Hovnanian Enterprises, Inc.
110 West Front St.
Red Bank, NJ 07701

WESTWOOD CAPITAL HOLDINGS, LLC
Westwood Capital Holdings, LLC
489 Fifth Avenue
New York, NY 10017

April 8, 2009

VIA OVERNIGHT COURIER AND
<u>EMAIL TO: LLPComments@FDIC.gov</u>
The Hon. Sheila C. Bair, Chairman
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

RE: Request for Comment – Legacy Loan Program

Dear Chairman Bair:

Thank you for giving us the opportunity to comment on the proposed Legacy Loan Program ("**Legacy Loan Program**"). We strongly support the efforts of the FDIC in crafting the LLP to date, and we believe that the program is an essential tool in the resolution of the banking crisis that is severely restricting economic growth in the United States and elsewhere.

Founded in 1959, Hovnanian Enterprises, Inc. ("**Hovnanian**"), designs, constructs and markets a variety of housing in 18 states. Hovnanian ranks among the largest homebuilding companies in the U.S., with operations in Arizona, California, Delaware, Florida, Georgia, Illinois, Kentucky, Maryland, Minnesota, New Jersey, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Texas, Virginia and West Virginia. It is the 6th largest homebuilder in the United States.

Hovnanian has joined forces with Westwood Capital Holdings, LLC ("**Westwood**"), the parent company of a New York-based investment bank, to form HovWest Land Acquisition Corp, LLC. ("**HovWest**"). We intend to seek approval to participate in the Legacy Loan Program as an investor willing and able to commit over $100 million in equity of Hovnanian's capital to a Public Private Investment Fund ("**PPIF**") established for the purpose of investing in troubled residential housing development land loans ("**Land Loans**").

HovWest expects to add to its own $100 million of capital resources, the capital of financial investors participating in HovWest, to ultimately make several billion dollars of potential Land Loan acquisitions under the Legacy Loan Program. Each $1 billion purchase price of Land Loans acquired is expected to yield the ability to develop homes on 12,000 building lots per year, to result in the creation of over 36,000 construction and other jobs and additional economic expenditure of over $2 billion in construction and development costs.

In addition to providing detailed answers to many of the questions the FDIC has asked the public to respond to, we have several additional suggestions to make that are relevant to our business and our proposed investment in a PPIF. Our additional suggestions are:

1. **The Legacy Loan Program should aggregate eligible asset pools on a property-specific and region-specific basis.**

- HovWest believes that the FDIC should cause the Legacy Loan Program to aggregate eligible asset pools on a property-specific basis, including pools offered for sale by multiple participant banks in the program (*i.e.*, assembled into discrete pools of assets such as residential mortgages, retail property, office buildings, Land Loans, etc.) We further believe that eligible asset pools of Land Loans offered for auction under the program should be regionally focused – ideally into major U.S. geographic zones (*i.e.* New England, Mid-Atlantic, Southeastern, Texas, Southwestern, Mountain, Pacific, Mid-Western, Northern, etc.). We believe that the sale of property and regionally specific multiple asset pools will maximize the prices that we and our fellow bidders would be willing to pay for Land Loans and thus maximize recoveries by banks, the FDIC and the U.S. taxpayer.

- In past mass sales and transfers of non-performing real estate-related loans from distressed financial institutions,[1] non-performing Land Loans have typically been commingled with other packages of loans and collateral and were sold to financial buyers at little to no value given the difficulty of valuing land during distressed times and the uncertainty of a financial buyer's ability to exit. The magnitude of the current crisis and the volume of Land Loans and other non-home construction loans (approximately $400 billion) held by vulnerable banks, demands that the U.S. government obtain maximum value from the loan pools. Aggregating asset pools on a property-and region-specific basis does so.

2. **The Legacy Loan Program should permit PPIFs to engage in, and allow funding of, all activities necessary to maximize value from the assets.**

- Obtaining value from non-performing real estate loans requires active and experienced managers of business activities such as obtaining title to underlying collateral, physically maintaining and improving assets, marketing, renting and selling to tenants and buyers, and other functions requiring the expenditure of capital beyond acquisition costs. In general, we believe the Legacy Loan Program should permit PPIFs to engage in, and fund, all activities attendant to the maximization of value from assets acquired, and that the capital structures of PPIFs include provisions for such additional spending including the funding of working capital across the capital stack, where possible.

