A Response for

THE U.S. TREASURY & FDIC

For Real Estate Services

April 10, 2009

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Response to the FDIC/Treasury request for comment regarding the Legacy Loan Program.

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 Legacy Loan Program should cover both whole loan and REO (Real Estate Owned) assets. Given the diversity of options already available for other types of assets on the balance sheets of banks through the TALF program, focusing this program on real estate loans and REO assets only would aid in the FDIC's administration of the plan and maintain focus on an area (commercial real estate in particular) where there is an urgent need for intervention. The expansion of the program to include REO assets would enable banks to sell assets that have already fallen into foreclosure. It would have the same beneficial balance sheet effect as the sale of whole loans and would have other beneficial effects including creating additional price discovery for the underlying real estate.

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?

One of the main goals of the Legacy Loan Program is to increase the price that investors are willing to pay for troubled assets so that institutions are more likely to clear whole loans or loan portfolios in an active free market. Permitting a secondary market for these assets would increase the value of the assets to be sold by increasing the potential liquidity of the investment. Allowing participants to pledge, sell or transfer their interests in the PPIF will increase what many investors would be willing to pay for the loan pool. A secondary market for sales could work in favor of the Treasury and FDIC as well, as the PPIF could sell the entire pool to a private third party if the pool is trading at a premium. The proceeds can be recycled by the Treasury and FDIC in the program for new assets or other purposes.

The FDIC can ensure that subsequent investors meet the program's criteria by requiring any proposed counter-party to a pledge, sale or transfer of the interests be pre-approved in the same manner that the FDIC approves the original counter-party in the initial PPIF bidder approval process. To the extent that a transfer were made by the investor in violation of this rule, it should be clear in the Treasury/private investor PPIF partnership documents that such transfer would be void.

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?

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

No opinion offered.

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

The two competing concerns when dealing with disclosure are confidentiality (the breach of which will cause some groups to be less likely to bid) and the public's right to know with whom the government intends to partner. To the extent that bidder identity is public, it will reduce the number of individuals/groups that would be willing to bid which, in many circumstances, will reduce the price payable to the selling institutions. Confidentiality is a key consideration for many private bidders. The competing concern is the public's interest in which firms the government chooses to partner. This interest is mitigated, somewhat, by the FDIC's initial bidder vetting process (i.e. the FDIC will know who is bidding which lessens the need for a wider broadcast of bidder identities).

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 one characteristic of bidders that needs to be clear is their financial ability to close any transaction on which they bid. Beyond financial ability, any additional restrictions that are placed on the proposed bidders will limit the bidding pool, reduce diversity and therefore reduce the price that would be paid in some transactions. Additional restrictions on bidder characteristics should only be put into place to meet a compelling government interest as it relates to the character of the proposed bidder (such as to avoid criminal history) or otherwise serves a function (such as asset management) that otherwise cannot effectively be performed by the FDIC. As many of these functions (most categories of real estate asset management) can be performed by third parties who can be hired by the FDIC and/or the PPIF, requiring fully integrated bidders (those with both financial ability to close and in-house asset management capabilities) may not be necessary.

Structuring the valuation and bidding process in an optimal manner involves two questions. First, on valuation, the FDIC should use a valuation technique/process that gives the potential selling institutions enough information that they would be comfortable proceeding to an "absolute" auction (an auction with no minimum or "reserve" price). Specifically, while there is likely no mathematical or comparable sale based valuation technique that can give the selling institutions complete comfort that the estimated value will be the value that can be achieved in a sale, a technique should be chosen such that at the conclusion of the valuation the bank will make a "go or no go" decision to an "absolute" auction at that point. A process that does not give the banks an opportunity to clear will damage the bidding pool not only for that transaction, but for all subsequent transactions with a similar reserve price format. The key is not giving banks the incentive to go to an auction (as they would have limited downside if they were able to maintain a reserve price), the key is determining what it is going to take to give banks incentive to clear at the market clearing

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price. We address some of the suggestions to clear in an absolute auction in item number 13 below.

