

STEPTOE & JOHNSON^{LLP}

ATTORNEYS AT LAW

Scott A. Sinder
Avenue, NW
202.429.6289
20036-1795
ssinder@steptoe.com
202.429.3000

202.429.3902

1330 Connecticut

Washington, DC

Tel

Fax

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TO: Commercial Mortgage Securities
Association

FROM: Scott A. Sinder
Rhonda M. Bolton

RE: U.S. Department of the Treasury's Public-Private Partnership Investment
Program

Overview

You have asked us to provide an overview and analysis of the Public-Private Partnership Investment Program announced by the U.S. Department of the Treasury on March 23, 2009. Generally, the program will attempt to combine capital from the Troubled Assets Relief Program ("TARP") with that from private sources to purchase troubled loans and securities from financial institutions, with the expectation that such institutions ultimately will be freed to resume more normal lending practices with these troubled assets removed from their balance sheets.

As has often been the case recently, Treasury announced the creation of the program without providing all of the details about how it will operate. However, the public-private program does appear to be consistent with one or more of the approaches that CMSA has advocated to address the credit and liquidity crises. Significantly, the component of the program

involving “legacy securities” will initially target purchase of AAA-rated commercial mortgage-backed securities (“CMBS”) originated prior to 2009 (as well as non-agency residential mortgage-backed securities), so its development and roll-out warrant very careful attention.

The public-private program involves the formation of Public-Private Investment Funds (“PPIFs”) aimed at two types of assets: one PPIF program will address “legacy securities,” and the other will address “legacy loans.” Although the operating mechanics of each component will differ, they both share the following three basic operating principles: 1) government co-investment with the private sector; 2) risk sharing between the public and private sector; and 3) private sector price discovery, as opposed to a scenario in which the government determines the price of assets to be acquired. Specific funding levels for the two programs have not been announced, although Treasury advises that \$75 to \$100 billion in TARP funds will initially be used to serve as capital for the programs, with this amount counting against the \$700 billion total currently appropriated to TARP for the purchase of troubled assets by the government.

More details concerning each component of the public-private program are discussed below.

Legacy Securities Program

The stated goal of the Legacy Securities Program is to re-start the market for legacy securities, allowing financial institutions to free up capital and stimulate the extension of new credit. The previously-announced Term Asset-Backed Securities Facility (“TALF”), which will be extended to provide non-recourse loans to investors seeking to purchase AAA-rated commercial mortgage-backed securities and non-agency residential mortgage-backed securities, is described as being under the Legacy Securities Program umbrella. Significantly, although terms and conditions for TALF loans for CMBS are still being worked out, Treasury’s

announcement states that “the Federal Reserve is working to ensure that the duration of ... [TALF] loans takes into account the duration of the underlying assets.” This acknowledgment is encouraging, as the adoption of an appropriate loan duration is one of the issues that has concerned CMSA.

A second, and new, aspect of the Legacy Securities Program is the creation of Public-Private Investment Funds (“PPIFs”) to purchase troubled legacy securities. Under this plan, Treasury will provide capital and leverage to private fund managers, whom it will select to manage to the PPIFs, and who will be expected to raise funding from private investors that will then be matched by Treasury. The Legacy Securities PPIFs are expected to initially target for purchase are AAA-rated CMBS and non-agency RMBS that were originally issued before January 1, 2009, as mentioned above. And depending on availability, these PPIFs may also be eligible to obtain loans through the expanded TALF program for CMBS once that program is operational.

The materials Treasury has released to date explicitly state that passive investors in the PPIF will not be required to comply with executive compensation restrictions under TARP, but the materials do not address whether there will be any executive compensation obligations for sellers of securities and/or for fund managers. It should be noted that an argument can be made that such restrictions are applicable to sellers and fund managers because the Emergency Economic Stabilization Act of 2008 (“EESA”), as amended, provides that the restrictions apply to “TARP recipients,” and sellers and fund managers are receiving or benefitting from TARP funds, directly or indirectly. However, some comfort may be taken in the fact that the most recent set of Terms and Conditions for TALF (released on March 19, 2009) explicitly state that executive compensation restrictions will not be imposed on TALF sponsors, underwriters and

borrowers, and imply a belief on Treasury's part that such restrictions might be inimical to the goals of the TALF program. Similar reasoning should apply to the Legacy Securities Program. In any event, additional guidance may be provided by Treasury on the subject of executive compensation restrictions.

More details concerning the Legacy Securities PPIF program are summarized in a chart at the end of this memorandum.

Legacy Loans Program

In addition to the formation of PPIFs for Legacy Securities, the public-private initiative will also involve creation of PPIFs to buy, own, and manage "legacy loans" from financial institutions. Although fewer details have been provided about this program than for the Legacy Securities Program, the Legacy Loans PPIFs will be overseen by the Federal Deposit Insurance Corporation ("FDIC"), which is expected to issue guidance on the exact requirements and structure of the loans program after a rulemaking proceeding.

In the meantime, Treasury advises that private investors are expected to invest 50% of the equity capital in the Legacy Loans PPIFs, to be matched by Treasury, and the FDIC will provide a guarantee for debt financing issued by the PPIFs to help fund asset purchases. The PPIFs will not issue guaranteed debt beyond a 6-to-1 debt-to-equity ratio, although the FDIC will obtain an analysis of individual loan pools to determine the precise level of debt that it is willing to guarantee for each.

No specific determinations have been made as of yet concerning the types of loans eligible for purchase, although financial institutions will identify to the FDIC the types of assets, typically pools of loans, that they wish to sell, and eligibility will be determined jointly by the selling institutions, primary banking regulators, Treasury, and the FDIC. Once eligible pools of

loans have been identified, they will then be auctioned off by the FDIC to qualified bidders. The winning bid will define the price offered to the selling institution, which then has the option of accepting or rejecting the offer price. Once the initial transaction has been completed, the private capital partners will control and manage the assets until final liquidation, subject to “strict” oversight by, and reporting obligations to, the FDIC.

