GOODWIN PROCTER LLP
RESPONSE TO THE FDIC REQUEST FOR COMMENTS ON THE
PPIP LEGACY LOANS PROGRAM

APRIL 10, 2009

If you would like discuss our comments in greater detail, please contact one of the Co-Chairs of our Real Estate, REITs & Real Estate Capital Markets Group:

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Response to the FDIC Request for Comments on
PPIP Legacy Loans Program

Goodwin Procter LLP[1] is pleased to present comments in response to the Request for Comments by the Federal Deposit Insurance Corporation (the "FDIC") on the Public-Private Investment Program (the "PPIP") Legacy Loans Program (the "LLP"). While we have solicited and considered input from a number of our clients, the following comments are our own and are not made on behalf of particular clients. Our objective is to offer constructive input to assist the U.S. Department of the Treasury (the "UST") and the FDIC in designing a program that accomplishes the U.S. government's announced objectives as simply and effectively as possible. We note that our comments are presented principally from the perspective of those of our clients in the real estate industry whom we expect will be buyers or asset managers of commercial legacy loans. We appreciate the opportunity to comment. Section A of this comment addresses the questions posed by the FDIC in its Request for Comments. The balance of this comment addresses other issues we identified in our review of currently available program materials.

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[1] Founded in 1912, Goodwin Procter LLP is one of the nation's leading law firms, with 900 attorneys and offices in Boston, Hong Kong, London, Los Angeles, New York, San Diego, San Francisco, Silicon Valley, and Washington, D.C. The firm's strategic practice areas include Real Estate, REITs and Real Estate Capital Markets, Financial Services, Corporate, Intellectual Property, Private Equity, Tech Companies and Life Sciences, and Litigation.

A. FDIC Questions.

1. Eligible Assets. 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?

We believe that the LLP should extend to all real estate-related assets on bank balance sheets. Commentators have suggested that economic recovery will not proceed until real estate prices stop declining and banks, thrifts and other financial institutions are "back in business," actively lending again. Underwater real estate loans and "other real estate owned" held by financial institutions represent an overhang on real estate markets that can slow stabilization of real estate prices. Encouraging movement of these assets on market terms into the hands of investors with "value add" or "longer term hold" strategies should help stabilize real estate values. The U.S. real estate industry is well equipped to form, capitalize and manage investment funds to accomplish this. Depending upon the demand for other, non-real estate related assets, such as unsecured credit facilities that are in default and other non-real estate related receivables, the PPIP's objective of recapitalizing financial institutions could be served by extending the LLP to other types of assets.

2. Transferability. 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?

To optimize both participation by private investors and the ultimate success of the program, initial investors should be permitted to pledge, sell or transfer their interests in a public-private investment fund ("PPIF"). It is common for investment funds to permit investors to

pledge, sell or transfer their interests while also imposing restrictions on such pledges, sales and transfers. Thus, the FDIC can require a PPIF to impose and enforce transfer limitations that require transferees to meet the LLP's criteria. The FDIC should require PPIF sponsors to obtain suitable representations from proposed transferees and should allow the PPIF to rely upon those representations (*i.e.*, the government should not impose remedies on PPIFs if those warranties are obtained but are breached (in the absence of collusion on the part of the PPIF sponsor)).

3. Percentage of Government Equity. 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?

We believe that a 50-50 *pari passu* equity participation strikes the correct balance between government and private participation. Our understanding is that PPIF sponsors will receive customary market-based compensation (*i.e.*, a management fee and a carried interest) from the private investors through the private pooled funds, if not from the PPIFs. It is unclear to us whether the PPIF sponsor also would be paid a fixed-percentage management fee based on assets under management from the UST, as proposed by the UST with respect to the PPIP's Legacy Securities Program. To the extent a PPIF sponsor is motivated by the expectation of earning a carried interest on the investment made by private investors, it will be focused on buying at a low price. This motivation provides integrity to the bidding process and tends to protect the interest of the government both as equity investor and loan guarantor. To the extent a sponsor is motivated solely or primarily by the prospect of earning a fixed-percentage management fee on assets under management, it is less motivated to buy low, and in fact can benefit from overpaying. Accordingly, the larger the percentage of PPIF equity raised from private investors on conventional terms involving a carried interest to the sponsor, and the smaller the percentage of the government's participation in equity, the greater the likelihood of arm's length pricing. The government, therefore, should avoid providing more than 50% of the equity capital to PPIFs in order to foster the integrity of pricing. In addition, as discussed below, a key element to the success of this program is the assurance that the PPIF sponsors will actually control decision-making within the PPIF. To the extent that the UST would seek to obtain additional control rights if its equity participation were to rise above 50%, we feel that would adversely impact the attractiveness of this program to private investors.

Now more than ever, the sophisticated institutional investors that typically invest with the types of real estate investment managers that are well-positioned to sponsor private investment in PPIFs will be sensitive to the financial incentives of the asset managers and PPIF sponsors. These investors may be discouraged from participating if they conclude that the financial incentives of the asset manager and PPIF sponsor are unduly distorted by the fact that too large a portion of the capital contributed to the PPIF will bear only a fixed management fee and not compensate the manager through a conventional carried interest.

The considerations noted above are largely independent of the nature or the type of pools of legacy loans approved by the FDIC (each an "Eligible Asset Pool").

The reasons for the government to provide a portion of the equity capital are (i) to allow the taxpayers to participate in the potentially high returns on the UST's investment and (ii) to increase the leveraging of private capital to maximize the transfer of assets into the LLP. These objectives should be accomplished by the proposed 50% participation in equity and FDIC guarantee of as much as 6 to 1 leverage. The participation of the government in providing equity to PPIFs also will have the effect of allowing private investors participating in this market to increase the diversification they can achieve through the investment of a given amount of capital, which in turn may encourage investment in PPIFs and increase competition in bidding.

We note that the Legacy Securities Public-Private Investment Funds Summary of Terms provides that the UST may cancel its uncalled capital commitment at any time. No such provision is included in the Legacy Loans Program Summary of Terms (the "Term Sheet"), which may be because additional capital contributions to a PPIF are not anticipated. However, if additional capital contributions to a PPIF are anticipated, we believe that the incorporation of this concept into the LLP would be a disincentive for private investors to participate, unless the private investors could be assured that the initial equity contributions were sufficient, together with operating revenues, to cover all operating costs and capital expenditures of the PPIF. In addition, if future equity funding is contemplated, the joint venture agreement between the private pooled fund and the UST will need to address maximum funding commitments, remedies for failure to contribute and other typical provisions related to equity capital calls that are typically contained in joint venture agreements.

4. <u>Disclosure of Investors' Identity</u>. Is there any reason that investors' identities should not be made publicly available?

Public disclosure of investors participating in PPIFs may discourage certain investors from participating. For example, foreign investors – an important potential source of private capital for the LLP – that are not otherwise obligated to disclose their investments may be deterred by such a requirement. It is common for private fund investors to restrict fund sponsors from publicly disclosing their involvement in investment funds. Disclosure of the identities of direct investors in the PPIF is not likely to be problematic, but disclosure of the identities of all upstream investors is likely to be both chilling to the market and extremely cumbersome in implementation.

