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Cc: Jeff Ludwig
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Comments for the Record

LLP Program

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What is a Legacy Asset?

Legacy assets are those assets which are less productive (outdated) and in some cases least productive overtime, they are just on the brink of being a liability. When assets lose considerable value they are often termed as legacy assets. The literal meaning of the word legacy is outdated or obsolete.

1. Which asset categories should be eligible for sale through the LLP?

Other Real Estate Owned (OREO) properties immediately, ultimately, all categories should be eligible

Should the program initially focus only on legacy real estate assets or should any asset on bank balance sheets be eligible for sale?

Yes, as mentioned previously OREO's are already on the books. Therefore, it appears that the largest pool of legacy loans are real estate related. After the FDIC has successfully sold a significant portion of the legacy real estate assets, they can apply the lessons learned to develop specific protocols to sell non real estate assets.

Are there specific portfolios where there would be more or less interest in selling through the LLP?

We believe there would be more interest by prospective purchasers for asset classes that are similar in nature. During previous down cycles, there was a belief that good assets should be pooled with bad assets to raise the value of the bad assets. Unfortunately, the reverse was true in that the bad assets frequently pulled down the value of the good assets resulting in many sales occurring for a fraction of the fair market value and a loss to the taxpayers.

Specifically, some consideration should be given to unbundling asset pools. One method would be to create smaller pools that offer similar products such as a pool for performing commercial loans and a pool for nonperforming commercial loans.

Another way to explain this concept is that there are some investors who will only be interested in purchasing cash flow from performing loans while there will also be speculators who will only be interested in purchasing nonperforming loans based on the value that the underlying collateral assets will have upon foreclosure.

2. Should the initial investors be permitted to pledge, sell or transfer their interests in the PPIF?

They should be allowed to sell the asset but not sell, transfer or pledge their interests in the PPIF.

If so, how should the FDIC ensure that subsequent investors meet the program's criteria for investors?

Inasmuch as the LLP has come about as a result of a crisis and is not intended to be a long term policy change for lending in the United States, it is in everyone's best interest to repay the government for their equity investment and retire the government guarantees on the debt. Accordingly, an initial investor should be allowed to sell the asset to a third party for cash thereby returning the equity to both parties and retiring the contingent liability of the loan guarantee.

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?

50% is surely stimulative and should encourage many different classes of investors to participate, especially if the structure allows for smaller pools of similar assets grouped geographically.

How would a higher investment percentage on the part of the government impact private investment in PPIFs?

By sharing the risk, the government can encourage investors to come "off the sidelines" and contribute to the recovery. It will be critical, however, to ensure that there are no disincentives such as caps on executive salaries or governmental ownership of companies or funds that participate. Likewise, it will be critical for there to be clearly defined rules and tax structures as the perception of changing rules and punitive regulations has heretofore been one of the factors that has kept third party money "on the sidelines".

Another benefit to having the government invest as a 50% partner is that it will provide much needed equity into the market. Over the past six months, US taxpayers have lost trillions of dollars of equity. If the LLP can ensure that "Main Street" can participate, when and where appropriate, instead of sending all the loans/equity and guarantees to "Wall Street", then there will be more competition for assets which should yield higher prices for the banks.

Should the amount of the government's investment depend on the type of portfolio?

No, if the government selects arbitrary terms on equity investment and percentage of guarantees, they could inadvertently inflate or diminish value for entire classes of assets.

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

No. Under normal circumstances it may helpful in enticing more investors to participate by offering privacy on who has purchased an asset; however, we are faced with a global financial crisis that has negatively affected almost every US taxpayer so it is essential that the FDIC create a structure that is completely transparent and verifiable.

5. How can the FDIC best encourage a broad and diverse range of investment participation?

Let the taxpaying public know that there is a way for them to participate. There is a strong concern and aversion by average citizens that the FDIC will simply send the funds for the PPIP to Wall Street whom they blame, rightly or wrongly, for the financial crisis in which we find ourselves. Recent reports suggest that citizens have lost more than 13 Trillion Dollars of equity in homes, securities, and retirement accounts. The FDIC could work with the Treasury to create a new form of municipal or regional funds in which citizens could invest. By creating local or regional funds, servicing and asset management jobs could be spread out across the country in the broadest manner ensuring ongoing economic benefits don't simply end up on Wall Street.