As is the case for the Legacy Securities Program, the materials provided by Treasury explicitly state that passive investors in Legacy Loans PPIFs will not be required to comply with executive compensation restrictions under TARP, but executive compensation obligations for sellers and for the private capital partners in the PPIFs are not addressed. This issue should be addressed by the rules FDIC will issue to govern the program.

Summary of Additional Details Regarding the Public-Private Investment Programs

The following chart provides additional information of interest concerning the public-private initiatives for legacy securities and legacy loans:

<u>Parameter</u>		<u>Legacy Securities</u>	<u>Legacy Loans</u>
Funding Source	· Private	Treasury-approved Private Fund Managers responsible for raising at least \$500 million in capital from private investors within a specific time period	Private investors in the PPIF will provide at least 50% of equity capital
	· Public	<ul style="list-style-type: none"> · Treasury will match equity funds based on amount of private capital raised; · Fund will have option to obtain secured non-recourse loan from Treasury of up to 50% of Fund’s total equity capital subject to certain restrictions, and Treasury will consider requests for additional Treasury Debt financing of up to 100% of fund’s total equity capital subject 	<ul style="list-style-type: none"> · Treasury will match private equity capital; · FDIC will guarantee debt issued by PPIF, collateralized by assets purchased by each PPIF. Leverage will be determined on a pool-by-pool basis at the FDIC’s sole discretion with input from a third-party valuation firm, with debt-to-equity ratio not to exceed 6-to-1.

<u>Parameter</u>		<u>Legacy Securities</u>	<u>Legacy Loans</u>
Funding Source cont'd	Public cont'd	to certain additional restrictions	
Investment Details		<ul style="list-style-type: none"> · Public and private funds invest and divest pro rata at the same time and on the same terms; · Managers expected to adopt buy-and-hold strategy though Treasury will consider approaches involving limited trading; · Public and private investment will share gains and losses pro rata; · Treasury will take warrants in the PPIF 	<ul style="list-style-type: none"> · FDIC will oversee multiple PPIFs which will own and manage pools of assets; · Public and private capital will invest proportionately at the same time in the PPIF; · Public and private investment will share gains and losses pro rata; · Treasury will take warrants in the PPIF
Eligible Assets		<ul style="list-style-type: none"> · CMBS and non-agency RMBS issued prior to January 1, 2009; · Assets must originally have had AAA rating or equivalent from two or more NRSROs without rating enhancement; · Assets generally must be secured directly by the actual mortgage loans, leases or other assets and not other securities; · Underlying loans or assets must be situated predominately in the U.S.; · Eligible assets can be purchased solely from “financial institutions” as described in Section 101(a)(1) of EESA (i.e., not from foreign central banks or foreign government-owned banks). 	<ul style="list-style-type: none"> · Assets are expected to be pools of loans, which will be identified by banks interested in selling them and their primary regulators; more details to be provided by FDIC after rulemaking; FDIC will publish qualification criteria for eligible assets; · Eligible assets and any supporting collateral must be situated predominately in the U.S.
Eligible Participants	·Sellers	· “Financial institutions” as described in Section 101(a)(1) of EESA (i.e., not from foreign central banks or foreign government-owned banks);	· Eligible sellers include any insured U.S. bank or savings association; those owned or controlled by foreign banks are ineligible.

<u>Parameter</u>		<u>Legacy Securities</u>	<u>Legacy Loans</u>
Eligible Participants cont'd	Sellers cont'd	<ul style="list-style-type: none"> · Sellers cannot be affiliates of Fund Managers in the program, or any private investor that has contributed at least 10% of the aggregate capital raised by the Fund Manager. 	
	· Investors	See above re Sellers	<ul style="list-style-type: none"> · Private investors are expected to include financial institutions, individuals, insurance companies, pension funds, and private equity funds; · Private investor groups must be approved by FDIC, and cooperation between them will be prohibited once auction process begins; · Private investors may not participate in any PPIF purchasing assets from affiliates of the investors or that represent 10% or more of the aggregate private capital in the PPIF
Price Discovery Mechanism		Private Fund Managers will control asset selection and pricing	Auction of eligible asset pools, with FDIC supervising the valuation process that will facilitate bidding, and the auctions; sellers may accept or reject the offered price that is based on the winning bid.
PPIF Management		Treasury will initially select 5 private sector Fund Managers based on criteria that will include demonstrated capacity to raise at least \$500 million of private capital, experience and track record in investing in eligible assets, a minimum of \$10 billion under management, and having a U.S. headquarters. Fund manager applications are currently available and are due	Once the initial transaction has been completed, the private capital partners will control and manage the assets until final liquidation, subject to “strict” oversight by, and reporting obligations to, the FDIC.

<u>Parameter</u>	<u>Legacy Securities</u>	<u>Legacy Loans</u>
	April 10, 2009.	
Oversight	Funds will be managed by the private managers, but managers must provide detailed monthly reports to Treasury, must publicly report prices paid for assets and have annual audited valuations, and must agree to open their books to Treasury, the TARP IG and GAO, among other oversight requirements.	Funds will be managed by the private capital partners, subject to “strict” oversight by the FDIC in accordance with pre-established parameters, and must agree to open their books to Treasury, the TARP IG and GAO, among other oversight requirements.
Executive Compensation Restrictions	None for passive investors in the PPIF; unclear for sellers and for Fund Managers, although there should be none if the rules are consistent with those for TALF	None for passive investors in the PPIF; unclear for sellers and for private capital partners, although there should be none if the rules are consistent with those for TALF