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TARP UPDATE: The New Financial Stability Plan

On Tuesday, February 10, 2009, Treasury Secretary Timothy F. Geithner announced, in summary fashion, a series of new measures that are intended to provide additional relief from the credit crisis and complement the stimulus package that is working its way through Congress. The approach consists of six broad initiatives:

1. **Financial Stability Trust**. This element is intended to strengthen financial institutions so that they are in a position to support economic recovery and will include:
 - (a) Comprehensive "Stress Test" for Financial Institutions. This will consist of a supervisory review and forward-looking assessment that is intended to increase transparency and disclosure, to be conducted under the auspices of all relevant financial regulators – the Federal Reserve, the FDIC, the Office of the Comptroller of the Currency and the Office of Thrift Supervision. All banking institutions with assets in excess of \$100 billion will be required to participate.
 - (b) Capital Assistance Program (the "CAP"). Banks that have undergone, and presumably passed, the "stress test" will have access to a Treasury-provided capital buffer (or contingent equity) to absorb losses and serve as a bridge to receiving increased private capital. The banks would receive from the Treasury preferred security investments in convertible securities which could be converted into common equity as needed to preserve that bank's lending ability. Those securities will have a to-be-determined dividend and a conversion price modestly discounted from that bank's prevailing stock price as of February 9, 2009. Banks with assets *under* \$100 billion will be eligible for the CAP, after a supervisory review.
 - (c) Financial Stability Trust. Any capital investments that the Treasury makes under the CAP are to be placed in a separate entity – the Financial Stability Trust – to be set up to manage the government's investments in US financial institutions.
2. **Public-Private Investment Fund**. This initiative – which is currently very thin on details – is intended to provide greater means for institutions to cleanse their balance sheets of troublesome legacy assets by encouraging the private sector to partner with the FDIC and the Fed. Treasury indicates that there will be a program which will be designed with a public-private financing component, which could involve public or private capital invested side-by-side and using public financing to leverage private capital on an initial scale of up to \$500 billion. This feature has the potential to expand to \$1 trillion. The intent is not only to bring in private sector equity contributions to make large-scale purchases, but also to allow private sector buyers to determine the market price for current, troubled, and previously illiquid assets. No additional details have been provided – Secretary Geithner said in his speech yesterday that the government was "exploring a range of different structures for this program, and will seek input from market participants and the public as we design it."

3. **Consumer & Business Lending Initiative.** With the goal of kick starting the secondary market for bundled small business, commercial real estate and auto loans, the Secretary announced that the previously outlined initiative between Treasury and the Fed entitled the Term Asset-Backed Securities Loan Facility (“TALF”) is being expanded. Previously Treasury was to use \$20 billion to leverage \$200 billion in lending from the Fed – that will now be expanded to the use of \$100 billion to leverage \$1 trillion. The current initiative will expand TALF beyond its existing focus on auto loans, student loans, credit card loans, and SBA small business loans, and will now include commercial mortgage-backed securities (and possibly additional asset classes such as non-agency residential mortgage backed securities).

4. **New Era of Transparency, Accountability, Monitoring and Conditions.** As expected, the Secretary indicated that there will be tougher standards imposed on firms receiving exceptional assistance. These measures will include: (a) a requirement that firms demonstrate how receipt of bailout funding will expand its own lending; (b) a requirement that recipients commit to participate in mortgage foreclosure mitigation; (c) certain restrictions on dividends, stock repurchases and acquisitions; (d) additional executive compensation limitations (consistent with the tightened-restrictions announced last week); (e) prohibitions on political/lobbyist interference in investment decisions; and (f) required disclosure of all contracts entered into under the Financial Stability Plan on the new government website, located at www.FinancialStability.com within five to ten business days of completion.

5. **Housing Support and Foreclosure Prevention.** The government indicated it will soon be announcing a comprehensive plan (a) directed at driving down mortgage rates, (b) committing \$50 billion to foreclosure prevention for owner-occupied middle class homes, (c) bringing order and consistency to efforts to address the foreclosure crisis, (d) requiring recipients of aid to participate in foreclosure mitigation plans, and (e) building flexibility into the Hope for Homeowners and FHA programs to expand access to loan modifications.