In terms of the optimal process that will give banks incentive to trade, it would be one that finds the best balance of speed and value, the two factors that are traditionally balanced in any auction decision. As value seems to be the paramount concern in this situation (the fundamental issue is that banks are reluctant to sell their assets at the existing market clearing price), it would be the process that achieves the maximum value in a reasonable period of time. With respect to large complex commercial real estate transactions, the optimal process is the managed bid program. In a managed bid, the bidders will all receive the same marketing information and typically will have access to additional information electronically. The added benefit of the managed bid vs. an on-line auction process (which may be a good approach for certain smaller commodity real estate) is that you will have the greater ability to know your customer in ways that matter to the client including: (a) who has the greatest ability to close and (b) what concerns/other information might a particular customer need to raise their bid (which likely would not be available in a pure on-line auction).

Notwithstanding the market clearing benefits of the absolute auction process, we recognize that additional incentives may be required to encourage banks to participate in an absolute auction format. The reason for the need of additional incentives is because an absolute auction may not be the preferred means by which a seller would bring assets to market (sellers may prefer a "reserve price" format so that they do not have to clear below a certain value). Some of the means by which the FDIC and Treasury can motivate sellers are discussed in more detail in the answer to question 11 below.

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?

The auction process that will maximize value is one that creates maximum transparency for the highest number of bidders. While the on-line auction option is an increasingly popular means of bidding on certain real estate assets (and serves a strong purpose for clearing large volumes of largely commoditized real estate product efficiently), the managed bid process is one that may lead to the highest value for the client for larger and more complex deals. Generally speaking, commercial deals are less of a commodity than residential transactions and may be better suited for a managed bid process. The advantage of the managed bid process is increased transparency to the bidders (by giving them the ability to speak to both the broker and/or the client to get additional due diligence information), and greater underwriting of the bidders (increasing confidence in the bidder's the ability to

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close). We offer no opinion on the Dutch auction either with respect to the auction for the asset or an auction for individual bidders to join a bidding pool.

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

The greater the uniformity of the asset type and location in the collateral pool, the better the bidding process. Uniformity (by asset type and/or location) is an important characteristic of any pool of assets as many institutional investors target their investment decisions based on narrowly defined investment preferences. Diluting a pool in multiple locations and asset types will make it more difficult for many institutional investors to bid and will reduce the gross price of many of those assets at auction. The competing consideration to higher bids is the ability to clear certain "difficult" assets off of the balance sheets of depository institutions. Specifically, in some circumstances, matching good and bad assets (or assets of various types) is an effective strategy to clear assets that are otherwise difficult to trade on their own. While the default position should always be to have pools of assets as uniform as possible, in some circumstances adding more difficult assets to a bidding pool will enable you to clear those deals as well. The incremental benefit will be clearing the difficult assets off the balance sheets of the depository institutions. It is unclear, however, whether adding these "difficult" assets to the pool increases the gross value of all the assets should the same be sold individually.

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

The pool of assets offered by the selling institutions should be as small as one whole loan (no minimum size) and no larger than that which a reasonable number of bidders can comfortably finance through their capital combined with the Treasury equity and FDIC debt capital. The level of debt financing will cause the equity required to vary, but, to the extent that there are few pools where the gross value exceeds $100 million per pool (which, based on the basic proposal of maximum 6:1 FDIC leverage and 50/50 Treasury equity participation would equate to an approximate private contribution of $7 million), you will maintain a deep pool of interested buyers. This is a comfortable number for almost the entire community of institutional investors and many high-net-worth individual investors. However, since the original term sheet makes it unclear that the FDIC would provide 6:1 leverage on all deals (they may choose to provide substantially less), the potential amount of equity contribution will vary for transactions of a similar gross value. To the extent that the maximum expected private equity contribution does not exceed approximately $25 million (using 6:1 leverage plus the 50/50 Treasury/Private Investor Split, this would imply a maximum value per pool of up to approximately $350 million), you should comfortably include most institutional investors and maintain some private individuals. Above the $25 million level, the number of private investors/individuals tends to get very thin and would almost exclusively be bought by institutional investors. This does not mean that individuals (even individuals with relatively little capital to deploy) will not be participants in the institutional pools (such as through mutual funds or similar investor programs), but few could do so individually and would also be outside the reach of smaller institutional funds. The optimal characteristics of the pool are addressed in item number seven.

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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?