Organize pools in a manner so that loan pools are structured by city or region. It has been said that all real estate is local; this is particularly true for managing Legacy Loans and OREO's. If a real estate asset is nonperforming, then it is likely that sooner or later the investor will be required to foreclose. Nonperforming assets have a tendency to be wasting assets, OREO's more so. By this we mean, the state of the physical asset is not static. Development projects can lose entitlements, unfinished construction projects can deteriorate if left exposed to the elements and empty buildings are often vandalized. If pools are organized by city or region there is a much better chance that asset managers will be familiar with the assets and ensure that the asset is preserved for the benefit of the investors.

Clearly define the operating agreement for the equity partners. One area that needs definition is what role the government will play as an equity partner when there is a call for additional capital contributions which should be anticipated. While it is hopeful that some of the performing loan assets will perform to the end of their term and pay off the full balance, it is more likely than very few of the loan assets will mature without repayment or default and end up needing foreclosure to perfect the title. There will be legal expenses to foreclose or if the borrower files for bankruptcy protection. There could be construction costs to complete projects or provide tenant improvements and real estate commissions for leasing commercial properties. There could be legal and engineering fees to preserve entitlements for development projects or to complete the horizontal development. If the government is to share in the upside profit potential verses earning a fixed fee, then there will need to be provisions in the operating agreement that ensures the government contributes a pro rata share of additional capital costs along with provisions that create an approval process for additional funds that does not hamper the ongoing operation or preservation of an asset due to unnecessary or avoidable delays in obtaining approvals and funding of capital calls.

Create a protocol that ensures investors' time is not wasted. Under the current terms being considered, there is some thought that banks can contribute properties to pools and then with draw certain properties if the overall bid is too low. This scenario is problematic for several reasons and will likely create a disincentive for investors to take the time to underwrite an asset or pool.

One challenge will be to create an equitable value model for pools of assets that may be contributed by a bank. It seems unlikely that several different banks will be able to agree on what value should be placed on their Legacy Loans. Surely some will think their assets are more valuable than others, accordingly pools from multiple banks may be too cumbersome to work. If pools are limited to individual banks but the bank retains the right to withdraw assets from the sale if the bids are too low, then potential investors may be discouraged from participating. If an investor bids on a pool, they will want certainty as to what assets that pool contains. Allowing banks the option to withdraw the good properties and only leaves bad properties will undermine certainty, and investors will not want to waste their time or resources bidding on uncertain pools.

Create consumer confidence in the program by ensuring full disclosure of participants and transparency in the sale process.

How can the FDIC best structure the valuation and bidding process to motivate sellers to bring assets to the PPIF?

KEEP IT SIMPLE!

Value: With OREO properties already on the books of many banks, there will also be recent appraisals. Therefore, invite banks to bring these assets to the PPIF using the value confirmed in the most recent MAI Appraisal. With Legacy Loans, require that banks procure a current MAI Appraisal of the asset in the present market and have the bank contribute the same to the PPIF.

6. What type of auction process facilitates the broadest investor participation?

We recommend that assets be listed for sale on an Absolute Basis in an open cry auction. While Absolute Auctions seem risky, inasmuch as the asset will sell to the highest bidder with no reserve, history demonstrates that Absolute Auctions generate the most interest, the most competition, and therefore the best price.

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?

We recommend that you keep it simple, rather than bid on partial stakes, consider unbundling the pools and sell individual assets or small pools with similar product types and geographic locations.

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?

Not Applicable

If multiple investors are allowed to bid through a Dutch auction, or similar process, how should asset management control be determined?

Not Applicable

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

As mentioned, there are significant numbers of OREO properties that banks have already foreclosed on or could foreclose on if there was a willingness to do so. There are numerous reports of borrowers who have simply quit paying debt service on commercial loans without the banks initiating foreclosure proceedings. Likewise, there are numerous reports of borrowers whose loans have matured without a clear exit strategy yet banks have been unwilling to foreclose. We recommend that the FDIC consider some type of short term suspension of adverse regulatory affect for banks that take immediate and definite steps to foreclose on nonperforming assets and then place the same into the PPIF for disposition.

