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To: LLPComments
Subject: Legacy Loans Program

For the program to be effective, I would encourage the following:

1. The pools should be smaller, and concentrated by geography and product type as much as possible in order to widen the pool of bidders and ensure access by local market participants. Real estate is a local business at the end of the day.
2. The sales should state a minimum bid price that is not too high (I'd prefer no minimum) and the pools that are taken to market should be allowed to sell at whatever the high bid price is. If pools are taken to market and not sold it will discourage bidders on subsequent pools.
3. Due diligence materials should be given to bidders via an online "war room" and ample time should be given in advance of the bid date for participants to properly underwrite the pool.
4. The government should be a "silent partner" in the PPIF similar to limited partners or LLC members in the typical arrangement. If the government politicizes economic decisions of the PPIF manager or tries to micromanage it won't work.
5. Regulatory pressure should be put on institutions to sell troubled assets. In the RTC days nothing really got moving until the regulators got serious about selling assets at whatever the market clearing price was.

By providing very cheap government financing for the PPIFs, the argument that the banks have given about the market values being artificially low due to lack of liquidity should be neutralized. The reality is that valuations have shifted downward dramatically and are likely to stay lower. In residential it is due to housing prices returning to a more historical relationship to incomes and rents and in commercial it is due to cap rate expansion and flat or declining net operating incomes. Whereas someone might only be willing to pay 20 cents on the dollar for a troubled asset today that the bank may be carrying at 80 cents, even with this new program, the investors only might be willing to pay 40 or 50 cents. If by selling their troubled assets at these market prices some banks become insolvent and fail, so be it. There is an established procedure for that. The fact is we are in the midst of a massive deleveraging process and it stands to reason that the banking and finance sector will be smaller as a result. Losses should be borne primarily by the shareholders and creditors of the failed institutions, not taxpayers.

Another important point is that there needs to be an exit strategy for this program. Target metrics of market liquidity and volume should be defined in advance so we will know when we've reached the goal of kick starting the market and get out. Temporary government programs have a way of becoming permanent.

With respect to commercial real estate, I have heard talk of TALF making 5 year loans. I think this is very risky in terms of limiting the Fed's ability to shrink the money supply when growth restarts and the velocity of money picks up again in order to prevent massive inflation down the road (setting aside the risks to that from current fiscal policy). Some of the larger commercial real estate firms understandably are pushing for this because of the rolling maturity defaults that many of them face. I think it is important to let these firms that made poor financing decisions and/or overpaid for assets in recent years to fail. Complex CMBS financing structures need to be tested robustly in foreclosure and bankruptcy situations. Future precedents will be set and a new set of best practices will likely emerge from that slow and litigious, but necessary, process. I think some form of CMBS will return to the market because of the liquidity it provides but the model will need to change. Part of understanding how it should change is learning from the failures that should be allowed to occur.

-David Allison, CFA