5. <u>Encouraging Participation</u>. 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 making both the financial and procedural terms of the program as clear, simple and predictable as possible. All terms of the government's equity investment, financing and guaranty arrangements, as well as the terms of the auction itself, should be fully specified at the time Eligible Asset Pools are designated for auction. This will require greater clarity in several areas, including, in particular, the warrant requirement, the terms of available financing and the guaranty, executive compensation and FDIC or UST involvement in the oversight of asset management. In addition, PPIFs should be structured in a manner that anticipates the regulatory and other constraints applicable to the broadest pool of potential direct and indirect investors for

this program, and, to the extent practicable, in a manner that eliminates significant impediments to participation by important investment groups. Many of these issues are discussed in greater detail later in this comment.

The FDIC can encourage broad and diverse participation by (i) assuring selling banks that the bidding process will be robust, which of course leads back to the points mentioned above regarding encouraging broad participation on the investment side, (ii) giving selling banks significant control of the auction process and (iii) facilitating the selling banks' ability to receive all-cash sale proceeds as quickly as possible, which relates to the issue of the transferability of the seller financing discussed in the response to Question 10.

Solely with respect to commercial (as opposed to residential) loans, we believe that limiting the ability of PPIFs to enforce remedies under loans (including the acquisition of the underlying properties through foreclosure or other remedies) would unnecessarily deter private participation. Unlike the residential context, commercial borrowers are generally sophisticated enough to understand the terms upon which they borrow money. Thus, there is no public policy rationale for a protective regime in the context of commercial loans, as there is for homeowners. For many troubled loans, the PPIF's most prudent business plan may be an aggressive exercise of remedies and the acquisition of the underlying properties. Indeed, this was the strategy used with respect to many Resolution Trust Corporation portfolios in the early 1990s.

6. Auction Process. 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?

We note that the Term Sheet provides that each selling bank will have the option of rejecting all bids. Evaluating the assets offered at an auction will require a significant investment by bidders, which investment bidders may be reluctant to make without a binding reserve price. Before committing to the process, potential bidders will want assurances that the subject assets will ultimately trade as a result of the process, as opposed to the end result being simply a pricing exercise by the selling banks. To optimize the success of the program, at a minimum, selling banks should be allowed to elect whether to announce a reserve price or not. Announcing a reserve price may be in the best interest of the selling banks because it would (i) encourage more robust participation on the buy side, and (ii) reduce the risk of the selling bank having to reject all bids as being insufficient, and then having to address the impact of that market assessment upon not only the particular pool of loans, but also on all of the other loans on its books. Selling banks could also protect their interests in announcing a reserve price by being allowed to cancel the auction unless an adequate number of qualified bidders elect to participate within a specified period after the announcement that specified assets are to be auctioned.

If the FDIC is inclined to use a Dutch auction (*i.e.*, announcement of an initial ask price, which is then incrementally reduced over time, with the sale awarded to the first bidder to bid the as-reduced ask price), it should consider using a sealed-bid auction to eliminate the need for all

bidders to participate contemporaneously. Indeed, a sealed-bid auction would likely be preferable from the perspective of the selling banks in a conventional auction as well because, in the case of non-performing loans, a sealed-bid process would increase the chances of an outlying high bid.

In addition, as is the case in most FDIC and HUD loan auctions today, bids should be "final," not "indicative," in order to bring the auction to a predictable and timely close. We would also suggest scheduling auctions at set intervals once the level of interest in the LLP is known. This logistical step would likely improve participation.

Investors should be required to bid on the entire equity stake in a PPIF and should not be allowed to bid on partial stakes in a PPIF. It is important to allow the winning bidder the right to control management of the PPIF's assets and servicing. Designing mechanisms to allow bidding on partial interests in PPIFs would add material complexity to the auction process and, in our view, reduce investor interest in bidding.

Rather than providing flexibility for investors to participate in partial interests in a PPIF, the FDIC should consider allowing investors flexibility in specifying which assets will be owned by PPIFs by designating separate sub-pools within an Eligible Asset Pool and allowing bidders to bid on some or all of those sub-pools and to specify different prices for combinations of the sub-pools. *See* the discussion in response to Question 8.

For commercial Eligible Asset Pools, consideration should be given to maintaining the confidentiality of the winning bid for small or single-asset pools. If the winning bid were publicly disclosed, the borrower on an applicable loan could easily determine the new lender's "pain threshold" in the case of a subsequent loan modification or discounted pay-off. This potential loss of leverage could deter buyer participation in the program, and reduce the UST's equity return as well. Unlike, for example, typical FDIC auctions, under the LLP the selling bank will be a private entity rather than a governmental agency. Therefore, it may not be necessary to publish winning bids for Eligible Asset Pools.

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

To maximize investor interest and participation in the program, the FDIC should prioritize auctions of assets for which the reserve price is lowest relative to the FDIC's third-party valuation consultant's estimate of value, and for which the selling bank is prepared to announce the reserve price, in order to maximize the likelihood that early auctions will be completed successfully. *See* the discussion in response to Question 8.

8. <u>Optimal Size and Characteristics</u>. What are the optimal size and characteristics of a pool for a PPIF?

Specifying a relatively small Eligible Asset Pool secured by real estate in a particular geographic location will facilitate participation by smaller, regionally focused bidders that do not have the capabilities to handle Eligible Asset Pools above a certain size or Eligible Asset Pools in multiple regions. Similarly, separating assets into Eligible Asset Pools by the nature of the

asset (*e.g.*, multifamily, office, retail, industrial, hospitality) will encourage participation by investment managers with focused investment strategies. Sub-pools also could be designated, taking into account licensing requirements that may be applicable to the purchase of certain assets. *See* the discussion of licensing below in Section F. In some cases, a single loan may be so large as to warrant its own "pool." Indeed, for loans of any size, with current "bid optimization" software, a sub-pool could be as small as a single asset, and bidders could bid in any configuration of sub-pools that they choose. However, we note that smaller Eligible Asset Pools would of course increase the FDIC's exposure on debt guaranties as a result of reduced cross-collaterization (*i.e.*, fewer assets securing the guaranty), as well as increase overall transaction costs.

Designating such collections of assets as sub-pools of a larger Eligible Asset Pool may allow more well-capitalized national investment managers with broad-based expertise in multiple asset classes to submit a bid for a collection of sub-pools, thereby increasing the number of potential bidders and motivating national participants and regional participants to participate side-by-side in the bidding process. While adding to the complexity of analyzing the bid results, this approach should provide comfort to the selling banks that they have optimized proceeds (*i.e.*, if selling the sub-pools to different buyers yields a greater return than a sale of the entire Eligible Asset Pool to a single buyer, that value will be realizable).

9. Financing Parameters. 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?

To obtain the highest possible bids for the PPIF equity, it is critical that the financing terms be fully defined, and that the terms not interfere with the asset-management strategy contemplated by the bidders. All terms and conditions of the debt and the FDIC guaranty, including rate, term, payment obligations, prepayment rights, prepayment premium, release provisions, covenants, loan-to-equity ratio and maximum loan amount, if applicable, should be specified for each identified Eligible Asset Pool. If complete loan documentation is not provided, there will be a risk that auctions will not close as a result of disputes in completing final documentation of the financing.