The private investor will need complete transparency as to the terms of the FDIC provided debt at the time of their initial investment. Some of the standard provisions would include the amount, the term and the rate, but would also include any negative covenants or other terms that could put the loan into default prior to any monetary default. They would have to know that the loan cannot be subject to change except as set forth in the original loan agreement. Any weakness in the clarity of the loan will diminish the size of the bidding pool, as investors will have less certainty in their investment decision.

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?

Given the explicit government backing by the FDIC of any note provided to the participating depository institutions, the issuance of a note, rather than cash, is a reasonable alternative and will increase the immediate buying power of the FDIC. The key issue will be the transferability of any note. While administratively cumbersome to permit the transfer of the notes (though it could be done to certain "pre-approved" FDIC institutions, much like the FDIC is putting restrictions on bidders and which institutions are eligible to sell into the program), such a mechanism would increase the value of these notes to the recipient bank by increasing liquidity.

The second question is whether the PPIF's should issue debt publicly as a means to pay the bank for its assets. Assuming this public debt issuance (bonds) would go along with the explicit guaranty by the FDIC of such debt, this could be a very valuable step toward reinvigorating the securitized real estate debt markets. Specifically, both the CMBS and RMBS markets are almost completely closed to new issuances for a number of factors, most notably the great uncertainty as to the stability of the underlying collateral. An explicit government guarantee on new debt in the market place backed by similar loans that might otherwise have been securitized in a more vibrant securitization market, would bring investors back to the table. This could, in the intermediate term, be the first step toward reestablishing confidence in the RMBS and CMBS markets. No matter how healthy the banks become as a result of this government effort to purchase troubled assets, there is simply not enough capital in aggregate in the banks necessary to finance or refinance the multi-trillion dollar residential and commercial loan demand in the marketplace. An explicit government guarantee (which is something that may be phased out over time) is likely the most realistic means of regaining investor confidence in the securitized real estate debt markets.

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A transaction to raise debt rather than issue a note to the selling banks would limit the flexibility of the PPIFs due to the time, uncertainty and transaction costs associated with the capital raise. While there are ways to raise the debt capital based on the initial profile of the whole loan pool before the auction, given the uncertainty of the total price to be paid and the nature of the buying party (two key factors in debt underwriting), it is possible that the debt capital raise would not be finalized until after the auction has been completed. This injects a measure of uncertainty into the viability of the auction. Nevertheless, it is something that should be seriously considered since: (a) the explicit guarantee of the FDIC will materially increase investor confidence in the debt offering despite uncertainty in terms of price and the characteristics of the private PPIF buying party and (b) the goal of jump-starting the securitization market is so important not only for the financing of secondary market trades, but more importantly for the underwriting of new originations, that this tool should be seriously considered notwithstanding the drawbacks in terms of the flexibility and timing of the investments by the PPIFs.

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 FDIC has multiple factors that it can adjust for each loan pool including the leverage, the cost of the debt and the guarantee fee. In short, any decrease of leverage (below the maximum 6:1 ratio) and increase of the interest rate and the guarantee fee will have a direct and negative effect on the price that private investors will be willing to pay banks for the purchase of their whole loan assets. That being said, prudent underwriting dictates that the greater the risk profile of the underlying collateral the more the lending institution (government or otherwise) needs to tighten the terms of credit. Here we have two competing considerations: (a) the public interest in improving the balance sheets of the depository institutions selling into the PPIF program and (b) the public interest in not "overpaying" for the same legacy loans. To the extent that the cost of the capital is placed too high, this will negatively impact the willingness to sell into the PPIF program as it is less likely that the buying community will pay the price the bank considers necessary to clear the assets from its balance sheet. To the extent that the cost of the capital is too low for riskier loan pools, the public may face an undue risk of overpaying for these assets since more bidders will be prepared to take undue risk given the low cost of debt capital. The end result will likely be a case-by-case analysis of each loan pool by the FDIC to determine the optimal amount and cost of leverage. While this runs the risk of being a burden to the administration, it is superior to a one-size-fits-all solution, which would err in many situations in the balance between optimal cost and minimal risk.

