IRR

Corporate & Public Finance, LLC

April 10, 2009

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
LLPComments@FDIC.gov

VIA EMAIL AND FIRST CLASS MAIL

Re: Comments Regarding Legacy Loan Program

Dear Mr. Feldman:

These comments are being submitted by IRR Corporate & Public Finance, LLC (IRR C&P), a national real estate advisory group specializing in the structuring of public-private real estate partnerships. IRR C&P's comments come from the unique perspective of having acted as an advisor to each of the key stakeholders in the Legacy Loans Program (LLP) – federally insured financial institutions, government entities, and private real estate investors.

IRR C&P felt that the most comprehensive and accessible way to provide comments was simply to list a brief response after each specific question in the pages that follow, however, before getting to those responses, there are two major points that in my opinion will drastically impact the effectiveness of the LLP that I first want to emphasize. First, many financial institutions with whom we have discussed the LLP have indicated a hesitance to participate because they fear that the losses incurred as the result of participating may push them closer to insolvency without the government providing some sort of assistance in recapitalizing. There are a variety of incentives that could be offered to financial institutions to ease the burden of participating, and most were hopeful that the LLP would be amended to include such incentives following the public comment period. Second, many private investors may be reserved about investing through the LLP unless they receive fool-proof assurances that profits will not be clawed back in the form of new special taxes on investors in the LLP. Most investors with whom we have spoken have indicated that they don't mind their upside investment return potential being limited by the inclusion of government warrants, however, when this is combined with the fact that any significant profits could be heavily taxed as a result of special legislation, many investors are considering drastically limiting their investment exposure to the LLP. Thus, an explicit and ironclad exemption from special taxation of any profits earned through the LLP would go a long way to expanding the private capital base interested in participating.

Additionally, our firm feels that all stakeholders are best served by requiring absolute transparency throughout the program and its processes. In particular, independent third party valuations are critical to establishing true real estate asset values upfront in order to protect the federal government from potential abuse and protect the taxpayers' equity investments. Our firm is supportive of the efforts being made by the Treasury Department and FDIC to jump start the capital markets in the real estate sector and beyond, and we stand ready to clarify and/or expand on any of the comments that we have provided. Best of luck in your momentous task.

Respectfully submitted,

Kevin K. Nunnink
CEO – IRR Corporate & Public Finance, LLC

Please find below our responses to the questions upon which specific comments were requested:

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?**

An initial focus only on real estate assets will allow for everyone to evaluate the program and add liquidity to a frozen asset class, and if that is successful, the program can be expanded out to include other asset classes as necessary.

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, it is critical that the PPIF must be eligible to pledge, sell, or transfer its interests. Any transfer should be subject to a fee, and this fee should pay for an administrative review by an independent servicer or some other oversight entity, which would need to confirm that the credit quality of the PPIF will not be materially diminished, increasing the riskiness of the related FDIC-guaranteed loan, as a result of the transfer.

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 proposed dollar for dollar equity investment match is a good ratio. A dollar for dollar equity investment match provides private investors with additional purchasing power while maintaining enough of a private equity investment to retain the private investors attention in providing sound asset management on behalf of the PPIF.

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

Full transparency should be a cornerstone of the program.

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 FDIC can best encourage a broad and diverse range of investment participation by keeping the loan pools small and homogeneous in terms of asset type and geographic location. This will allow for smaller regional investors and real estate professionals to participate, thus increasing the competition among private firms.

Additionally, any assets offered for sale through the PPIP program should be required to be sold. If financial institutions retain the right to hold assets after offering them for sale, some smaller private investors may be discouraged from spending the time and money to perform the necessary due diligence to participate in the bid process, thus reducing competition for assets. Banks should be allowed to set and disclose a reserve price prior to the bidding process and retain such assets that do not receive bids in excess of the reserve price, however, if the reserve price is met by a pre-qualified bidder, then a transaction should be required to be consummated.

The FDIC may need to provide further incentives in order to motivate sellers to bring assets to the PPIF. This is the case because many financial institutions would likely struggle to replace any regulatory capital eroded as a result of losses taken on sales to PPIF's. One incentive to consider would be to allow sellers to amortize any losses incurred as a result of a sale to a PPIF over the life of the loan, which would more slowly reduce the institution's regulatory capital base and give the institution more time to find the means to replace capital, as necessary. For example, assume that a financial institution is holding a note with a $100 par value on its balance sheet. The note has 5 years left to maturity, and the note's value has already been written down by the financial institution from its par amount to a value of $90. If the institution sold the note to the highest bidding PPIF at $80, the institution would incur a loss of $10, which would either reduce the institution's level of excess reserve capital or may require the institution to raise additional capital in order to meet minimum capital requirements. Obviously, raising capital in the current environment would be very difficult, so some institutions may be discouraged from participating in the PPIP if they believe that bids on assets would require them to raise significant additional capital. However, more institutions would likely participate if doing so meant that they would only be required to raise $2 in capital each year for the next 5 years (the $10 loss amortized over the remaining life of the loan), rather than attempting to raise the entire $10 loss in the current capital markets environment. The full $10 loss should be disclosed to bank investors in order to keep financial reporting standards transparent, however, earnings and regulatory capital ratios would only be reduced by $2 per annum, allowing the bank more time to recapitalize, with such recapitalization hopefully even possible through the retention of earnings rather than requiring outside capital infusions. Such an incentive very well may be the key to widespread seller participation, as without such an incentive, many institutions will likely balk out of fear that their participation will only create further capital shortfalls and draw unwanted attention to an institution's financial position.