10. Source of Debt. 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?

We assume, based on the Term Sheet, that the PPIF indebtedness, whether from the public, from the selling bank, or from another third-party lender, will be 100% guaranteed by the FDIC, and that there will be no additional financing at the PPIF level. We further assume that the terms of the guaranty will not depend upon the composition of the PPIF investor base. The FDIC may be able to increase auction proceeds and simplify the auction process by setting parameters for the FDIC debt guaranty (*e.g.*, not more than a specified multiple of equity, not more than a specified term, collateral release rights, if any) and allowing bidders to arrange financing sources of their choice on mutually acceptable terms. This would allow bidders more

flexibility regarding term, payment obligations and prepayment rights. The FDIC will need to balance its interests in protecting its position as guarantor and encouraging wide participation by bidders with diverse investment strategies. *See* the discussion of guaranty terms below in Section I.

Two benefits of seller financing are that (i) it would be easier to address post-sale selling bank obligations if breaches by the selling bank are discovered, and (ii) it avoids the risk of default by a third-party financing source upon which the transaction depends.

One alternative to seller financing of each Eligible Asset Pool is financing through a private placement or public offering of the FDIC-guaranteed debt. We note that, in connection with the Temporary Liquidity Guarantee Program, the FDIC requested and received confirmation/no-action relief from the U.S. Securities and Exchange Commission that the debt instruments issued under that program were exempted securities under Section 3(a)(2) of the Securities Act of 1933, as amended. We recommend that the FDIC request similar confirmation with respect to the LLP's FDIC-guaranteed debt.

11. Guaranty Fee. 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?

The FDIC may wish to retain the ability to vary the amount of financing it guarantees based on circumstances relating to either the selling bank or the assets to be auctioned. It may also wish to offer bidders flexibility regarding the application of proceeds to repayment of guaranteed debt, as discussed in Section I below. As a result, the level of risk entailed in providing the financing guaranty will vary from PPIF to PPIF. It is appropriate and consistent with the policies underlying the PPIP that the guaranty fee reflect the perceived risk undertaken by the FDIC in providing the loan guaranty. What is essential to the auction process is that the bidders understand the available financing and the applicable guaranty fee, or the basis on which each will be determined, at the time assets to be auctioned are designated, so that they can evaluate whether they want to bid and formulate their bids accordingly.

12. Adjustment of Government Participation in Returns. 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?

The proposed 50% *pari passu* participation by the UST in the equity of each PPIF provides the government with a substantial and fair participation in the PPIF's investment returns. Including a provision that would allow the government additional means to participate should profits exceed certain levels is likely to dampen interest both on the part of investment managers and private investors, and therefore, would likely lower the expected bid prices at auctions. We note that in typical private joint venture arrangements, the equity "money" partner (here, the UST) typically pays the "operating partner" (here, the private pooled fund) a carried interest based on performance. We believe that doing the opposite would discourage private participation. If the UST's equity investment is not burdened by a carried interest payable to an

asset manager or sponsor, the UST's internal rate of return on its invested capital will, by definition, exceed that of private investors in a successful fund.

It seems an unnecessary complexity to provide for an adjustment in the government's participation in returns based upon the level of returns. The government already has the ability to adjust the expected returns to equity on specific Eligible Asset Pools by specifying the amount of leverage for which the FDIC guaranty will be available. *See* the discussion of warrants in Section G below.

Sponsor and manager compensation should not require a greater return to the UST. Sufficient competition among potential fund sponsors and asset managers with respect to the terms of their compensation arrangements within the private investment vehicle (including the terms of any carried interests) should provide the necessary comfort at the inception of the program that the investment return of the UST and private investors will adequately compensate the investors for the risk taken by investing in the program. We believe that this process, not the bidding process, is the correct pressure point to insure that compensation to sponsors and managers is at a market rate. The selling banks should be indifferent to the compensation structures of the PPIFs, as those compensation structures should not impact the selling banks, and we believe that imposing those variables into the bidding process would unnecessarily disrupt and complicate the auction process and deter participation by both selling banks and private investors. Presumably, the asset managers and fund sponsors will be competitive in setting their compensation terms in order to attract capital from the private investors.

13. <u>Pooling of Assets From Multiple Sellers</u>. 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?

The FDIC should consider pooling assets from multiple selling banks as necessary to create appropriately sized Eligible Asset Pools of particular types in order to attract specialized or regional asset managers to participate in auctions. *See* the discussion in response to Question 8. Under this scenario, allowing selling banks the ability to reject bids will complicate the bidding process. Proceeds can be equitably allocated among selling banks on the basis of the FDIC's third-party valuation consultant's estimate of value for each loan in the Eligible Asset Pool. As noted in the response to Question 8, sub-pools could be designated for each selling bank's assets, or even for each individual asset. Such a designation would eliminate most of the arguments against allowing pooling of assets from multiple selling banks, while enabling the LLP to take advantage of the benefits of pooling assets, and increase participation.

14. <u>Potential Conflicts Among LLP Participants</u>. 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?

The principal conflicts of interest that arise among investors in conventional real estate funds relate to the tax treatment associated with alternative investment strategies. *See* the discussion of tax considerations in Section B below. While investors also could have conflicting

interests regarding liquidity objectives, participation in pooled investment vehicles with these types of investment strategies generally is limited to investors that expect to be able to satisfy their liquidity needs from other sources. Potential conflicts relating to differences in tax treatment generally are addressed in negotiations among the fund sponsor and private participants at the time the fund is formed. Other than with respect to the proposed FDIC guaranty, the warrants and differences relating to the terms of the asset managers' compensation with respect to invested capital, it is not apparent to us that the government's interests would vary sufficiently from those of private investors to merit special arrangements or require additional safeguards.

Another conflict of interest may arise if a sponsor, manager or other investor in the private pooled fund that invests in a PPIF desires to acquire an underlying asset at a foreclosure sale. We believe that such an acquisition should be permitted, provided that such investor discloses in writing to all other investors (including the UST) that such investor will be bidding at the foreclosure sale. Given the market forces at work in a foreclosure sale, we do not believe that an independent appraisal or other evidence of value should be required.

15. <u>Oversight of Asset Managers</u>. 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 anticipate that the FDIC should have a role in pre-qualifying asset managers, whether they be PPIF sponsors or third-party asset managers, but that, at least in the commercial loan context, the FDIC should not have an active role in overseeing the asset management activities of the asset managers. The role of sophisticated institutional investors in pooled private real estate funds with investment strategies similar to PPIFs in the selection and oversight of investment managers is typically very limited. Funds are typically sponsored by asset managers, and investors effectively select the asset manager by investing in the fund. We expect that many PPIF sponsors will serve as the asset managers for their respective Eligible Asset Pools. Alternatively, some PPIFs will engage third-party asset managers for their Eligible Asset Pools. In either case, we believe it would be appropriate for the FDIC to pre-qualify investment managers prior to their participation in an auction or engagement, as applicable. However, it would be cumbersome for the FDIC to negotiate specific rights with regard to the selection and oversight of managers, particularly in light of the pre-existing arrangements among the managers and the private investors that will be participating in PPIFs. If the FDIC has particular concerns regarding asset management – *e.g.*, restrictions applicable to the exercise of remedies on loans secured by owner-occupied housing – they should be specified in connection with the designation of collateral, and incorporated into the terms of the bidding. To the extent "public investors" (*i.e.*, the UST) negotiate specific rights in the fund documents (*e.g.*, asset manager removal provisions), those rights should be equally available to private investors, and the selection of asset managers and their replacements should be made by the private investors so long as the selected managers meet reasonable qualification standards agreed upon by the UST.