- Inasmuch as the end-use and optimal financial returns from residential development land results from the relatively granular process of building and selling homes, we

[1] During the S&L crisis in the U.S., via the RTC, and the ultimate liquidation of Japan's toxic bank assets by that country's RCC.

believe that Land Loan PPIFs should, after acquiring title to Land Loan collateral, be permitted to engage in, and fund, a full scope of land development and home construction and sales activities in order to maximize land value. Furthermore, we would suggest that Land Development PPIFs be allowed to revolve proceeds from home sales into additional acquisition and development activities, involving bank liquidated assets, over a finite fund term of five to seven years, after which the PPIF would return all capital to its lenders and investors in orderly liquidation from subsequent sales. We are not proposing that equity investors, such as ourselves, be permitted distributions of their *original* capital from a PPIF until the PPIF is in liquidation mode.

3. **The FDIC should encourage participation of those investors with established experience and the wherewithal to protect the interest of their government co-investor and lender.**

■ The managing equity investor in a PPIF will have a substantial fiduciary obligation to the FDIC and the U.S. taxpayer. We would therefore hope that the FDIC will encourage participation in the Legacy Loan Program of those investors with established experience, governance, financial controls and reporting capabilities – and the financial wherewithal to protect the interests of their government co-investor and lender. We believe that the FDIC will be more inclined to permit PPIF activities along the lines we seek if the FDIC has the greatest possible confidence in investor managers by demanding a high level of demonstrable experience, controls and capabilities.

■ Residential Land Loans are particularly illiquid under current market conditions because they are typically secured by projects that have been abandoned by the original borrower and require significant additional capital investment in order to be able to monetize them. Management of a portfolio of Land Loan collateral requires the ability to execute on the balance of land development and maintain local entitlements and development rights or to determine the best alternative use for the land. This requires a highly specialized and unique management team – few managers outside the homebuilding industry would have such ability.

4. **Established PPIFs should also be permitted to acquire loan or REO assets in auctions administered by Bankruptcy Courts.**

■ As a program-wide general comment, we would suggest that, in addition to acquiring assets through FDIC administered auctions, already established PPIFs should also be permitted to acquire loan or REO assets in auctions administered by the U.S. Bankruptcy Courts, where the principal creditor is a banking institution regulated by the FDIC. Once the FDIC goes through the difficult and detailed task of approving an investor for management of, and to receive financing for, a PPIF, it would make sense to permit that PPIF to engage in subsequent bidding in both Legacy Loan Program and U.S. Bankruptcy Courts proceedings. The FDIC might also consider whether existing PPIF's can subsequently acquire competitively bid troubled loan portfolios marketed by FDIC regulated banking institutions, outside of the Legacy Loan Program auction process by with access to Legacy Loan Program funding.

5. **In addition, we submit the following general program comments:**

   a. ***The Legacy Loans Program should be structured to attract investors that will bring U.S. taxpayers the greatest total positive impact on the economy.***

- As taxpayers ourselves, we share your goal to see U.S. taxpayers gain the greatest benefit from the investment of their tax dollars. However, until now, the debate over return on investment has focused on how much cash taxpayers can expect to see as return on investment. We believe that cash is not the only terms by which the government should assess bidders' ability to benefit U.S. taxpayers. Some investors, such as HovWest, are particularly well suited to add incremental value to the U.S. economy by both providing immediate return on the government's investment through the creation of new jobs and then later providing a strong monetary return on investment when the assets they have bought are put to highest and best use and monetized.

- For instance, HovWest expects to add to its own $100 million of capital resources, together with the capital of financial investors participating in HovWest, to ultimately make several billion dollars of potential Land Loan acquisitions under the Legacy Loan Program. Each $1 billion (purchase price) of Land Loans acquired, is expected to yield the ability to develop homes on 12,000 building lots per year, to result in the creation of over 36,000 construction and other jobs and the additional economic expenditure of over $2 billion in construction and development costs.

- The FDIC should strive to structure the Legacy Loan Program to achieve the maximum overall economic benefit from the U.S. taxpayer funds being committed with job creation and incremental spending being valued highly when selecting among bidders. In the case of Land Loans, for example, the government will be no doubt receive bids from buyers who intend to hold the undeveloped land until years and wait until the market is willing to pay for more for the asset. Our alternative, a bidder committed to adding economic value to assets bought by spending to develop the property rather than letting it lie fallow, creating tens of thousands of high-wage, tax-paying construction jobs for the economy when it needs them most and then sharing the rewards with the U.S. taxpayer once the developed properties are sold, should be far more desirable. Accordingly, the Legacy Loan Program should give special consideration to PPIF bids that involve incremental economic development and job creation to a significant degree in their business plans.

