EASTDIL SECURED Response to
FDIC REQUEST FOR COMMENT ON LLP

April 10, 2009

Eastdil Secured ("ES") is pleased to submit responses to the LLP Request for Comment posted on the FDIC website.

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?

All asset categories - *Real Estate* (Commercial and Residential), *C&I* and *Consumer* - should be included in LLP, although the general make up of bank portfolios are heavily weighted toward residential and commercial real estate loans (52% per FDIC statistics, and higher among many community banks) likely leading to a higher volume of legacy residential and commercial real estate assets being sold though the LLP. LLP should also allow both ORE (Real Estate Owned) and Non-Performing loans to be contributed. Loans should be segregated into pools with regional and/or product type concentrations and offered separately, to the extent possible.

In all cases, the following assets should be offered/pooled separately – as few buyers have expertise across all asset classes – a) Commercial Real Estate Loans, b) Single Family 1-4 Residential, c) C&I, and d) Consumer

It is likely that financial institutions will be motivated to contribute assets to the program which they view to have a) limited upside potential and/or, b) require significant asset management/property management to achieve maximum recovery.

Ideal candidates for contribution include legacy loans acquired via M&A activity and non-performing assets with appropriate marks already taken. A modestly leveraged PPIF structure could also be suitable for portfolios of non-cash flowing ORE assets such as residential and commercial land as these types of assets will require on-going funding by financial institutions. Non-cash flowing assets may need to be commingled with cash flowing assets to support additional leverage, making the pool less homogenous.

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?

Equity investors should have flexibility to sell or transfer *a portion of* their interest, subject to certain restrictions. This flexibility will lead to higher initial pricing and could help maximize returns to the government. Restrictions should include requiring investor to maintain a majority (Control/51%) interest in their original position (i.e. if an investor purchased a 50% interest in the PPIF – the investor could sell 49% of that 50% interest to another party- i.e. sell roughly a 24% interest in the overall PPIF). The PPIF should not

be required to be a "buy and hold" facility and should allow for ongoing asset dispositions at operating partner discretion.

An investor should not have the ability to pledge its interest in the PPIF in order to receive financing on such position.

Treasury must clarify governance issues prior to launch regarding their ability (or inability) to replace the equity investor/asset manager in the PPIF for cause. The ability to replace an investor would need to be limited to fraud or other egregious acts.

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 investment size should be a balance between total dollars invested and percentage of equity participation. A 50/50 split provides equal benefit and a true alignment of interest; however, a lower participation level by the investor (e.g. 20-30% of required equity) with a minimum total dollar investment (e.g. $25-$50 million) on a large portfolio may benefit the government in several ways without reducing alignment of interests.

Higher proportionate investments by the government should be considered for relatively illiquid asset pools. For instance, large land portfolios in distressed housing markets would benefit by increased investment by the government in lieu of higher leverage.

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

None

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?

In order to encourage diversity amongst bidders, each PPIF should be tailored to appeal to a targeted investor based upon investment scale/size, equity availability and asset type. For example, pooling small balance loans into geographically concentrated areas with manageable equity requirements for regional investors will ensure proper focus and expertise on assets that may be of little interest to institutional investors. A one-variable bid process (solving only for price with all other variables provided prior to pricing) is critical to the success of the transaction. Multi-variable bid processes, especially for portfolios, create non-conforming bids as well as investor confusion which slow down the process and often result in lower prices.

Potential areas of concern by banks are that they could be required to re-mark LLP reviewed assets to the preliminary sale values estimated by the valuation/pooling contractors and are hesitant to monetize those losses today. To address these issues, ES thinks it is important that the FDIC explicitly state that the valuations represent liquidation value and not asset impairment and that under no circumstances would the FDIC require the financial institutions to mark assets based on this valuation.

The PPIF sale process, similar to the recent FDIC Structured Sale activities, will require investors to perform significant upfront due diligence likely resulting in material pursuit costs. As such, potential investors are concerned that under the preliminarily proposed structure, banks will have the ability to decline to move forward with a pool sale after due diligence and bidding has been completed. Multiple investors could be left with significant pursuit costs and could become increasingly reluctant to continue to participate. Given the investor concerns, we would recommend the following LLP procedures:

1) **A Financial institution would approach the FDIC to participate in LLP with a data tape of loan information and the complete loan files;**

2) **FDIC would engage one or more pre-approved valuation/pooling contractors;**

3) **Contractor (could include 2-3 independent firms valuing assets simultaneously but should include firm retained to run the auction process) would estimate pricing on each loan – using a "DIV" type standard valuation methodology.**

4) **Bank would review pricing for each loan and decide which loans it would like to market and sell based on this initial estimated pricing feedback (since seller has no ability to negotiate price once bid process starts – only the ability to sell or not sell);**

5) **Bank would elect to move forward on the assets where the initial pricing feedback was acceptable. Bank would commit to sell these assets/pools if bids equaled or exceeded a minimum price (some where between 90-95% of valuation numbers) and the reserve price would be set (but not disclosed);**

6) **Potential investors would be supplied with complete due diligence files including the valuation models;**

7) **Potential investors would submit non-contingent bids with pre-determined (material) deposit amounts with closing set for a period to allow time to call capital; and,**

8) **The <u>critical</u> factor is generating maximum competition to drive pricing.**

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 real estate investment markets are most accustomed to bidding through a sealed bid auction process as the vast majority of assets are bid and sold in this manner by real estate intermediaries.