16. Servicing. 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?

Auctions are likely to attract the widest range of participants and yield the highest prices if bidders have flexibility with regard to servicing arrangements. The FDIC could suggest that selling banks designate the terms on which they are prepared to continue servicing and allow bidders to factor those terms into their bids. After being awarded the bid, the successful bidder could then determine whether to (i) retain the selling bank as servicer, (ii) transfer the servicing to a third-party selected by the successful bidder, or (iii) provide its own servicing. In considering this issue, under the scenario in which the selling bank continues to control the loan servicing post-closing, the parties should be aware of the potential for a conflict of interest with respect to any representations and warranties made by the selling bank to the purchasing PPIF in the closing process.

17. Independent Valuation Consultant Data and Analysis. 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?

As much data as possible regarding assets to be auctioned should be made available to potential bidders at the time assets are designated for auction. This should include the data used by the independent valuation consultant. We believe it would be useful also to provide the consultant's analysis and conclusions to potential bidders. *See* the discussion of due diligence in Section E below.

The data used by the FDIC's independent valuation consultants and the results of their analysis should be made available to prospective selling banks prior to initiation of the auction process, in order to manage the expectations of the selling banks. As discussed above, the FDIC should consider prioritizing auctions of assets based on the ratio of the selling bank's indicated reserve price (whether or not announced or binding) and the valuation consultant's indication of value, with those Eligible Asset Pools with the lowest ratio processed first, to establish momentum in the program.

B. Tax.

Numerous potential tax consequences may impede the objective of encouraging a broad and diverse range of investor participation in the LLP. Potential taxable and tax-exempt investors may find investing in Eligible Asset Pools or other assets through a PPIF unattractive due to tax costs that may arise under current law. In addition, as the FDIC and the UST apparently intend to permit investment of foreign capital in the program, there are potential tax considerations that may make a PPIF unattractive for non-U.S. investors.

The outline below (i) describes certain of the principal tax impediments to PPIF participation by taxable, tax-exempt and non-U.S. investors, (ii) identifies some basic structuring techniques that are in use under current law but that would complicate a PPIF investment, and (iii) suggests some potential areas where legislative or administrative relief might alleviate

certain of the tax impediments under current law and/or limit the circumstances under which an investor might seek to use complicated, transaction cost-intensive structuring techniques to address tax concerns.

1. Tax Impediments.

a. Tax-Exempt Investors: UBTI.

Tax-exempt investors such as pension plans, university endowments, private foundations and public charities are subject to federal income tax with respect to any "unrelated business taxable income" ("UBTI") that they recognize. Income and gains from securities investments generally do not constitute UBTI, except in the case of investments that are financed with "acquisition indebtedness."

The FDIC-guaranteed debt issued by a PPIF would appear to constitute acquisition indebtedness and, therefore, a tax-exempt investor could expect to recognize significant amounts of UBTI from investing in a PPIF. A limited exception under current law permits certain types of tax-exempt organizations to invest in debt-financed real estate. However, an investment in mortgages or other loans through a PPIF would not qualify for this exception.

Certain other types of income that might be generated by a PPIF may constitute UBTI, even if the acquisition indebtedness rules did not apply. For example, a PPIF that disposes of its assets with some frequency could be treated as a "dealer" with respect to those assets for federal income tax purposes, with the resulting income being treated as UBTI. It is also possible that certain types of fees earned by a PPIF could be characterized as UBTI.

b. Taxable Investors: Deduction Limitations and Phantom Income.

Individual investors may be subject to significant limitations on their ability to deduct for federal and state income tax purposes any interest expense charged on the FDIC-guaranteed debt issued by a PPIF. For federal income tax purposes, such interest expense may be subject to the limitations on itemized deductions and may be further restricted by the rules that limit the deduction of investment interest. In addition, certain states do not permit any deduction to individuals for investment interest.

Taxable investors may recognize income from investing in a PPIF when there is insufficient cash available for distribution to such investors to cover their related tax liabilities. Such "phantom income" could arise, for example, if loans held by a PPIF are modified in a manner that results in a deemed exchange for federal income tax purposes, triggering potentially significant taxable income and gain even though no liquidity event has occurred. In addition, a PPIF could recognize phantom income as a result of the deduction limitations described above or because loans held through a PPIF may be subject to certain income accrual rules such as the "original issue discount" provisions of the Internal Revenue Code.

c. Foreign Capital: Portfolio Interest and U.S. Trade or Business.

Non-U.S. persons generally may invest in U.S. securities without incurring direct liability for federal income tax. In addition, non-U.S. persons may invest in certain types of loans that

are in "registered form" and receive the related interest payments (referred to as "portfolio interest") free of federal withholding taxes.

It is unclear whether the mortgages and other loans acquired by a PPIF will be in registered form in all cases. To the extent such loans are not in registered form, any interest payments received by non-U.S. investors generally would be subject to a 30% federal withholding tax. Certain non-U.S. investors may be entitled to a reduction or elimination of such withholding taxes if they are eligible for benefits under an applicable income tax treaty between the investor's country of residence and the United States.

Non-U.S. investors also may be concerned that a PPIF investment could involve certain activities that would expose them to a risk of being treated as engaged in a "U.S. trade or business." A non-U.S. person that engages in a U.S. trade or business is required to file federal income tax returns and incurs direct federal income taxes and, in some cases, additional "branch profits" taxes with respect to any income that is effectively connected with its U.S. trade or business. Similar concerns would arise to the extent that a PPIF holds or acquires through foreclosure any U.S. real estate. The disposition of an interest in U.S. real estate by a non-U.S. investor is treated as a U.S. trade or business under the "FIRPTA" tax rules, and the resulting gain is subject to federal income tax and, in some cases, an additional branch profits tax.

2. Structuring Techniques under Current Law.

Several commonly used structuring techniques for investing in pools of mortgages and other loans are described briefly below. Such techniques involve varying degrees of complexity and administrative costs, and each of them has significant limitations.

a. REITs.

A real estate investment trust ("REIT") can provide an efficient tax structure for taxable and tax-exempt investors to invest in real estate assets. Taxable individuals who invest in a REIT receive the benefits of deductions taken at the REIT level for interest and other expenses, which would be limited if recognized by the individuals directly, and REIT dividends generally do not constitute UBTI for tax-exempt investors. A REIT that is "pension held," however, does not eliminate UBTI for tax-exempt pension plans that own more than 10% of the REIT's shares.[2]

A REIT is permitted to own only certain types of real estate assets, is subject to compliance requirements, and, as a result, can be expensive to create and maintain. In addition, it is unclear whether all of the assets acquired by a PPIF would be eligible to be held by a REIT.

[2] A REIT is pension-held if (i) its qualification as a REIT depends on the application of a special ownership look-through rule for pension trusts and (ii) at least one pension trust holds more than 25% (by value) of the interests in such REIT, or one or more pension trusts (each of whom own more than 10% by value of the interests in such REIT) hold in the aggregate more than 50% (by value) of the interests in such REIT.

b. Non-U.S. Corporations.

