From: John Bailey [mailto:johndbaileyco@sbcglobal.net]
Sent: Tuesday, April 07, 2009 4:40 PM
To: LLPComments
Subject: RE: Legacy Loans and PPIPs

Gentlemen:

In response to your call for comments on the above referenced program for disposing of bank loans and other assets, I submit answers to some of your questions below:

Q: 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?

A: The program should include all real estate related assets, including loans and REO properties. Smaller banks should be allowed to aggregate loans or REO assets for inclusion into pools of similar assets (i.e., office buildings in North Carolina, land developments in Texas, etc.) Portfolios of non-complementary assets (like hotel loans and restaurant properties) would likely be heavily discounted and the pooling of such assets should be avoided. However, as respondent Joe Dengel noted, "pools that include properties of similar quality and asset class (i.e. residential subdivisions/land developments in the Southwest, or a grouping of hotel/motel loans in primary U.S. market areas) that require uniform reporting, comparable management expertise, and similar investment strategies should attract a significant premium."

Q: 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?

A. A 50-50 equity split, as proposed, will allow the Treasury to participate directly and equally in market recovery, which was not accomplished in past cleanups. The taxpayers actually have the same potential for "investment" returns as private investors. The capital structure proposed, requiring only 7% funding from private investors, will be sufficient to attract their capital. As a previous respondent noted, under this scenario (and assuming an 86% debt ratio), an investor could control a $100M portfolio for only a modest $7M capital investment.

Q: Is there any reason that investors' identities should not be made publicly available?

A: No, the investors' identities should be made public. In a plan ultimately funded by taxpayers, transparency is paramount. Nobody wants to subsidize a fund owned by Swiss bankers, drug dealers, or the government of Iran.

Q: 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?

A: Allow aggregation of assets by any or ALL banks, not limited by their size. Let every bank in the country contribute individual assets (or pools of their assets) to asset-

appropriate PPIF pools. The greatest motivator to potential bank participants is to prove out a high rate of recovery on the first funds formed. You won't motivate anyone if you pool garbage, and recover 10 cents on the dollar on your initial funds.

Q: 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?

A: Keep it simple. Each pool should be sold to the highest bidder with no provision for selling partial interests to individual investors. As proposed, asset managers should be chosen by the private equity investor of the pool.

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

A: Aside from pools of owner-occupied residential real estate, focus the first pools on relatively strong markets like Texas. Commercial loans and REO properties should be categorized by asset type and geography, to maximize management economies of scale, as well as initial analysis and due diligence. Include loans and REOs in a single pool, under the assumption that many current loans have the potential to become REO.

Q: What are the optimal size and characteristics of a pool for a PPIF?

A: While it is easy to believe that the FDIC's management responsibility would be minimized by having larger sized funds, this would likely not maximize the recovery rate on assets. As noted, focus pools on assets of similar type, quality and location, in order to maximize recovery rates. This will encourage banks to contribute assets to future pools. If you start out with massive pools of "garbage" assets from any and all markets, you will set an extremely low "bar" of expectations for banks and investors alike. This will influence future investor expectations, and likely reduce the amount of money recovered. Low recovery rates will discourage banks from contributing high quality assets to future pools. Given the size of the overall problem, a minimum pool size of $100 million would balance the interests of focus/maximum price recovery, and minimizing FDIC management oversight. Keep in mind, in the last "crash", tens of thousands of foreclosed assets
were disposed of individually by the RTC and FDIC. A fund of $100 million is a compromise between speed/administrative costs, and recovery of taxpayer funds.

Q: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?

A: The rates for FDIC debt issuances should parallel that of a 10 year Treasury Note, for a similar term loan (Just under 3%, as of this writing). Once the first funds are raised, investors will have more guidance. Investors should be able to see the standard note agreement before they ever bid. No changes allowed. If they don't like the terms, they shouldn't bid. If individual investors are allowed to object to specific legal terms, or negotiate them after the fact, you will waste an enormous amount of time, and legal fees.

Q: 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?

A: Quit playing smoke and mirrors. If the plan is to clean-up the balance sheets of the banks and free-up capital, cash them out from the FDIC guaranteed debt issuances.

Q: 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: No. Again, keep it simple. If you do it on the basis of "degree of difficulty", somebody has to assign the scores or ratings. I think we have had enough of bogus ratings from "experts". They helped create this situation. Set an overall rate that is sufficient to cover the FDIC's costs, and live with it.

Q: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?

A: Forget it. The Treasury is already a 50% equity participant. Don't try to complicate this any more than necessary. Raise the spectre of "windfall tax" and you can kiss the program goodbye.

Q: 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?

A: ABSOLUTELY. Unless you allow the pooling of assets by smaller banks, you will shut the vast majority of them out of the whole process. This program must apply equally to large banks and small. The only way for smaller banks to maximize their recovery in focused pools is to allow the aggregation of assets. The FDIC-commissioned appraisals of pool assets should serve as the basis for allocating "participant shares" of the overall pool, on the basis of the percentage of the appraised value of the individual asset to the aggregate appraised value of all assets pooled. That percentage times the total fund amount (including financing) would be that asset's share of the fund proceeds. This is not much different from a loan with multiple participants.

Q: 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?

A: As I understand the proposed process, the selection of asset managers is up to the private equity participant, subject to the approval and oversight of the FDIC. The private investor is highly motivated to maximize his own return (and by extension, that of the Treasury). This is one place where the less "oversight", the better. Sell the assets, and let the investors take care of the investments. Don't set up a cumbersome or expensive reporting process that reduces the desire of investors to participate.

Q: 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?

A: Servicing rights should be transferred to the investor. If the investor chooses to retain the existing lender (or choose a 3rd party servicer), they should have the ability to do so.

Q: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?

A: ABSOLUTELY. Provide as much information as you can at the outset so that potential investors (and banks)can make timely decisions. Be absolutely transparent about all issues of the underlying debt or asset. Potential investors should be able to access ALL information on pool assets online.

In brief summary:

Keep the size of the pools modest, and focused, to maximize recovery rates.

Allow aggregation of assets by multiple banks.

Then, stand back, and let the investors maximize the investments, on their behalf, and that of the Treasury/American taxpayer.

Thanks for the opportunity to provide input. The PPIP program has the potential to minimize bureaucracy (and its cost), minimize the negative impact of bad assets on the economy, stabilize the real estate market, and maximize potential recovery for taxpayers. IF done right, this will be a benchmark for dealing with future downturns. If done wrong, it will be just another massive bailout for huge banks, and a feeding frenzy for vultures. Keep it honest, and keep it simple.

Sincerely,

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