investors and asset managers. We would encourage FDIC to circulate draft transaction documents for comment, and RECRA would be pleased to provide input.

We note with concern the provision of the Legacy Loan Program that would enable contributing institutions to decline to close on a sale. Prospective investors will dedicate substantial resources in performing the due diligence necessary to formulate a bid, and we think that the institutions should be required to close on the sale of offered assets if there is active bidding. The refusal of a contributing institution to close because of dissatisfaction with the competitively determine market price for an asset pool would, we believe, deter many investors from further participation in the program.

The following are RECRA's comments to specific FDIC questions:

**FDIC Question 1:**

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?

Comment: RECRA recommends that FDIC prioritize the liquidation of distressed legacy real estate assets (e.g., real estate loans where the owner has defaulted). It is critical that such assets be properly serviced by a motivated and capable party because the owners of the underlying real estate may be unable to fund asset protection costs, or may lack motivation because they have no further equity to protect.

**FDIC Questions 5 & 8:**

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?

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

Comment: To maximize investor interest in and competition for legacy loans, RECRA recommends that assets be marketed in pools and sub-pools that are (i) segregated as to asset type, (ii) geographically concentrated, and (iii) sized so that the equity requirement does not place bidding out of reach of all but the largest players.

(i) Creating Pools of Similar Assets and Geographically-Concentrated.

a. Investors will bid most competitively for portfolios that reflect their expertise and investment profile. Additionally, given the high degree of leverage afforded by FDIC-guaranteed loan financing and Treasury co-investment, the effectiveness of the special servicer in working out the portfolio assets will likely be as important a factor in maximizing the Government's recovery as the initial bid price for the equity piece. The greater the consistency of the asset type and geographic location of a pool, the better the pool can be matched with investors and servicers that bring the appropriate skill set to bear.

b. For example, the expertise and experience of an investor in undeveloped land differs significantly from that of an investor in hospitality or retail or multifamily assets. For this reason, the RTC correctly formulated separate sales initiatives for different categories of assets (land, hospitality, commercial, multifamily, etc.). Likewise, regional markets may vary significantly from one to another, and by geographically segmenting portfolios FDIC can more closely match the available product to investors so as to obtain the best execution.

(ii) Creating Pools Sized to Maximize Investor Participation.

We believe that it is important that asset pools be sized so that the equity requirements do not exclude all but the largest capital sources as prospective investors. The equity requirements to participate in the N- and S-Series equity partnerships with the RTC ranged from as little as $4 million to roughly $100 million. We believe that in the case of distressed real estate assets, pools of different sizes should be assembled in order to maximize the number of potential equity partners and not be so large that only the biggest capital sources can participate.

**FDIC Question 7:**

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

Comment: As noted in the response to Question 1, we believe that FDIC should prioritize the sale of distressed real estate asset portfolios which require the most intensive servicing to preserve asset valuation.

**FDIC Question 9:**

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?

Comment: It would be essential for potential private capital investors to know the following terms about the note:

(i) Provisions that allow liquidation proceeds to fund (a) working capital to operate the PPIF, (b) assets protection costs, (c) additional financing to a borrower, and/or (d) seller financing to a third party investor in a PPIF asset;

(ii) Provisions governing the ability of a third party capital source or the PPIF investor to fund specific projects (e.g., whether and on what terms mezzanine financing could be provided to help a borrower complete a project);

(iii) Release schedule terms for the underlying assets; and

(iv) Provisions governing the distribution of liquidation proceeds to the PPIF partners.

(v) Provisions to clarify how the PPIF will meet funding obligations in underlying loans (e.g. as with construction loans).

**FDIC Question 12:**

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?

Comment: We believe it would be counterproductive for the government to increase its participation once investment returns exceed a trigger level. This could discourage investors from making a maximum effort on the hardest assets, because their diluted percentage interest might not compensate investors for the incremental risk and effort of maximizing their investment. We note that private capital sources who team up with asset managers to invest in asset portfolios typically increase the asset manager's percentage interest as threshold targets are reached (as does the FDIC's current structured sales program) in order to provide extra incentive to maximize.

**FDIC Question 13:**

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?

Comment: One source of concern for prospective investors is the ability of contributing institutions to refuse to sell at the price offered. This accentuates the normal risk that investors take of losing a bid after performing significant due diligence, and as noted above, we recommend that the program prohibit institutions from declining to close where there is competitive bidding. If there is a portfolio auction comprised of assets pooled from, say, five institutions, it should certainly not be the case that any one of those five institutions can "veto" the sale by declining to close.

**FDIC Question 15:**

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?

Comment: As noted above in the introductory section, professional asset management of distressed assets is critical to the successful workout of PPIF portfolios, and we encourage FDIC to pre-qualify asset managers based on their demonstrated track record. Weight should be given to prior governmental experience of asset managers in other equity partnership or contracting programs with Government. In as much as private investors (including their asset management team members) will have interests aligned with those of the Government (to protect equity and maximize profits), FDIC oversight should not involve second-guessing the workout decisions of the asset manager.

**FDIC Question 16:**

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?

Comment: We think that distressed assets should be sold with servicing released and with no separate value attributable to the servicing. Given the importance of asset management to maximizing the value of problem assets, we believe that it is unlikely that private investors will be interested in making large investments with whatever servicing happens to be in place at the time of the sale.

**FDIC Question 17:**

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?

Comment: We believe that all data and assumptions used by the valuation consultant, as well as the results of the consultant's analysis, should be made available to potential bidders. We encourage FDIC to establish a standard valuation methodology (such as that established by the RTC for "derived investment value") so that investors have a standard valuation benchmark to assist in their due diligence and to understand the results of prior bids. The more due diligence information the FDIC provides, the better will likely be the execution of the sale event. We also recommend that FDIC publish the full bid results for each event (not just the winning bid) to promote transparency.

In conclusion, while the financial structure and government leverage will be important in attracting capital, financial re-engineering will not be sufficient in and of itself. We believe the success of the Legacy Loan Program will depend on the broad and effective participation of professional asset management firms in working out distressed assets.

We thank the FDIC for this opportunity to provide comments to the FDIC's Legacy Loan Program questions, and hope to have a productive ongoing dialogue with the FDIC.

Sincerely,

REAL ESTATE CAPITIAL RECOVERY ASSOCIATION

David Fensterheim

David Fensterheim, Executive Director

Donald Bean

Donald Bean, Jr., General Counsel