[*remainder of page left blank intentionally*] *b. Land Loans are disproportionately held by mid-to-large sized regional and super-regional banks.* [2]

- As money center banks and their mass securitization apparatus worked with non-bank originators to dominate the national housing mortgage market over the past decade, regional and local banks were squeezed out from their traditional housing loan markets. Development land lending, far more risky and cyclical, became a mainstay for such institutions and jeopardizes the survival of many in the current economic climate. The ability to successfully recapitalize or seize and merge distressed regional and super-regional banks, and minimize taxpayer loss, is significantly linked to the successful recovery of value from Land Loan portfolios.

c. Protection of investor/managers and passive investors in PPIF's from TARP related restrictions.

- While the matter has received some attention by the UST and FIDC already, we would like to reiterate the importance of making certain that investor participants in the PPIP are not negatively impacted by any restrictions arising from the use of TARP funds as part of the funding of PPIF's. These restrictions may include, but are not limited to tax and compensation issues. While protecting investor/managers from unintentional capture under TARP restrictions, the Treasury and the FDIC should also endeavor to inoculate otherwise un-conflicted financial investors that provide additional equity to PPIF's from the risk of TARP restriction contamination.

Having given our specific program comments above, we now turn to answering the questions raised in your solicitation. We provide such answers in Q&A format below:

1. ***Which asset categories should be eligible for sale through the Legacy Loan Program? 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 Legacy Loan Program?***

   ANSWER: Real estate collateralized whole loans on the books of U.S. commercial and savings banks aggregated $4.7 trillion at December 31, 2008, far larger than the entire amount of the $2.7 trillion of non-government-guaranteed mortgage backed securities outstanding on all U.S. real estate, that have been the focus of the bulk of booked reserves and losses to date. In it also important to note that a sizable chunk of that $2.7 trillion is held by investors outside of the domestic banking system. Real estate whole loans are also larger in aggregate amount than all other categories of directly held bank loans (totaling approximately $3.2 trillion). The real estate and debt bubble this decade saw aggregate mortgage debt more than double to $14.5 trillion from $6.8 trillion on the seven years from 2000 to 2007. As much of this incremental lending was driven by ill advised lending policies, it also represents that lion's share of existing and forecast loan defaults and delinquencies in the banking system. Consequently, we believe that the Legacy Loan Program should focus its efforts on the troubled real estate whole loans in

[2] Relative to the size of institutional assets – See Exhibit A for the holdings of various sized banks.

the banking system, before turning to other asset types. Having said that, we would encourage the FDIC to include REO assets, as well as distressed loans in Legacy Loan Program auction pools.

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?***

   ANSWER: We believe that the *original* equity committed by the managers of PPIFs should remain in the vehicle for the duration thereof. The FDIC should evaluate managers' financial commitment on the basis of each manager's level of direct commitment relative to the dollar value of assets acquired in the PPIF – in order to ensure the strongest commitment and most meaningful assumption of risk. Having said that, if managers enlarge their bidding flexibility by partnering with passive financial investors, such investors (*subject to whatever other restrictions imposed by the FDIC, such as sales to affiliates of borrowers, etc.*) should be permitted to pledge or otherwise convey their interests to third parties.

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?***

   ANSWER: A principal goal of the Legacy Loan Program is using private capital to establish transfer pricing of bank-held assets into a resolution program. Therefore, the private capital must bear substantial enough risk of loss relative to the assets it will be controlling. We believe that some sensible minimum should prevail regardless of asset type. We also believe it would not be wrong, in the case of real estate loans and REO, to adopt a lower maximum leverage ratio than the 6:1 maximum suggested in the initial Legacy Loan Program description. For any real estate asset class, we would suggest that 80% leverage (4:1) should be the maximum in order for the equity investor to bear an appropriate risk of loss – especially given the 50% equity participation the FDIC has suggested for the government. Such 50% could be also be varied with the leverage provided – perhaps with less government equity at a 4:1 leverage ratio and more at lower leverage ratios (for example – 2:1 leverage = 50% government equity participation; 3:1 leverage = 40%; 4:1 leverage = 33%, etc.). We believe the leverage ratio provided by the FDIC should be based on the relative liquidity of the assets being auctioned. Income producing property would be offered greater leverage, for example, Land Loans and land REO, less so.