Structures involving one or more corporations organized outside of the United States (typically in a low- or no-tax jurisdiction) can provide an efficient tax structure for taxable and tax-exempt investors to invest in certain types of loan pools. Like REITs, non-U.S. corporations can be used to pass-through the benefit of interest deductions to individual investors and to eliminate UBTI for tax-exempt investors. However, non-U.S. corporations may also involve additional tax risks and compliance costs, such as those described in Section B.1.c. above with respect to non-U.S. investors.

In recent years, there has been increasing negative sentiment toward the use of "offshore" entities to address tax considerations. For example, legislation is currently pending in the U.S. Senate that would treat non-U.S. corporations that are managed in the United States as taxable domestic corporations for federal income tax purposes.[3] If enacted, this legislation would effectively foreclose the use of non-U.S. corporations by investment advisors located in the United States.

c. "Fractions Rule" Partnerships.

Real estate investment funds may be designed to comply with a limited exception to the UBTI rules for certain investments made by pension plans and university endowments through a partnership that satisfies the so-called "fractions rule." The fractions rule can be extremely complicated to implement and can interfere with the economic terms that investors would otherwise negotiate. Moreover, the fractions rule does not eliminate UBTI for all types of tax-exempt organizations, and it does not apply to debt-financed investments in mortgages or other loans. Even if the assets held by a PPIF were eligible for this UBTI exception, certain terms of the PPIF program may be inconsistent with the technical requirements of the fractions rule.

d. REMICs.

A real estate mortgage investment conduit ("REMIC") can provide an efficient mechanism for tax-exempt organizations and, in some cases, allow non-U.S. persons to invest in mortgage pools. Like REITs, REMICs have significant investment limitations, involve burdensome compliance requirements and are expensive to create and maintain. In addition, REMICs often must be combined with other entities to achieve an effective overall investment structure.

e. Hybrid Structures.

Various hybrid structures have been developed which may use more than one of the techniques described above to improve the overall tax efficiency of an investment fund or to provide greater flexibility to address the specific tax concerns of different categories of investors (*e.g.*, a single investor group may include taxable, tax-exempt and non-U.S. investors with divergent views as to how to optimally structure the underlying investments). While hybrid

[3] Stop Tax Haven Abuse Act (S.506), §103, *introduced on* Mar. 2, 2009, by Sen. Carl Levin (D.MI).

structures can provide greater structuring flexibility, they involve increased complexity, costs and tax risks.

3. Potential Guidance Opportunities.

The following discussion identifies several areas in which formal guidance from Congress, the UST and/or the Internal Revenue Service could mitigate some of the tax impediments described in Section B.1 above or limit the circumstances under which investors would need to consider complicated structuring techniques such as those described in Section B.2 above in order to invest in a PPIF.

a. Create a UBTI Exemption for PPIF Investments.

Tax-exempt organizations could be granted an exemption from the UBTI rules with respect to any income or gain recognized from an investment in a PPIF. Such an exemption would remove a material impediment for tax-exempt organizations to participate in the PPIF program and would eliminate the need for tax-exempt investors to engage in complicated structuring to avoid UBTI.

Providing a UBTI exemption under these circumstances is not without precedent. In 1993, Congress relaxed a number of UBTI provisions in the Internal Revenue Code to encourage tax-exempt organizations to invest in real estate held by troubled financial institutions.[4] These amendments were passed as part of congressional efforts to alleviate the banking crisis of the early 1990s.

b. Mitigate Phantom Income Consequences.

Phantom income exposure for taxable investors could be mitigated, for example, by (i) providing an exemption to the investment interest deduction limitations that apply to taxable individuals with respect to PPIF investments, and/or (ii) creating a safe harbor that allows certain modifications and work-outs of PPIF loans to avoid being treated as deemed exchanges for federal income tax purposes.[5]

In addition, phantom income concerns could be alleviated if the PPIF program were structured to permit minimum cash distributions to investors in amounts sufficient to cover their tax liabilities arising from their PPIF investment. Such "tax distributions" are commonly included in private investment structures, and are treated as advances on distributions to be made to the investors with respect to their equity investments. Such tax distributions would need to be permitted in priority to payments on any debt issued by a PPIF and to distributions made with respect to a PPIF's equity interests.

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[4] Revenue Reconciliation Act of 1993, Pub. L. No. 103-66, §§13144-49 (1993).

[5] Alternatively, the "amount realized" from a deemed exchange could be limited to the fair market value of the new loan that is deemed to have been received in the exchange, rather than the new loan's stated principal amount.

c. Treat PPIF Assets as "Registered Obligations".

Mortgages and other loans acquired by a PPIF could be treated as "registered obligations" for purposes of applying the portfolio interest exemption from federal withholding taxes. This type of guidance would provide non-U.S. investors with clarity and comfort that they may invest in a PPIF without significant exposure to federal withholding taxes. Moreover, the policy objectives behind the registration requirements could be satisfied, for example, by requiring PPIFs to maintain a register of their loan investments and monitor any transfers.

d. Provide a Trade or Business Exemption for Non-U.S. Investors.

Non-U.S. investors could be granted an exemption from being treated as engaged in a trade or business in the U.S. solely as a result of investing in a PPIF. Such an exemption could be conditioned upon a PPIF's limiting its activities to a specified set of "permitted activities" intended to reflect the activities that a typical distressed debt investor would be expected to take with respect to a similar investment. Such a provision would eliminate a material impediment which might otherwise limit participation by non-U.S. investors in the LLP.

C. ERISA.

1. PPIFs Should not be Considered "Plan Assets" Vehicles under ERISA.

The UST has expressed the desire to encourage investment in PPIFs by pension plans and the expectation that PPIF sponsors will structure PPIFs in order to accommodate pension plan investors. Domestic, non-governmental pension plans, including investment vehicles that are deemed to include the assets of such pension plans, are subject to the fiduciary duty and prohibited transaction rules of Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and are referred to herein as "ERISA Investors." Typically, ERISA Investors invest in real estate and other assets via investment vehicles that are structured to not constitute "plan assets" subject to ERISA and Section 4975 of the Internal Revenue Code (as described below). Managers of such investment vehicles have traditionally structured such funds not to be subject to the fiduciary duty and prohibited transaction rules under ERISA to facilitate investments by ERISA Investors. However, as currently constituted, the program will restrict participation by ERISA Investors and limit PPIF managers' or sponsors' willingness to accept ERISA Investor's capital. To better promote the UST's stated goals for the LLP, PPIFs should not be considered "plan assets" vehicles subject to ERISA.

Under the "Plan Assets Regulation" promulgated by the Department of Labor (the "DOL") (as modified by Section 3(42) of ERISA), if an ERISA Investor acquires an equity interest in an entity, the assets of that ERISA Investor are deemed to include not only the equity interest itself but also an interest in the underlying assets of the entity (deemed to be "plan assets") unless (i) the equity interest is a publicly offered security or a security of an investment company registered under the Investment Company Act of 1940 (a "Mutual Fund"), (ii) "benefit plan investors" hold less than 25% of each class of equity interests in the entity, disregarding for this purpose interests held by the manager of the entity and its affiliates; or (iii) the entity is an operating company, including a "venture capital operating company" (a "VCOC") or a "real estate operating company" (a "REOC").