The issue of the cost of debt to be provided by the FDIC is of critical importance particularly with respect to the "most" risky assets. We make this observation as we have seen the greatest bid-ask spread (on a percentage basis) with respect to the most risky (often non-performing) loans. It is with respect to these loans rather than the performing whole loans with the best underlying collateral where we have the greatest concern that banks will be willing to clear the market even if the FDIC were to provide debt at the highest amount of

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leverage and lowest cost of capital. As such, the FDIC will likely have to make a public policy call as to how aggressive they want to underwrite their debt financing for the most risky pools; too loose and you will put the public capital at risk, too tight and you will not clear the market (which is the fundamental problem that we are trying to solve in the first place). There are several middle ground solutions here which may give the selling institution incentive to clear including: (a) the FDIC or Treasury may be able to provide additional capital to the selling institutions (in the form of preferred equity) in an amount equal to the difference between where the market clears and where they have marked these assets on their books and (b) revising accounting rules for banks to permit the amortization of write-downs over several years rather than all at once.

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?

Much like the prior question with respect to the cost of debt, any increase in the return structure of the government's equity in excess of pari-passu will decrease what private investors are willing to pay for the loan pools. In a "typical" transaction between investment capital (in this case the Treasury's through their equity) and a private operator, it is not the investment capital, but the private operator that would be the party that is "promoted" by virtue of earning an oversized return per their unique ability to add value. This "promote" structure provides motivation to the private partner in the PPIF to achieve the highest return possible which will likely increase the number of interested participants. The added incentive will also give the taxpayer, the FDIC and the Treasury an added level of assurance that any potential loss will be minimized. Of course, nothing is typical today and the inexpensive cost of the government's capital is certainly a reasonable thing to consider when determining whether the government should get an additional return if there is an outsidsized return. More important than all of this is not whether the government or the private investor gets an additional return for outsized performance, it is investor certainty as to what is "the deal" at the time the PPIF investment is made. To the extent that there is a material risk that the private party might lose some or all of its outsized returns in the PPIF through any ex-post-facto government rule change, you will materially and adversely affect the number of parties willing to participate in the program (and take this risk) which will decrease the prices paid to the participating banks in a competitive auction.

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?

Permitting multiple banks to pool their assets will have the advantage of creating: (a) a critical mass of assets which will open the bidding up to larger bidders which will enable more deals to clear more quickly and (b) has the potential to create a diverse pool of assets which will enable the clearing of some of the "good" assets when paired with some of the

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"bad" assets. This is a strategy frequently used in auctions to clear the more "difficult" deals in which fewer bidders have an interest (though it is unclear whether it leads to a higher gross price were the assets to be sold individually). The negatives of the multi-bank pooling process will involve the allocation of sale proceeds across the banks. In bidding processes where you pair "good" and "bad" assets, very often the allocation of the price between the assets is not as simple as placing an objective value on each asset using an appraisal or other third-party valuation tool. In some circumstances, these assets (particularly the more difficult ones) either would not clear at all or, if there were to clear, would clear at a price well below the price attributed to them in a pooled bid. As such, disputes would likely arise among the selling banks as to the fair allocation of the price among the assets as there will not be a purely objective manner in which to allocate the price among the same.

The issue of whether and how small banks can participate in the PPIF process is not a question of whether the deals can clear (as smaller deals, even as small as individual homes and small commercial properties are clearing in today's market), it is really a question of whether the administrative process of valuing, auctioning and asset managing smaller pools can reasonably be done in a manner that maintains the highest standards of transparency, accountability and quality control. We believe it can, by bringing in a few national firms to manage the assets on behalf of the FDIC/Treasury to off load many of the asset management functions (primarily loan servicing) from the PPIFs into a few centralized locations. The centralization of some core real estate services will create efficiencies, which will allow smaller banks to submit smaller pools into the program.