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

As mentioned previously, we believe that consideration should be given to creating a protocol that allows "Main Street" to participate in these sales. As such, having smaller pools should increase competition and prices paid for assets regardless if they are OREO properties or Legacy Loans. "Wall Street" may prefer larger pools of $100 Million or more due to the sheer number of loans that may be sold through this process. The challenge will be to find additional vendors that can sell smaller pools or individual assets. The FDIC may have to pay a little more to sell smaller pools or individual assets, but the potential return to the government and, by extension, the taxpayers is significant.

There is probably a logical break point to divide assets. For example, all OREO and loan assets that are valued below $10 Million would be sold by vendors (auctioneers and Realtors) from Main Street, while asset with greater values would be sold by vendors from Wall Street. The smaller pools or individual assets will have a greater sales cost, but with increased competition should yield greater sales prices, while the larger assets can be sold under terms and conditions currently being used.

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?

No Comment.

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?

No Comment

Would a public issuance of debt by the PPIF limit its flexibility compared to the issuance of a note to a selling bank?

No Comment

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?

Yes, but creating an equitable protocol might be problematic. For example, nonperforming loans for assets that do not have cash flow will create a situation where a purchaser will need to continue to fund the debt service and fees. In this instance, will the FDIC as a co-investor be responsible to pay its pro rata share of the ongoing expenses?

12 Should the program include provisions under which the government would increase its participation in any investment returns that exceed a specified trigger level?

No. As we understand the proposed program structure, the government will receive an annual fee for the government guarantee, and a pro rata share of any profits. It remains unclear how capital calls will be treated, but keeping an equitable split of profits seems reasonable.

Actually, the opposite should be considered. In the traditional private market transaction, the capital participants share pari passu up to a threshold and then the group doing the work would customarily have a promotional incentive as success thresholds are achieved.

If so, what would be the appropriate level and how should that participation be structured?

Not Applicable

13 Should the program permit multiple selling banks to pool assets for sale?

Not unless banks list OREO's and loan assets for sale on an absolute basis. If banks have the right to create minimum or reserve prices for assets, then it more likely than not that investors will either be reluctant to invest the time necessary to underwrite the assets, resulting in lower bids, or they will simply continue to sit on the sidelines waiting for better investment options to present themselves. The impact of investors withdrawing a bid due to bank(s) withdrawing assets can lead to the entire program being labeled as a waste of time for serious investors which could set back the resolution of the current financial crisis for months if not years.

Additionally, this scenario has the potential to open the door to possible litigation against the banks by shareholders and against the government by shareholders, banks and taxpayers.

On the other hand, banks will be reluctant to list OREO's and Legacy Loans on an absolute basis unless there is some type of temporary relief from FDIC regulations as they apply to OREO's and nonperforming loans. The current easing of the mark to market regulations may be sufficient to overcome this specific obstacle, but there may also be additional modifications that can be put in place to ensure that banks which cooperate with this process are not unnecessarily penalized for cooperation.

As mentioned previously, if banks are permitted to contribute a loan to a pool, who will decide what the "real value" of the loan is and, therefore, what the minimum or reserve price should be for an auction? If a pool sells for more or less than the listed asset value, how will the dollars be allocated?

If so, what constraints should be applied to such pooling arrangements?

This obstacle could be avoided if banks are required to list OREO's and loans on an absolute basis. This will give potential investors a confidence that the assets will sell and that the time they spend on underwriting the asset will not be in vain.

How can the PPIF structure equitably accommodate participation by smaller institutions?

By allowing individual OREO's and loan assets to be sold via an absolute auction. While the sales cost for an individual asset will be higher than the FDIC traditionally pays for pools sales, the price paid will ultimately be significantly higher than if the assets are included in a pool thereby offsetting the increased cost of sales.

Under what process would proceeds be allocated to selling banks if they pool assets?