Interests of PPIFs will not be publicly offered securities, nor will they be securities of a Mutual Fund. Further, PPIFs will not be able to meet the requirements necessary to qualify as an operating company, including a VCOC or a REOC, because the legacy assets acquired by the PPIF cannot satisfy the stringent requirements necessary to qualify as either "good" VCOC or REOC investments under the Plan Assets Regulation. Therefore, under current law, the only way for a PPIF to avoid being "plan assets" subject to ERISA is for "benefit plan investors" to hold less than 25% of each class of equity interest in the PPIF. This 25% limit will significantly restrict the amount of capital that ERISA Investors will be able to invest in a PPIF.

If equity participation in a PPIF by "benefit plan investors" exceeds the 25% limit under the Plan Assets Regulation, the assets of the PPIF would be considered "plan assets" subject to ERISA, and the PPIF and its manager(s) and sponsor(s) would be subject to the fiduciary duty and prohibited transaction provisions of ERISA. This would discourage participation in the LLP by potential PPIF fund managers and sponsors who have traditionally structured investment vehicles for real estate that are not subject to the ERISA fiduciary duty rules. Such a result would be inconsistent with the UST's stated intention to attract ERISA Investors.

Accordingly, we suggest that the UST and the FDIC coordinate with the DOL to amend the Plan Assets Regulation to provide that the underlying assets of any PPIF will not be considered "plan assets" regardless of whether equity participation in such PPIF exceeds the 25% limit under the Plan Assets Regulation (a result similar to Mutual Funds).

If the DOL will not amend the Plan Assets Regulation in this manner, the DOL should be asked to adjust the application of the 25% test (described above) in two respects. First, in applying the 25% test, the UST's and all private investors' equity interests in a PPIF should not be considered separate classes of equity of the PPIF even if they are actually structured as separate classes (*e.g.*, the class of equity held by private investors should not be considered a different class from the class of equity held by the UST). Second, and in addition, in applying the 25% test, all equity interests in the PPIF, specifically including the interests of the PPIF sponsor or manager, should be included in the test. Thus, the assets of the PPIF would only be deemed to be "plan assets" if benefit plan investors exceed 25% of the equity interests of a PPIF taking into account all equity interests held by all investors. This adjustment to the 25% test would encourage and facilitate increased participation in the LLP by ERISA Investors.

2. <u>PPIFs Should be Deemed to be "Good" REOC Investments</u>.

Traditionally, real estate investment vehicles intended to attract ERISA Investors are structured to meet the requirements necessary to qualify as a REOC. By qualifying as a REOC, these real estate investment vehicles will not be deemed to be "plan assets" subject to ERISA even if equity participation in such vehicle by benefit plan investors exceeds the 25% limit. For such vehicles to qualify (and to continue to qualify) as a REOC, however, among other things, more than 50% of the vehicle's assets must be invested in "real estate which is managed or developed and with respect to which such entity has the right to substantially participate directly in the management or development activities" (as explained further within the Plan Assets Regulation) (a "Good REOC Investment").

Under current law, a REOC's investment in a PPIF would not qualify as a Good REOC Investment because the investment is not likely to constitute an interest in real estate and the REOC would not have rights to participate in the management of the underlying real estate. To encourage participation by REOCs which have ERISA Investors in the LLP, we suggest that the UST and the FDIC coordinate with the DOL to specify that PPIFs will be deemed to satisfy the conditions necessary to constitute a Good REOC Investment. Without this change, REOCs would be limited in the amount they will be able to invest in PPIFs.

3. ERISA Prohibited Transaction Issues.

In connection with participating in the LLP, many managers will need a mechanism for obtaining capital commitments and pooling assets from investors in advance of the LLP bidding process. As a result, such managers will likely form commingled funds, which may include ERISA Investors, and which will constitute "plan assets" subject to ERISA if more than 25% of the interests in such pooled funds will be held by ERISA Investors. Therefore, regardless of whether the PPIF is subject to ERISA, the fund manager or sponsor will be subject to ERISA's fiduciary duty and prohibited transaction rules with respect to the ERISA Investors in the pooled vehicle when it eventually makes the investment decision on behalf of such fund to invest in the PPIF. In situations where the fund manager, or an affiliate, is also the manager or sponsor of the PPIF, ERISA would generally prohibit ERISA Investors in the pooled vehicle from investing in such PPIF because, among other reasons, the decision by the fund manager to cause the ERISA Investor to invest in the PPIF would result in additional fees being payable to the fund manager or its affiliate from the PPIF.

In the context of affiliated investments generally, the DOL has granted a number of exemptions from the ERISA prohibited transaction rules, including, for example, Prohibited Transaction Class Exemption 77-4 ("PTE 77 4") with respect to investments in affiliated mutual funds. Given its specificity, PTE 77 4 would not provide the necessary relief for the purchase of PPIF interests by an ERISA Investor when the PPIF sponsor or manager is acting as the authorized fiduciary on behalf of such ERISA Investor; however, similar relief should be granted with respect to investments in a PPIF.

Subjecting PPIF sponsors and ERISA Investors to the ERISA prohibited transaction rules where the sponsor or manager of a PPIF is also acting in a fiduciary capacity with respect to the ERISA Investor would discourage investment by ERISA Investors and cause PPIF sponsors to restrict or prohibit participation by ERISA Investors. Based on the factual similarities underlying PTE 77 4, we suggest that the FDIC and the UST coordinate with the DOL to grant a prohibited transaction class exemption allowing investment by ERISA Investors in PPIFs, similar in scope to PTE 77 4.

D. Eligibility.

The materials provided by the UST suggest a desire to encourage participation in the LLP by a broad range of investors. To facilitate the inclusion of as many private investors as possible, greater clarity and a set of objective criteria and approval processes should be established for pre-qualification of potential investors and asset managers.

As it is likely that sponsors or other investor groups will desire to bid on multiple Eligible Asset Pools, we suggest that such parties have the right to obtain "programmatic" pre-approval. Such programmatic pre-approval would require satisfaction of enumerated financial capacity and related experience criteria. Once a sponsor or other potential investor is programmatically approved, this approval should apply to all Eligible Asset Pools, subject only to satisfying certain Eligible Asset Pool-specific objective criteria. For example, the overlapping ownership threshold between the selling banks and the private investors would have to be complied with in respect to each Eligible Asset Pool in order for pre-approved private investors to bid on the pool. Similarly, there should be a streamlined approval process for all other previously approved sponsors or other investor groups who do not obtain programmatic pre-approval. We suggest that this subsequent approval be conditioned upon Eligible Asset Pool-specific financial capacity and related experience criteria. We note that there may be certain Eligible Asset Pools that might, with respect to certain private investors, be excluded from a programmatic pre-approval. For example, Eligible Asset Pools consisting of dealer-property loans (*e.g.*, condominium conversions, single home building projects, raw land) may require certain expertise that not all private investors might have. The foregoing approaches to streamlining the approval process are equally applicable to asset managers.

The Public-Private Investment Program for Legacy Loans Frequently Asked Questions (the "FAQ") indicates that participation by foreign investors will be limited to "foreign investors with a headquarters in the United States." This restriction could materially reduce the potential private investor pool. Allowing participation of foreign investors could be expected to increase bids and improve the success of the program.

The restriction on "affiliate" participation should be clarified. As suggested by Commissioner Bair in the March 26, 2009 Conference Call for Bankers, an appropriate standard would be the definition applied to such term in the Bank Holding Company Act (12 U.S.C. 1841(k)).