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

   ANSWER: None that we can foresee.

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?***

   ANSWER: With respect to investor participation, we believe that a broad and diverse number of qualified bidders is in the best interest of the government. Nevertheless, we hope that the FDIC will encourage participation in the Legacy Loan Program of those investors with established experience, governance, financial controls and reporting capabilities – and the financial wherewithal to protect the interests of their government co-investor and lender. As to motivating banks to sell, we believe this will be the principal challenge faced by management of the FDIC and their partners in the Treasury. We have given a great deal of thought to this issue and our suggestions regarding how the FDIC might approach this critical matter as respectfully submitted as Exhibit B hereto.

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?***

   ANSWER: We believe that the Legacy Loan Program's high levels of government provided leverage, along with government co-investment, require that management control be unambiguously vested in a qualified and financially "at-risk" party with respect to each PPIF. We do not see this as being a situation conducive to a partial interest bidding process via Dutch auction or any other method. We believe that investor participation will be maximized via an auction process that is transparent and structured.

   All information available to the FDIC or its agents and vendors with respect to any pool of, or individual, assets should be made available to qualifying parties as part of the request for bid proposals. Because the preponderance of assets sold via the Legacy Loan Program will be real estate related, bids can be expected to be highly structured as well – with the FDIC being likely to obtain offers that contain additional upside participation arrangements for the FDIC or selling banks, higher offers of equity relative to the minimums set in any given RFP, rejection of certain assets that may involve environmental liabilities, etc.

   We feel that a two stage bidding process will serve the interests of the government and the selling banks, in which a first round of carefully reviewed bidding yields a preferred, or "stalking horse" bid which sets final terms and ratios, and a second round is held in an open setting – preferably online – to determine final price on the terms set forth in the stalking horse bid. In essence, we are proposing that the bidding process, adopted for the Legacy Loan Program, be somewhat similar to procedures used under U.S. Bankruptcy Code Section 363 that are intended to obtain maximum value for creditors. Although not directly referenced in the above question, it is appropriate to point out that any bidding process for real estate related assets should involve sufficient lead times for prospective bidders to analyze the offered assets. We would suggest a minimum of a 60 day window between the provision of offering material and the deadline for the first round of bidding.

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

ANSWER: While we are focused on acquiring Land Loans, and recognize that the FDIC may have other priorities, it appears sensible to us that the initial auctions should focus on the most illiquid assets held by banks of which land backed loans or land REO would certainly be at the top of anyone's list. Illiquid and difficult to monetize assets, such as Land Loans, will, relative to other whole loans, likely (i) have the narrowest bid/ask spread and (ii) be marked down or reserved against by banks already, given the high proportion that have become non-performing, relative to other asset classes. From the standpoint of demonstrating the efficacy of the Legacy Loan Program, the sale of such assets would be the "low hanging fruit."

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

ANSWER: As stated above, we believe pools should be asset-type and regionally specific. The optimal size of a given pool should be commensurate with the granularity of the asset type. A pool of non-performing residential mortgage loans can have a substantial number of assets, but be sized at less than $100 million. At the other end of the extreme, a pool of non-performing mortgages collateralized by office buildings would have to be more substantial in size in order to obtain operating and funding efficiencies. The number of assets within each pool should also take into consideration the difficulties inherent in the asset type being auctioned. In order to maximize valuations for complex assets, such as Land Loans, granularity of pools should be kept to a number sufficiently limited so as to permit independent valuation of each asset within the timeframe of the auction process. Having said that, it is possible to contemplate the liquidation – via the Legacy Loan Program – of large syndicated real estate backed loans as a single offering.

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?***

ANSWER: We believe bidders will need to be provided with the following information, with regard to the proposed financing, sufficiently in advance of bidding:

(i) Maximum debt/equity ratio;
(ii) Interest rate – including any PIK or accrual rights – if financing is being provided directly by the FDIC, or guarantee spread if financing is expected to be privately placed subject to an FDIC guarantee;
(iii) Term in years;
(iv) Form of security (mortgage, etc.)
(v) Material covenants and events of default;
(vi) Prepayment restrictions, if any;

(vii) Release provisions upon the sale of individual assets in a PPIF;
(viii) Collateral substitution provisions;
(ix) Additional drawing rights and procedures; and
(x) Any representations and warranties required of borrower.