One other thing worthy of mention with respect to individual transactions is the possibility of auctions not only for small pools of whole loans, but also individual whole loans. This will be of particular importance in the commercial context where it would greatly increase the efficiency of the loan renegotiation process for underperforming loans. In such a process, the individual developers could purchase their own loans in an auction and would be eligible for the Treasury/FDIC PPIF funds to acquire the same (lowering the cost of capital and increasing the price they could pay to the banks for their loans). This would go a very long way to close what appears to be an increasing bid-ask spread in the value that originating banks are attributing to their loans and the values that the developers themselves are placing on these loans. Opening the door to this Treasury/FDIC capital source will enable a smoother series of loan "workouts" which will be healthy for both the lending and development communities. There are, of course, competing considerations to allowing individual deals into the program including the risks associated with the lack of diversification and the possibility of an "unfair" advantage going to the existing developer (who likely has the greatest individual asset knowledge). Nevertheless, these competing concerns should be mitigated by the fact that individual asset deals tend to be among the most attractive to institutional investors because of their relative ease of underwriting and transparency as compared to larger pools of the same (which should lead to higher prices for the selling banks).

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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?

No opinion offered.

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?

In the commercial real estate context, there are two basic types of real estate investors: (a) fully integrated real estate companies that are well capitalized and have all functions required to underwrite, manage and sell assets within their organization and (b) real estate investors who are well-capitalized, but serve in primarily in an "asset management" role and then contract out the other real estate services required to underwrite, manage and sell the assets. While there are many companies that fall into category "a" (fully integrated), there are far more in category "b", companies that do not have the full breadth of real estate services in-house.

Among the open items that we understand are being considered by the FDIC is how one can become a qualified bidder for assets. The Legacy Loan Term Sheet states that, among others, "individuals" may become qualified bidders, the FDIC and Treasury have clearly made an important public policy decision to try to open up the bidding process to as many parties as possible. In addition, by having as many bidders in the process as possible, you will drive a robust auction which should lead to the best pricing for the selling institutions. As such, limiting the pool of bidders to fully integrated real estate companies would unreasonably limit the number of bidders in the process.

The best way to select asset managers is to find the process that maximizes the transparency, quality and consistency of the service offering. In this regard, we might suggest that the FDIC distribute a request for proposal to create a list of approved vendors who would be subject to consistent standards of oversight, transparency and reporting. Giving the PPIFs total discretion to choose an asset manager runs an undue risk for the government, and this risk can be mitigated by pre-approved standards for service providers, much like the way bidders are going to be qualified.

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 assets underlying the LLP will be both residential and commercial whole loans. There are dozens of firms in the country that have servicing capabilities designed for either or both of residential and/or commercial whole loan assets. There is value in the underlying servicing rights to these servicing firms. The fundamental question that the FDIC will need to ask is whether they should permit the private partner to select the servicer in each

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instance and for each pool, or will the FDIC select a few servicers to manage the assets for the entire program. From an administrative standpoint, much like how the Treasury/FDIC decided to select five firms to asset manage the Legacy Securities program, it would administratively easier to have a fewer number of firms selected as the designated servicers for the FDIC. This will materially aid the consistency, transparency and quality of the asset management services. Servicing rights should be awarded based on the quality of the servicing platform and not based on "auctioning" or "purchasing" the servicing rights. The latter would be inconsistent with the public policy goals of consistency, transparency and quality. We would suggest that the FDIC issue an RFP for whole loan servicing in a similar fashion to what was done in, October 2008 when the original TARP program was proposed.

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?

In order to maximize the transparency of the auction process (with respect to the underlying collateral) it is vital that any information obtained from an independent valuation consultant provide as much objective data as possible to both the buying and selling communities. This transparency will directly reduce the underwriting expenses of the bidding pool and allow the potential buyer to bid a higher nominal value for the asset. It will also improve the odds of the seller participating in an "absolute auction" as referenced in question 5.

Providing the sellers the collected data will be of great importance as their decision whether or not to participate in the auction may be determined upon the information obtained. One of the great concerns among market participants is that these auctions will be run and the deals may not clear. This risk will diminish the willingness of many market participants to enter the process in the first place (as participants will be less likely to spend the time and expense of underwriting deals that have a lower likelihood of clearing). If a decision is made by the selling institution to move forward with an absolute auction after reviewing the information provided by a third party valuation consultant, it is likely that the number of participants in the bidding pool will be substantially higher than if this step was not taken (due to the market's understanding that the deal will trade). This process will allow for the private sector to bid up the value of these assets and ultimately price discovery will occur for the loan or portfolio of loans within the Legacy Loan Program.