The prohibition on 10% overlapping ownership should be clarified. We understand that this provision is intended to prohibit the selling bank in respect of an Eligible Asset Pool from owning 10% of the aggregate private capital in the PPIF for such Eligible Asset Pool. In determining such overlapping ownership, we suggest that third-party funds that are managed or advised by such selling bank be excluded from this calculation to the extent such funds are passive investments in the PPIF.

The restriction on joint bidding after the auction process begins should be clarified. We suggest that the restriction only preclude joint efforts between pre-approved bidders that have made initial bids (*i.e.*, permit joint bidding for the initial bids). In any event, any prohibition on joint bidding should not extend to the addition of passive investors to a pre-approved bidder, even after an initial bid has been made.

The Term Sheet indicates that the UST and the FDIC will encourage small, veteran-, minority-, and women-owned firms to participate in the LLP. The details as to what, if any, preferential treatment such firms will receive should be clarified.

E. Diligence Matters; Representations & Warranties; Covenants; and Remedies.

1. Due Diligence Matters.

It is our understanding that the FDIC's third-party valuation consultants will be conducting a diligence review of each loan in the applicable Eligible Asset Pool. The more complete this diligence review is, the less independent diligence bidders will feel compelled to undertake. We suggest that due diligence materials prepared and reviewed for each Eligible Asset Pool should include, at a minimum, the items set forth below, to the extent the same are available. We recommend making this material available to bidders through online resources. A web-based "data room" would help facilitate investors' timely review of the Eligible Asset Pools and would make the third-party valuation consultant's assessment more transparent to bidders.

Recommended Diligence Materials (to the extent available):

a. Operating statements for income producing underlying properties.

b. Appraisals and any available capital or operating budgets.

c. Copies of leases and contracts for the underlying properties.

d. Land use entitlement and zoning analyses for the underlying properties.

e. Property tax information (current and historical) for the underlying properties.

f. Title commitments or preliminary reports and updates to either, as well as existing title insurance policies, underlying title exception documents and ALTA land surveys for each underlying property.

g. Environmental reports for each underlying property.

h. Physical condition report for each underlying property.

i. All loan documents to identify business terms, any enforceability issues and any requirements that could limit transferability. For example, some commercial loan documents contain provisions that require the original lender to be the borrower's exclusive point of contact, even if the loan is later securitized or participated. For any such provisions, the selling bank would have to obtain the borrower's waiver of such requirement.

j. Any existing bankruptcy analysis of the likelihood of the borrower's filing and likely outcomes if it does.

k. Review of loan correspondence files and loan officer notes and memoranda to identify any purported modifications and lender liability issues.

l. If the loan has been participated, tranched or otherwise apportioned between multiple lenders, all co-lender agreements, including any amendments or

correspondence among the lenders (to determine the rights of the holder of the purchased interest *vis-à-vis* all other co-lenders).

m. If mezzanine debt sits atop the loan, the mezzanine loan documents and any intercreditor agreement, including any amendments or correspondence among the lenders (to determine the rights of the holder of the purchased loan *vis-à-vis* the mezzanine lender or lenders).

n. Any escrows and reserves required under the applicable loan documents.

o. Any other borrower information in the possession or control of the selling bank.

2. Additional Diligence Period.

The Term Sheet seems to contemplate only a single, pre-bid due diligence period. This will be sufficient (and, we believe, desirable) if the FDIC third-party valuation consultant's diligence review is sufficient and made available to bidders. To the extent that such review is insufficient or not made available to bidders, bidders may be disinclined to undertake a thorough diligence review prior to becoming the winning bidder on account of the considerable cost of diligence. This can be expected to result in a smaller number of bidders and lower bids from those willing to make bids. In this event, a secondary, post-bidding diligence period should be considered for the winning bidder or bidders. In lieu of post-bidding termination rights, "kick-out rights" could be granted for loans not conforming to certain parameters and/or the selling bank's representations and warranties. In the interest of efficiency, we recommend the single bid, pre-bid due diligence approach.

3. Representations and Warranties for Loan Purchase Agreements.

Each of the bidders will likely expect the inclusion of certain representations, warranties and covenants in the loan purchase agreement ("Loan Purchase Agreement"). We assume that there will be an approved form of Loan Purchase Agreement used in connection with sale of the each applicable Eligible Asset Pool to ensure consistency among the transactions, reduce transaction costs and reduce the need for negotiation. Consideration should be given to including the following representations and warranties, among others, in the form of Loan Purchase Agreement (in each case, with a disclosure schedule of any exceptions):

a. That a schedule attached to the Loan Purchase Agreement sets forth a complete list of all material loan documents under each loan in the Eligible Asset Pool, and full and complete copies of each of the listed documents have been provided or otherwise made available to the bidders.

b. That the selling bank is the sole owner of the loan documents, and that the related rights have not been pledged or assigned to any other third-party and are not otherwise encumbered.

c. That there has been no modification of the loan documents except as delivered or made available to the bidders.

d. The principal amount outstanding under the loan documents on the date of the Loan Purchase Agreement.

e. The status of the latest payment of interest (*e.g.*, interest as been paid through a certain date).

f. The status of required impounds and reserves (for property taxes, insurance, etc.).

g. That the due diligence materials made available to the bidders include all physical condition, environmental and other property reports in the selling bank's possession with respect to the underlying properties for the subject loans.

h. That no loan provides for future advances.

i. That no loan is cross-collateralized with another loan outside the Eligible Asset Pool, and the extent of cross-collateralization within the Eligible Asset Pool.

j. That no consent, approval, authorization or order of, or registration or filing with, or notice to, any court or governmental agency or body having jurisdiction or regulatory authority over the selling bank (except as already obtained) is required for the execution and delivery of the Loan Purchase Agreement or the sale, transfer and assignment of the applicable loans.

k. That there have been no waivers of any material provisions of the applicable loan documents.

l. That neither the selling bank nor any of its affiliates, subsidiaries, officers, directors, employees or any agent of any of the foregoing has taken, implemented, instituted or otherwise commenced any enforcement action, offset or other remedy in connection with any of the applicable loans and there is no outstanding litigation related to the loan.

4. <u>Covenants for Loan Purchase Agreements</u>.

Each of the bidders will likely expect the inclusion of certain covenants in the Loan Purchase Agreement. We recommend including the following covenants, among others, in the Loan Purchase Agreement:

a. Covenants that address the selling bank's servicing rights and responsibilities, including any right to modify loans or take remedial actions, prior to the closing of the loan purchase transaction.

b. That the selling bank will take all such other reasonable actions and furnish such other documents or instruments as may be reasonably requested by the purchaser to effectuate the purposes of the sale, transfer and assignment of the applicable loans.

5. Remedies.

The PPIF's remedies for breach of the Loan Purchase Agreement should be clear. It should also be understood if monetary damages, put rights and set off rights against seller financing (if any) would be available, reduced by an amount based on the allocated value of the applicable loan.

F. State Licensing.

Some states (*e.g.*, California) have laws that require a purchaser of mortgage loans to be licensed to own or service such loans. The licensing requirements vary significantly by state, and, in many cases, are onerous. In many states where licensing is required, significant investors of the licensee (*e.g.*, owners of 10% or more of the licensee) must submit informational materials with the license application and may be subject to some degree of regulation. There are also timing considerations associated with obtaining these licenses; once a completed application is submitted to the state licensing authority, it can take up to three months or more for a license to be granted.