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?***

ANSWER: We would prefer that amounts paid to selling banks be settled either for cash or with special credits issued by the FDIC (which credits would be deemed cash for regulatory purposes). If the purchase price of PPIF assets is settled in cash, we believe the loans component should take the form of a privately placed master loan facility backed by a full performance guarantee from the FDIC. Consideration should, however, be given to the provision of non-monetary compensation by the FDIC to selling banks, as this would – we believe – reduce transaction costs to the bidder and allow for higher purchase prices. We would envision, in either case, that all credit level negotiations, with regard to PPIF financing, would take place between the PPIF manager/investor and the FDIC.

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?***

ANSWER: We believe the debt/equity ratio should be adjusted to reflect the differing risk characteristics of pools, not guarantee fees.

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?***

ANSWER: Other than in connection with the warrant requirements mandated under TARP, we believe that *pari passu* participation by the government should be a consistent feature of PPIFs in order to maximize bid pricing.

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?***

ANSWER: We believe that the FDIC should undertake to allocate assets, for sale pursuant to the Legacy Loan Program, into multi-seller, commingled portfolios – specialized by asset type and general region. The FDIC might consider quarterly pool participation cut-off dates for the submission of assets that selling banks wish to dispose of (for example, "Q3 2009 Mid-Atlantic Region Non-Performing Residential 1 to 4 Family Loan Pool") in order to accommodate all institutions. The level of sell-side demand for access to the program will determine the actual frequency and regional geography of a given type of asset pool, under the foregoing arrangement. Bulk sales proceeds should be allocated amongst selling banks either (i) in accordance with relative pre-sale valuation ranges established for each asset by the independent valuation consultants retained by the FDIC, or (ii) by having each bidder allocate purchase price among pool assets at the time of bidding.

14. ***What are the potential conflicts which could arise among Legacy Loan Program participants? What structural arrangements and safeguards should the FDIC put into place to address or mitigate those concerns?***

    We do not have any particular response to this question.

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?***

    We do not have any particular response to this question.

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?***

    ANSWER: We believe all assets sold under the Legacy Loan Program should be on a "servicing released" basis. Distressed assets do not lend themselves to ready valuation of servicing rights and any disconnection of servicing rights from ownership and management would likely reduce overall valuation by investors.

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?***

    ANSWER: We believe the Legacy Loan Program should be as transparent a program as is possible and that all analyses commissioned by the FDIC should be made available to bidders.

[*remainder of page left blank intentionally*]

Thank you again for involving the public and potential participants in the structuring of the Legacy Loan Program. We hope that the forgoing has been helpful and make ourselves available to you and your staff in your further consideration of these matters.

Very truly yours,

HOVNANIAN ENTERPRISES INC.

By: N Pappas
Nicholas Pappas
Executive Vice President
npappas@khov.com
Tel. 732-383-2988

WESTWOOD CAPITAL HOLDINGS, LLC

By:
Daniel Alpert
Managing Director
dalpert@westwoodcapital.com
Tel. 212-953-6448

