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### Public-Private Investment Program

On March 23, 2009, the Treasury Department released details of the much anticipated Public-Private Investment Program (the "Program"). The Program is Treasury's latest attempt to remove troubled or illiquid assets from the balance sheets of financial institutions and is designed to maximize the impact of each taxpayer dollar, ensure shared risk (and profits) between taxpayers and private sector participants, and establish private sector price discovery through competing investors. Under the Program, banks will be able to sell certain troubled or illiquid assets to partnerships created between the U.S. Government and private investors. The Treasury has broadly categorized the assets that are the subject of the Program as "legacy loans" and "legacy securities". Legacy loans are real estate loans held directly on the books of banks and legacy securities are commercial mortgage-backed securities and residential mortgage-backed securities originally issued prior to 2009. Therefore, the Program is naturally divided into two components - The Legacy Loans Program (the "Loan Program") and The Legacy Securities Program (the "Securities Program"). The Program contemplates using between \$75 and \$100 billion of funds authorized under the Troubled Asset Relief Program ("TARP") for the equity co-investments by Treasury in both programs. While Treasury's announcement still leaves many specifics to be determined, including the timeline for implementing the Program and the allocation of TARP funds between the two programs, the outlines of the Program are now clearer.

In an effort to provide a practical explanation of each of the foregoing programs, the discussion below provides an example of a typical transaction under each program.

#### The Legacy Loans Program

The Loan Program incorporates FDIC debt guarantees and a co-investment of Treasury equity and private equity to enhance demand for bank-held distressed assets and to facilitate market-priced sales of troubled assets by private investors.

An example of a typical transaction consummated under the Loan Program is as follows:

1. Identification of Assets by Banks. A bank will work with its primary regulator to identify and evaluate asset pools to be sold to a newly created public-private investment fund ("PPIF"). Eligible assets and supporting collateral must be situated primarily in the United States, but nothing in the program materials expressly limits legacy loans to real estate-related assets, and accordingly, the Loan Program could be expanded to include a broader range of assets. For purposes of this newsletter, let's assume that a bank wishes to sell a pool of mortgages with a \$100 face value.

2. Debt Guarantee Analysis by the FDIC; Third-Party Valuation. A third-party valuation firm selected by the FDIC will provide independent guidance to the FDIC on each asset pool with respect to valuation and structure and value of bids at auction. The FDIC, with input from the third-party valuation firm, will on a pool-by-pool basis and in its sole discretion, determine the supportable leverage for that pool. The maximum amount of leverage that the FDIC is expected to guarantee with respect to a PPIF is a debt-to-equity ratio not to exceed 6 to 1. For purposes of our ongoing example, let's assume that the FDIC has elected to guarantee the leverage of the loan pool at the maximum 6 to 1 ratio.

3. Auction to the Highest Bidder. The FDIC will then auction off the loan pool to the highest bidder. The proposed financing terms and leverage ratios with respect to a PPIF will be disclosed to prospective investors as part of the auction process. The FDIC is currently soliciting comments to assist in its determination of which form of auction will produce a fair price for sellers.

4. Formation of the Public-Private Fund; Financing Provided through FDIC Guarantee. Treasury and the winning private investor will then form a PPIF to acquire and manage the loan pool. Debt to finance the purchase of the loan pool will be issued by the PPIF, and the FDIC will provide credit support for the financing by guaranteeing the debt issued by the PPIF up to a maximum 6 to 1 debt-to-equity ratio. If the winning bidder in our example offered a price of \$84, the FDIC would guarantee the first \$72 of any financing obtained in connection with the acquisition of the loan pool. The private investor and Treasury would each simultaneously contribute 50% of the equity funding to the PPIF. In our example, of the \$12 in equity needed to acquire the loan pool (\$84 purchase price less \$72 FDIC guaranteed debt), \$6 would be contributed to the PPIF by Treasury (out of TARP funds) and \$6 would be contributed to the PPIF by the private investor. The FDIC guarantee will be secured by the loan pool being acquired by the PPIF. The FDIC will receive a fee in connection with providing such guarantee.

5. Management of the Loan Pool. The PPIF will be controlled and managed by a private fund manager until final liquidation, subject to strict FDIC oversight.

6. Executive Compensation Restrictions. Treasury has not imposed executive compensation limits upon any "passive" private investors participating in the Loan Program. Presumably, this means passive private investors not otherwise subject to executive compensation restrictions will not be subjected to new restrictions as a result of investment in a PPIF under either program. Further clarification is likely to be forthcoming from Treasury.