Another incentive that may be considered would be to allow the seller to participate in investment returns after the equity investors have exceeded certain hurdle rates. In this way, the seller would participate along with the investor and government in excess profits above specified trigger levels, giving the sellers an incentive to participate and a means to recover incurred losses if assets recover their value. Additionally, if our suggestion to allow banks to amortize losses incurred as the result of sales through the program is adopted, an equity participation by banks could allow a portion of the amortized losses to be recovered prior to recognition, further reducing the strain on banks and encouraging more widespread seller participation.

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?

Partial equity stakes would likely result in material "control" discounts, which would adversely affect the overall price received by the bank and/or FDIC for the assets. Therefore, we would recommend that no such partial stakes be auctioned, subject to the investment pools being small enough to attract smaller investors without offering such partial interests.

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

Non-multi-family assets should receive a priority over multi-family assets in the PPIP auctions, as the multi-family sector still benefits from Fannie Mae and Freddie Mac lending capacities and therefore have a relatively liquid and viable funding source available in the market, whereas all other asset classes are currently much more capital constrained. The inclusion of multi-family assets will likely simply cannibalize the market share of Fannie and Freddie for multi-family loans, with the total market lending capacity for real estate (FNMA + FMLC + PPIP) being reduced as result. This should be prevented by limiting debt on multi-family assets to a level that still leaves FNMA & FMLC programs very competitive.

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

As stated above in the response to #5 above, the loan pools should be kept as small and homogeneous in terms of asset type and location as possible in order to encourage many smaller and regional investors to participate in addition to the larger investment institutions.

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 entire note should be made available for investors review, preferably with a summary containing the key information (rate, rate type (fixed/floating), rate reset date(s), extension options, etc). Additionally, key information regarding the underlying collateral will also be necessary in order for an efficient auction process.

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?

It is preferable for the selling bank to take a note from the PPIF. The PPIF's notes (carrying FDIC guarantees) could be pooled and sold by the financial institutions more easily than PPIF's selling the debt in the market for each deal individually. If PPIF's are required to find debt for each deal individually, many qualified real estate players that would otherwise be bidders may choose not to participate simply due to a lack of capital markets knowledge and/or resources available to provide the necessary debt for bidding purposes.

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?

Fees should increase with the amount of leverage being guaranteed by the FDIC. Perhaps PPIF's could be given a menu of leverage options (i.e. – they can borrow 6-to-1 leverage for a 1% annual fee, or 5-to-1 leverage for a 0.75% annual fee, etc.).

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?

Yes, the government should be able to participate in additional investment returns above certain hurdle levels. Above reasonable investment return hurdle rates, warrants or some debt conversion mechanism should increase the government's equity participation level. Additionally, it may be wise to offer financial institutions some level of participation once private investment returns reach certain hurdle levels. Allowing banks to participate in the profit potential along with private investors and the government would provide a strong incentive for banks to sell assets, and without such an incentive and/or assistance in recapitalizing any losses incurred as a result of the sales, many financial institutions may balk at participating, limiting the program's effectiveness.

In conjunction with limiting private investor profit potential through the government increasing its profit participation upon certain investment return trigger levels being achieved, private investors will likely expect for the government to explicitly exempt investment returns from any existing or new special tax legislation. The failure to provide such an explicit exemption may result in the loss of a significant portion of the private capital investment base that is considering program participation.

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?

We have no comment.

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?

Representations and warranties by the private investor in the PPIF must be made to protect the FDIC and Treasury interest in the PPIF. One basic safeguard that must be required is that a private investor in a PPIF must be prevented from selling the PPIF to an affiliated entity.

Transparency should be made a cornerstone of the program. A fundamental tenet of maintaining transparency and eliminating conflicts of interest must be to ensure that the valuation of assets is done separately and distinctly from the commission-based management and disposal of those assets. The FDIC should ensure that the PPIP requires independent third-party valuations and that those valuations be performed consistent with the methodologies used by professional licensed real estate appraisers. An independent appraisal, separate from a broker's price opinion (BPO) as a buyer or buyer/seller agent, is critical to establishing the true real estate asset values to protect the federal government from potential abuse and protect the taxpayer from paying more than it should.

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 should retain full control over selection of asset managers, with at least an annual review of audited financial statements by the government. Asset managers should be pre-qualified with the FDIC, and qualification standards should be such that small investors will not be required to partner with only a handful of larger qualified asset managers in order to bid. Additionally, the government may want to consider requiring all asset managers for a PPIF to utilize hard lock boxes and other standard default loan structures/mechanisms to protect the government's stake in assets. The PPIP should ensure that contracts bid by the government to asset managers require that an independent appraisal be obtained. Without such a requirement, entities that earn commission-based fees from the government to manage and dispose of troubled assets are able to bid on providing the valuations of those very assets as well. At best, this is a conflict of interest; at worst, it creates the potential for fraud and abuse.

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 separately valued, with PPIF's having the option to purchase servicing rights or allow the selling institution to retain them.

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?

Transparency with respect to all available information will help to increase the value of bids for the assets being sold as well as aid financial institutions in making informed sales decisions, and therefore, all data and results of the independent valuation consultant should be made public.