Investors should be required to bid on the entire equity stake to avoid problems associated with a multi-variable auction. Pricing will be maximized by proper pooling of the collateral into separate PPIF's, rather than allowing for a more flexible bid approach.

We do not believe a Dutch auction is an effective method for disposing of pools of non-commodity, unique, management intensive assets. Creating a PPIF of multiple investors through a Dutch auction could subject a winning bidder to management/control by the largest investor (or whatever the mechanism is for determining control) and will most certainly be problematic for most real estate investors.

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

The overriding priority for determining a pool for the initial PPIF action is creating one that maximizes the probability of a successful closing and demonstrates attractive enough pricing to encourage subsequent financial institutions to participate. Further, given the significant role of Loans Secured by Real Estate in the current banking crises, a real estate based transaction should be an early offering. Refer to ES response to Question #1, Para 3 stating priorities of 1) Commercial Real Estate Assets with appropriate marks, 2) geographic or product type concentrated pools, 3) Equity sizing of $25-$50 million.

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

An effort should be undertaken to create pools of assets in geographically concentrated areas in an effort to simplify asset underwriting and allow for the most aggressive regional "sharpshooters" working with captive equity or institutional investors to pursue portfolios. Unique, stand-alone assets could be structured as one-off dispositions using PPIF structure.

Optimal size varies based upon targeted investor type; however, a recent informal polling by ES of multiple national private equity investors with a real estate focus indicates a general comfort level of investing between $20 million and $50 million in equity into each potential deal. This amount represents a meaningful equity commitment by a $500 million to $1 Billion+ fund, yet is an appropriate amount to put at risk at this stage of the broader economic recovery. A 6:1 maximum leverage ratio with a 50/50 equity partnership would imply pool sizing of $280-$700 million of market value (e.g. not face amount of debt). Assuming a 2:1 leverage ratio, this would imply pool sizing of $150-$400 million of market value. The ability of a single financial institution to provide pools in the mid- to upper-end

of this range is likely to be limited to only a handful of money center and regional banks, unless a structure could be devised to combine homogenous assets from multiple contributing banks (something we deem difficult in the near term – see response to question 13).

In summary, ES keys to successful marketing of a PPIF would include:

1) **Create pools with regional and/or product type concentration – but separate pools for Single Family 1-4 loans to individual consumers (vs. Builders), Commercial Real Estate, Land, C&I, and Consumer Loans.**
2) **Size initial pools to roughly $25-$50 million of new equity investment.**
3) **Create minimum qualification requirements for assets management partners – allow any bidder that meets those minimum qualifications to bid on a pool.**
4) **Maximize competition via good quality due diligence.**
5) **Structure process in a way that provides investors confidence that a successful transaction is likely to occur (in order to encourage them to spend the time and money to do due diligence and bid)**
6) **Structure debt in a way that both protects FDIC and maximizes price.**
7) **Set asset management fees, reserve funds, debt size/terms, and JV structure upfront and bid price only.**

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?

Critical data points would include detail on proceeds (i.e. loan amount will be lesser of $xx or xx% Loan to Purchase Price), loan type (fixed and/or floating), rate (index and spread), any cash flow sweep, maturity, amortization (if any), prepayment fees (if any), and extension rights (if any). Other essential items would include detail on ability to transfer portion of the debt to subsequent investors (if any), non-recourse carve outs (if any), release price provisions for asset dispositions, cash flow waterfalls, any up front cash reserves that will be included in the financing, and the structure of the proposed FDIC Guaranty Fee.

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?

As a matter of practically funding the creation of the PPIF in a timely manner, we believe it is necessary for the selling institution to initially make and hold the loan (with FDIC guarantee) to the PPIF. This notwithstanding, in order to meet the fundamental goal of repatriating cash to the participant banks, it is absolutely necessary that an active and liquid market exist for the banks to subsequently exit the loan position at Par or better by selling the FDIC credit enhanced paper into the open market. A public issuance of debt,

rather than the bank selling into a secondary market, would likely prove to be more expensive and time consuming.

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?

A credit enhancement fee could be calculated based upon the make-up of the underlying PPIF assets (e.g. cash flowing vs. non-cash flowing collateral) and original Loan to Cost/Advance Rate. Fee would be based upon outstanding loan balance and paid on an annual or quarterly basis.

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?