Requiring each PPIF to comply with the various state licensing requirements will create an enormous administrative burden and significant transaction costs, particularly for multi-state Eligible Asset Pools. Bidding may be limited for Eligible Asset Pools with loans having underlying properties located in states that require licensure, as some PPIFs may not bid because they have decided not to obtain licenses in states with particularly onerous requirements, while other PPIFs that submit license applications may not bid because they are waiting for approval of their applications.

We believe that compliance with state licensing laws will impede the achievement of LLP's objectives, and therefore request that the UST and the FDIC consider determining that PPIFs are not subject to state licensing laws.

G. Warrants.

The warrant requirement of EESA § 113(d) applies when the UST purchases or agrees to purchase troubled assets under the authority provided in EESA. The warrants are to be received from "the financial institution from which such assets are to be purchased." We assume that the plan to take warrants in PPIFs under the LLP is based on treating the acquisition of equity in the PPIFs as the purchase of troubled assets, consistent with the Capital Purchase Program's treatment of preferred stock in banks as troubled assets. As discussed below, we feel that such an analogy is flawed, but in any event we respectfully suggest that any warrant requirement should be carefully designed to avoid discouraging participation in the LLP by private investors and participant banks.

It is our understanding that the original policy objective of the warrant requirement was to give taxpayers a stake in the upside potential of the transaction to compensate for the risk that troubled assets might be acquired at too high a price, a risk that was more likely at the time the legislation was adopted when the UST proposed to purchase legacy loans directly at negotiated prices. The new LLP has been designed to address this concern in two ways. First, the legacy

loans are to be acquired at market prices through an auction process, which should mitigate the risk of overpaying. Second, the taxpayers' stake in the upside of PPIFs will be provided by the UST's *pari passu* equity in the PPIFs. Issuance of warrants to the UST that change the economics of PPIFs to the disadvantage of private investors would discourage private investment, potentially undermining the objective of the program. Because the LLP has been carefully designed to facilitate market pricing for the assets to be purchased, there is a reasonable basis for taking the position that warrants should not be required in the context of the LLP. Accordingly, it may be appropriate for the UST to seek a legislative exemption from the warrant requirement for the LLP.

If warrants in the PPIFs are to be issued to the UST, the sole trigger allowing exercise of the warrants could be the issuance of new equity in the PPIF other than on a pro rata basis to the existing participants (including the UST) and their successors. Such warrants would prevent dilution of the UST's equity position.

H. Executive Compensation.

We respectfully recommend that the executive compensation restrictions of EESA § 111 should not apply to investors in, or managers or sponsors of, PPIFs. The UST has specified in the FAQ that EESA § 111's executive compensation restrictions will not apply to passive private investors in PPIFs, but has not indicated whether PPIF managers or sponsors or other investors will similarly be exempt from such restrictions on executive compensation. In a press conference on March 23, 2009, Secretary Geithner noted that "[t]he [executive] comp[ensation] conditions will not apply to the asset managers and investors" in PPIFs. Noticeably, however, the Term Sheet does not exclude from such restrictions the asset managers and sponsors of PPIFs, nor does it exclude investors who may not be considered "passive". The Term Sheet excludes only "passive investors" and, further, the Term Sheet can be read in a manner that implies that the executive compensation restrictions could be applied to other groups in the future. For example, the Term Sheet provides that each PPIF will be subject to "waste, fraud and abuse" protections established by the UST, which protections could presumably target compensation arrangements.

The concerns that EESA executive compensation restrictions were designed to address are not applicable in the PPIF structure. PPIF sponsors and investors are taking economic risks by participating in the LLP and their equity capital will be side-by-side with the public equity capital. If the government receives a significant return on its capital, so will the private investors, but the private investors will also lose their investment proportionally with the public equity capital if the PPIF is not successful. Thus, the potential misalignment of interests that was of concern in the TARP program is not present in the structure of the PPIFs. In addition, potentially limiting such sponsors' and/or investors' "upside" with respect to the PPIF investment would cause many to forego the program and would have a chilling effect on participation in the LLP. It also bears noting that whatever compensation is paid to private sponsors, investors and managers, other than perhaps a market-rate asset management fee that will be paid by the PPIFs, will be paid by the private investors and not directly or indirectly by the UST or the FDIC. In light of the foregoing, we believe there is a reasonable basis for taking the position that the executive compensation restrictions should not be required in the context of the LLP. Accordingly, in the interest of ensuring the success of the program, it may be

appropriate for the UST to seek a legislative exemption from the executive compensation requirements for the LLP.

I. Guaranty and Financing Terms.

As noted earlier, the terms of the debt to be made available to PPIFs will need to be fully specified in order to obtain competitive bids for PPIF equity.

Any requirement to pay down debt with net proceeds from PPIF assets should be balanced against the needs of the PPIF for working capital to meet debt service and operating expenses and to fund reserves (including the "Debt Service Coverage Account" described in the Term Sheet). For this purpose, we are assuming that additional capital contributions to a PPIF by its investors (both the private investors and the UST) subsequent to the initial PPIF formation are not anticipated. A key term that will affect the attractiveness of PPIF equity is the extent to which PPIFs may use proceeds from PPIF assets to make distributions to investors prior to full repayment of PPIF debt. The FDIC could, of course, reduce its exposure on guarantees of PPIF debt by prohibiting all such distributions. Doing so, however, would reduce the attractiveness of investing in PPIF equity. For example, taxable investors may need, at a minimum, distributions prior to full repayment of PPIF debt to fund state and federal income tax payments required to be made by such investors resulting from PPIF income allocated to them. Private investors and the UST may also desire to benefit from periodic distributions to the extent debt service, operating expenses and reserves are fully funded. The FDIC can satisfactorily address investor concerns while minimizing its exposure on its guarantees. For instance, lenders commonly resolve these competing concerns by establishing a release price for each item of collateral securing a loan. Typically the release price is a specified percentage, generally in excess of 100%, of the value allocated to the collateral at the time the loan was made. It would also be possible to revalue the collateral periodically and permit distributions based on the loan-to-value ratios of the remaining collateral. It might be desirable for the FDIC to reserve the flexibility to take different approaches in connection with different auctions. Approaches that permit PPIFs to distribute a larger portion of the proceeds of the PPIF's assets and thereby expose the FDIC to greater risk on its guaranty might entail larger guaranty fees.

J. Immigration Concerns.

We believe that it would be beneficial for the UST to clarify that participation in the LLP by private investors, sponsors and managers as purchasers will not, in and of itself, make such private investors, sponsors or managers "recipients" of TARP funds for purposes of the Employ American Workers Act, Pub. L. 111-5, Div., Title XII, s. 1611, and corresponding limitations on hiring foreign nationals to work in the H-1B visa category.

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We would be happy to discuss any of these comments with you in greater detail. Our designated point of contact is either of the Co-Chairs of our Real Estate, REITs & Real Estate Capital Markets Group, Gilbert G. Menna at (617) 570-1433 or Andrew C. Sucoff at (617) 570-1995.

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IRS CIRCULAR 230 DISCLOSURE: To ensure compliance with requirements imposed by the Internal Revenue Service, we inform you that any U.S. federal tax advice contained in this comment is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.