We believe this is one of the most challenging questions asked in this request for comments. As mentioned previously, there does seem to be an easy answer to the question. In fact, we believe that this issue poses the greatest risk to the success of the PPIF as it has been described. Unless there is an incentive for banks to list properties on an absolute basis, then we believe the program is at risk. We would suggest that all properties entering the pool be appraised prior to the sale. The individual appraisals would establish a pro rata share of the total pool's cumulative appraised valued. Allocations would then be made post sale based on the actual price using the shear factor established by the appraisal process.

14 What are the potential conflicts which could arise among LLP participants?

Self dealing, the public perception that this program is nothing but another bailout for Wall Street, endless litigation that could result from structural flaws in the program, loss of confidence from the investment community and a prolonging of the current financial crisis.

What structural arrangements and safeguards should the FDIC put into place to address or mitigate those concerns?

As mentioned previously, keep it simple, ensure that the process is transparent, and provide regular reports of the progress to the taxpayers. Specifically, ensure that banks that cooperate in this program are not penalized by instituting temporary modifications to existing FRIC regulations. Sell OREO assets first then Legacy Loans, and require banks to sell these assets on an absolute basis. Establish clear rules that prevent self dealing and establish appropriate sanctions to punish those who break the rules.

15 What should the relative role of the government and private sector be in the selection and oversight of asset managers?

The role of the asset manager is critical. The consolidation of information and management needs to come into play here. While selling the property the closer you can get to the retail market the better, for the asset management role the greatest economies and efficiencies will be gained by creating scale. By working with a select group of Primary asset managers and requiring them to employ standardized reporting systems to downstream asset managers by a product type or regional geography each with a cap on the number of properties (provided the cap is above a critical mass), the government could effectively leverage existing asset management tail end in the industry while also creating new jobs in diverse regional markets.

As mentioned previously, one area that needs to be clarified is how the government as an investor will treat capital calls for expenses incurred after the sale of an asset. This could be addressed by creating an operating agreement that allows the private investor to be the managing member of the joint venture with the authority to manage the asset. Additionally, an operating agreement of this nature could also address the protocols for capital calls for post settlement expenses such as legal fees to foreclose on an asset, property taxes, tenant improvements, leasing and sales commissions, etc.

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?

Create clear rules for asset managers and establish appropriate sanctions to punish those who break the rules. Create a standard operating agreement that provides for flexibility for working assets in a way that promotes profitability for both the public and the private investor. Use standardized software and reporting systems as well.

16 How should on-going servicing requirements of underlying assets be sold to a PPIF and paid for?

No Comment.

Should value be separately attributed to control of the servicing rights?

No Comment

17 Should data used by the independent valuation consultant, as well as results of such consultant's analysis, be made available to potential bidders?

Yes

Should it be made available to potential sellers prior to their decision to submit assets to bid?

Yes

In responding to the FDIC request for comments we have tried to offer our best opinion on how to make a good idea better. We also understand that there is a broad dissatisfaction amongst taxpayers with the "government bailouts" as they are perceived by the public. The LLP is simple in its structure, but will be difficult to put in place. We believe our company NAI Global is uniquely positioned to assist the government if they desire to make sure some of the moneys from PPIF make its way to "Main Street" instead of simply being sent to "Wall Street". With over 250 offices across the USA, our brokers, agents and staff are already in place to offer OREO and Legacy Loan sales, asset and property management and sales and leasing services.

We believe that making sure that the smaller local and regional assets remain in the hands of local and regional investors is in the best interest of everyone. Elected officials from villages, towns, cities, and state house have a vested interest in preserving their communities. OREO's and Legacy Loans that are not managed well can quickly become a detriment to a community and have an adverse affect on property values which can prolong this financial crisis and further erode property values and property tax revenue.

We have mentioned the contrast between Wall Street and Main Street not to be divisive. The firms who make Wall Street their home have an important role to play in the recovery we hope is currently underway. It has been reported that there are over $400 billion in securitized commercial loans coming due this year and each year thereafter for the next few years. Untying the Gordian Knot of how to resolve hundreds and hundreds of billions of dollars of maturing securitized debt is a job so enormous that we need the experts on Wall Street to help resolve this. We respectfully suggest that there is a way for Main Street and Wall Street to work together towards a resolution that will be equitable to all parties.

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