Exhibit A

A&D Loans vs. Total Assets

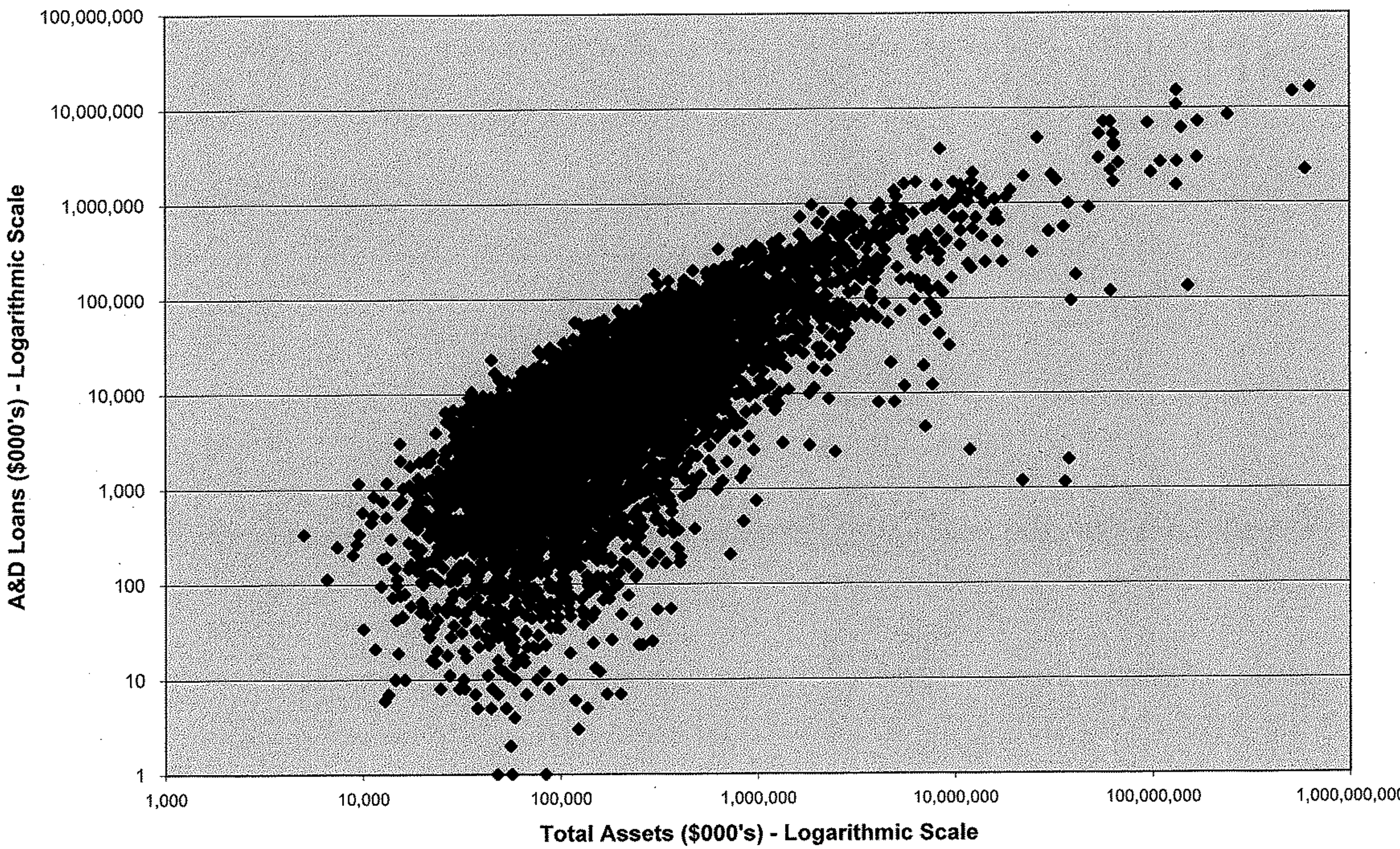


EXHIBIT B

Addendum to Question #5 – Legacy Loan Program Request for Comment

The following is a modified version of material originally contained in a report on the PPIP, published by Westwood's subsidiary, Westwood Capital, LLC on April 2, 2009. We are respectfully offering it as additional thought on the issue of how to induce banks burdened by troubled whole loans to offer those loans for sale under the Legacy Loan Program. We recognize that there is no single right answer to this complex question.

At some point in the process of removing troubled assets from the balance sheets of banks that are capital and operationally constrained, a further examination of whole loan holdings of banks may prove necessary in order to compel their disposition under the PPIP. While reexamining all +/-8,300 banks in this country would prove an impossible task, we are somewhat fortunate in that 679 banks with assets over $1 billion hold approximately 90% of system-wide bank assets. While the government is conducting "stress tests" on the largest twenty or so banks we frankly expect this to be the first of several rounds of such testing of large banks, as the first-round assumptions prove challenged by future economic developments. Over time, we expect weaker banks will be consolidated into the stronger ones, with the stronger ones receiving additional public and/or private capital to permit their full remediation.

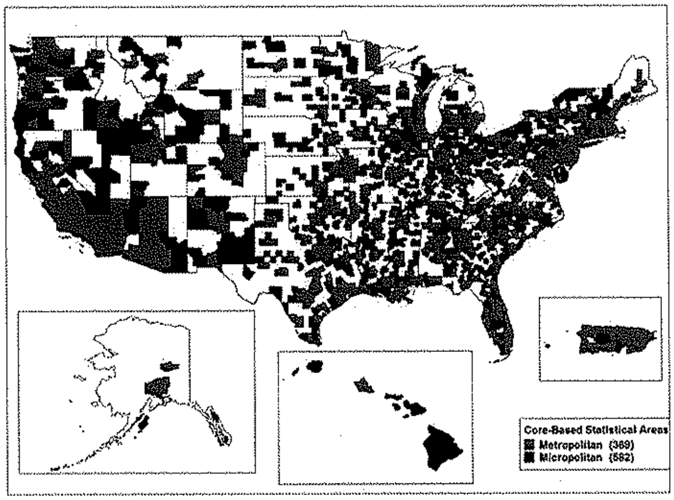
The stress test process, however, may be impractical in the case of most other large banks. Therefore, we would propose an alternative regime for the banks in excess of $1 billion in assets—including the largest banks—to determine which assets must be exposed to market valuation and sale through the Legacy Loan Program.