Our understanding is that one of the primary goals of the program is to increase participation among financial institutions by contributing asset for sale while protecting government exposure. Any realistic promote structure to the Treasury will likely reduce bid levels and further exacerbate the bid-ask spread. One concept that could increase participation by banks may be to give banks the option of selling assets into the PPIF with or without a residual participation feature. This residual participation feature would kick in if the PPIF investors achieve outsized returns.

Under any promote structure, return hurdles should reflect risk characteristics of the asset pool, but an acceptable definition of an "outsized return" would likely be a cumulative internal rate of return (IRR) on equity invested in excess of roughly 20% per year for loans secured by improved real estate and returns in excess of 30% per year for loans secured by land – provided that investors also received at least a 1.75x – 2.5x equity multiple.

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?

Commingled pools would be an ideal feature, however, one would need to have a mechanism that mitigates disputes between selling institutions on valuation/proceeds. The procedures outlined above (question #5, paragraph 3) could help overcome some of the major issues. In a multi-contributor PPIF, each institution could bring a pool of assets to the FDIC and, based on the valuation provided by contractor(s), determine which loans it is willing to sell through LLP. Valuation methodology would be standardized (similar to a modernized DIV model) and need to be accepted by all contributing banks. It is also likely that reserve pricing would be set as a percentage of the DIV valuation – established for

each asset pre bid by the third valuation agent. Selling institutions would share pro rata (based on DIV value of assets contributed) in proceeds. If the pool was not priced within a pre-specified range of the reserve price, the sale would not occur.

We believe that initial auctions should be limited to pools contributed by a single institution and that as the auction process and pricing becomes more understood by the banking community, the ability to successfully commingle assets from multiple financial institutions will become greater. The commingling of individual bank assets is likely necessary to get broad involvement from the smaller banks.

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?

Direct affiliates of selling institutions should not be allowed to bid on their related assets as pure third party investors will view their participation as providing an unlevel playing field. Potential areas of perceived conflict that may arise include the possibility of a bidder having a direct relationship with the selling bank. For instance, numerous bank holding companies have made direct equity investments (as an L.P.) in many well know private equity firms. These firms will likely be aggressive bidders for these assets. Ultimately, we do not see this as being a conflict of interest (assuming LP interest in private equity fund is less than 10% of the overall size of fund) but it could definitely be misconstrued in the political and media arena.

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 vast majority of PPIF sales (especially real estate related), the investment group acquiring a pool of assets would have captive asset management expertise and would not look to third party this service. If a third party asset manager is chosen, the private investor bidder should select that manager – subject to the minimum asset management qualifications set out in the bid process.

In a traditional partnership acquiring loans, a General Partner would expect certain control rights over certain major decisions including loan modifications/restructurings, asset sales, decisions related to foreclosure and operational matters in the event assets become owned in fee. Since the investors/operating partner will have a substantial equity investment and be pari pasu with the Treasury, the government can be comfortable delegating these rights to its operating partners. The Government would retain notice rights and the General Partner would have responsibility to provide complete asset management reporting to the Government. The government would retain the right to force removal of the investor via a sale of their interest in the event of fraud,

misrepresentation, repeated failure to adhere to reporting standards and other standard fiduciary obligations of a general partner.

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?

Master servicing of the loan portfolio should remain with the seller / participant bank initially in order to minimize transition time and ensure appropriate master servicing functions are performed. The master servicing should remain an "asset" of the selling bank; however the selling bank should have unilateral rights and authority to also "sell" the master servicing rights subject to minimum servicer rating standards to be defined by the FDIC. The PPIF investor should not be excluded from bidding on said master servicing. Master servicing fees will be set by the FDIC prior to marketing of the eligible assets, and paid by the PPIF to the "owner" of said servicing rights.

The PPIF will gain special servicing/asset management rights to the portfolio in order to ensure maximization of recovery to the PPIF, which includes the government participation. Special servicing/asset management fees will be set by the FDIC prior to marketing of the eligible assets. The PPIF should retain the right to sell the special servicing to another qualified special servicer/asset manager, subject to approval by the government via it rights in the JV agreement.

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?

All data utilized to create the independent valuation should be shared with potential bidders as part of a thorough underwriting/bidding process – including the individual, the specific underlying loan-by-loan valuation models. We believe it important to be able to provide potential investors with meaningful valuation expectations and guidance. As such, we would propose providing potential investors with a DIV-like valuation for each asset. This is similar to how the RTC operated. This information will encourage maximum competition and will not set a cap on value.

Potential sellers of PPIF assets should be given pricing results as their decision to move forward with marketing assets will be heavily based upon these results. We also believe that in order to encourage participation by financial institutions in the LLP program, that every institution must trust that by allowing their assets to be valued for disposition by an independent third party that they are not increasing the risk of being required to take additional marks to these specific assets or other areas of their portfolio if they do not agree with the independent valuation or sale results (liquidation values vs. credit impairment).