6. **Small Business and Community Lending Initiative.** This is a new program that is to be announced by the President, the Treasury Department and the SBA over the next several days, which is intended to address the dramatic slowdown in SBA lending. It will combine the Consumer & Business Lending Initiative mentioned above with measures in the pending American Recovery and Reinvestment Act (the stimulus plan currently before Congress) regarding an increase in the guarantee of SBA loans.

For more information, please see the transcript of Secretary Geithner’s announcement (<http://www.ustreas.gov/press/releases/tg18.htm>) and the fact sheet released yesterday on the new www.FinancialStability.com website (<http://www.financialstability.gov/docs/fact-sheet.pdf>).

D&S Commentary

Investment advisors and private capital managers are doubtless interested to see how the details of the new Public-Private Investment Fund are developed in the coming weeks. As noted, there are very few facts that have been announced regarding this program. There is speculation that the program could take the form of a type of “aggregator bank.” This would involve an entity being seeded with government money. Private investors could then invest in the aggregator, and that entity would acquire the troubled assets from the subject banks. Alternatively – or perhaps in combination with such an entity – the government might pool various different assets into classes and create vehicles to own these assets, creating a series of ventures between the government and one or more private investors. Irrespective of the final details, the government’s stated desire is clearly to provide incentives for maximizing private investment as part of the solution to the credit crisis. Some of these incentives could involve government backstops against potential losses resulting from further decreases in asset value and/or providing cheap (and possibly minimally recourse) financing to increase leverage and create potential for significant rewards in the event of an increase in asset value.

However, as the particulars of the plan are developed, it is reasonable to assume that any opportunities which may be available to private investors are likely to have certain characteristics that make such public-private deals distinct from otherwise similar deals among private parties. Transactions under the Financial Stability Plan may involve: (a) very short time frames for due diligence and transaction documentation (and – sometimes – restrictions on dissemination of information about specific assets in a manner that would be very unusual in a private deal); (b) being presented with documents that often are largely “non-negotiable”, and effectively shift most transaction risks to the private investor; and (c) inflexibility in structuring or revising the deal, as a result of the government’s desire to neatly fit the deal into its pre-defined boxes. In addition to these structural challenges, there are, of course, a host of additional issues associated with the target assets themselves – which are going to be distressed and troubled assets. Indeed, the sellers (i.e., the banks) are going to be most incentivized to off-load their most toxic and problematic legacy assets, heightening the buyer’s risk. Please note that we are not implying that any or all of these factors are, or should be, deal-killers. If the price is appropriate, some or all of the issues may be worth assuming.

Since many of our clients will be affected by the government’s actions – either because they are in a position to partner with the government, buy assets from troubled banks, or otherwise – the Distressed Real Estate Practice Group at Duval & Stachenfeld will, through this Plain & Simple format, keep our clients and friends of the firm advised on the various governmental programs as they unfold.

If you have a need for legal advice on any of the above matters, please contact any of the following partners in our [Distressed Real Estate Practice Group](#):

[Bruce M. Stachenfeld](#)
Co-Chair
Distressed Real Estate
Practice Group
(212) 692-5550
bstachenfeld@dslip.com

[Terri L. Adler](#)
Co-Chair
Distressed Real Estate
Practice Group
(212) 692-5533
tadler@dslip.com

[Kirk L. Brett](#)
Co-Chair
Distressed Real Estate
Practice Group
(212) 692-5525
kbrett@dslip.com

[Allan N. Taffet](#)
Co-Chair
Distressed Real Estate
Practice Group
(212) 692-5523
ataffet@dslip.com

[Distressed Real Estate Practice Group](#)

Duval & Stachenfeld has positioned itself to be ready for the downturn in real estate by acquiring and training knowledgeable and talented lawyers in the critical areas for distressed real estate; namely, **real estate, bankruptcy** and **litigation**. In that regard, the Firm has established its Distressed Real Estate Practice Group to provide coordinated expertise in these legal areas and to provide advice and guidance regarding workouts, debt and equity restructurings and recapitalizations, bankruptcies, distressed debt and distressed property acquisitions and dispositions, and related litigation.

Please contact Caitlin Velez at (212) 672-3747 or newsletter@dslip.com with any questions or comments.

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