Our proposal would be to have the FDIC, through a standardized approach, conduct a simplified Emergency Asset Review Protocol (EARP) of each such bank's mortgage loan portfolio, on the following limited and expedited basis:

■ All whole mortgage loans made from July 1, 2003, through June 30, 2008, should be considered for review. These five years constitute a reasonable enough approximation of the bubble period to ensure that a very high percentage of potentially problematic loans are included.

■ We would suggest that the EARP be applied to whole mortgage loans of types most likely to be severely impaired to narrow the task. These would include residential 1 to 4 family, HELOCs, all subordinate mortgages, land loans, hotel loans, commercial office building loans, retail property loans and specialty property loans. Multifamily (rental housing) loans would be generally excluded, as would farm loans.

■ Loans made on properties in certain areas of the country would be exempt from the review. We would suggest excluding properties in states containing no metropolitan statistical area (MSA) ranked in the top 75 MSAs in the country. We would also suggest excluding properties located outside the boundaries of an MSA (the red areas on the map below) or in any MSA with a population of less than 500,000 (about the top 100). Since the vast majority of the bubble's impact was felt in more urbanized areas, limitations such as these make sense.



■ With respect to whole residential mortgages, banks would be required to disclose the original appraised values upon which the loans were originally made. See below if the loan did not originally require an appraisal or if the original appraisal cannot be located.

■ As a proxy for the deterioration of value of whole residential mortgage loans, we would suggest using the Case-Shiller index for properties within the 20 MSAs covered by the index; for those properties in smaller MSAs, we would utilize the index for the nearest Case-Shiller MSA. This will be somewhat inexact, but will simplify the process of choosing which loans should be exposed for auction under the Legacy Loan Program.

■ The approximate current values (the "Conditional Value") of the reviewed residential properties would be calculated by taking the original appraised value, dividing it by the relevant Case-Shiller index value from the date of the original loan appraisal, and then multiplying the result by the most recent Case-Shiller index value.

■ Loans for which Conditional Values of the properties acting as collateral have declined to a point at which the Conditional Value is less than 85% of the outstanding amount of the mortgage loan shall be deemed "Materially Impaired."

■ Commercial property loans would be deemed Materially Impaired if the borrower's most recent quarterly or annual statements indicate that annualized cash flow from the property collateralizing the loan is insufficient to make payments of interest and principal on the loan, pursuant to the loan's original terms (and not as the result of a workout or subsequent compromise, unless the loan has already been written down to reflect such compromise). Construction and land loans on which debt service is being paid from a reserve account shall be considered Materially Impaired if they are "out of balance" in accordance with their original terms.

- The FDIC would require all banks subject to the EARP to offer Materially Impaired loans for sale under the Legacy Loan Program or to be written down to their level of Material Impairment. Banks should be permitted to establish reserve prices for Materially Impaired loans, but those that do not trade under the Legacy Loan Program should be marked to their reserve prices on the banks' books.

- For purposes hereof, residential loans for which an original appraisal is not available, or was not originally required, should be deemed Materially Impaired unless the holding bank commissions a current appraisal of the underlying collateral to prove otherwise.

- In addition to Materially Impaired loans, the FDIC should require all nonperforming whole mortgage loans held by banks to be offered for sale through the Legacy Loan Program or written down to a level consistent with their measure of Material Impairment. For this purpose, the definition of a nonperforming loan should include all loans on which borrowers had previously been paying interest, but have ceased to do so— regardless of the existence of an interest or other cash reserve from which a bank may be drawing to keep the loan nominally current.

The EARP's purpose is to identify loans constituting the most severe ongoing encumbrance on banks' ability to continue lending. These Materially Impaired loans, by virtue of their severe under-collateralization, have a higher probability of default, and—if not off-loaded or otherwise resolved—could be clogging the banking system for years.