From the private investor's point of view, clearly the most critical part of the Loan Program will be the proposed terms of the documents memorializing the PPIF (i.e., the joint venture terms), and the terms of the documents transferring the asset to the PPIF. The specific terms of either of the foregoing will of course depend on the asset being acquired and the negotiations of the parties, but Treasury has stated that (1) each PPIF will be managed within parameters pre-established by the FDIC and will be subject to rigorous FDIC oversight; (2) each PPIF must be prepared to make certain representations, warranties, and covenants regarding the conduct of its business and compliance with law; (3) a private investor may not participate in any PPIF that purchases assets from a seller that is affiliated with such investor; (4) Treasury will receive warrants in the PPIF consistent with the requirements under TARP; (5) each PPIF will be required to maintain a debt service coverage reserve, as determined by the FDIC; (6) ongoing administration fees will be paid from the PPIF to the FDIC for its oversight services; (7) profits and losses will be shared by Treasury and the private investors equally, in proportion to the equity each has invested; and (8) the seller of a loan pool may continue to service the loan pool, although control of servicing will be vested in the PPIF. The FDIC will be accepting comments from all interested parties on the Legacy Loans Program until April 10, 2009.

## The Legacy Securities Program

The Securities Program has two parts. First, a pool of private funds managed by selected fund managers and funds from Treasury will partner to invest in legacy securities. Second, through an expansion of the Term Asset-Backed Securities Loan Facility (“TALF”), private investors will be able to access financing to purchase legacy securities directly.

An example of a typical transaction consummated under the public-private aspect of the Securities Program will resemble the following:

1. Investment Strategy and Objectives. PPIFs will be established to invest in legacy securities (“eligible assets”) that will initially include commercial mortgage-backed securities and residential mortgage-backed securities issued prior to 2009 that were originally rated AAA or equivalent by two or more nationally-recognized rating agencies, without ratings enhancement and that are secured directly by actual U.S. mortgage loans, leases or other non-securities assets.

2. Selection of Fund Managers. Treasury will select the fund managers through which private investment into the Securities Program will be managed. Fund managers will be pre-qualified based on criteria that include (a) a demonstrated ability to raise at least \$500 million in private capital, (b) demonstrated experience investing in “eligible assets”, and (c) a minimum of \$10 billion (market value) of eligible assets under management. Treasury initially expects to select at least 5 fund managers to raise private capital for participation in the Securities Program. Applications to serve as a fund manager must be submitted to Treasury no later than April 10, 2009, and selection of the fund managers is expected to be made no later than May 1, 2009.

3. Selected Fund Managers Raise Private Capital. After a fund manager is selected, such fund manager will then seek to raise private capital for investment into a fund (“Private Vehicle”) through which private investors will invest in the eligible assets.

4. Treasury Matches Capital Raised. The fund manager will then invest funds from the Private Vehicle into a PPIF. For every private dollar invested into the PPIF by the Private Vehicle, Treasury will then contribute a dollar to such PPIF. So, for example, if the fund manager is able raise \$100 for investment into a PPIF, Treasury will also invest \$100 into the PPIF (giving the PPIF \$200 in purchasing power).

5. Fund Manager Obtains Financing. In addition to the co-investment from Treasury, a fund manager has the option to increase its purchasing power by obtaining secured, non-recourse loans from Treasury in an aggregate amount not to exceed 50% of the total equity of the PPIF. So, in our example, the fund manager may obtain up to \$100 in financing from Treasury (thereby boosting its purchasing power to \$300). There are, however, prerequisites to obtaining such financing. That is, this financing is available only for fund managers managing Private Vehicles that do not permit voluntary withdrawals by private investors. However, if a fund manager is willing to agree to additional restrictions on asset level leverage, withdrawal rights, disposition priorities, and other factors which Treasury deems relevant, the amount of financing could be increased to 100% of the equity of a PPIF (thereby boosting the purchasing power in our example to \$400). Any financing provided by Treasury will be secured by the assets purchased by the fund manager under the Securities Program, will bear interest at a rate to be determined by Treasury, and must be repaid at the end of the PPIF’s term. The term of the PPIF will be no greater than 10 years, subject to extension with the consent of Treasury.

6. Purchase of the Assets from Eligible Sellers. The fund manager will then purchase any eligible assets that it deems fit. Unlike the Loan Program, the eligible sellers include financial institutions, as defined in TARP, and are not limited to banks. The fund manager has full discretion in its investment decisions; however, Treasury recommends a long-term buy and hold strategy.

7. Executive Compensation Restrictions. Similar to the Loan Program, Treasury has not imposed executive compensation limits upon any “passive” private investors participating in the Loan Program. Presumably, this means passive private investors not otherwise subject to executive compensation restrictions will not be subjected to new restrictions as a result of investment in a PPIF under either program. Further clarification is likely to be forthcoming from Treasury.

Similar to the Loan Program, from the private investor’s point of view, the most critical parts of the Securities Program will be the proposed terms of investment in the Private Vehicle and the proposed terms of the documents memorializing the relationship of the fund manager and Treasury in the PPIF itself. Regarding the Private Vehicle, fund managers can charge fees to its investors. Regarding the PPIF, Treasury expects to release terms of the PPIFs prior to any fundraising efforts of the fund managers; however, Treasury has stated that (1) the PPIFs will be managed by the fund managers, not Treasury; (2) Treasury will reserve the right to cease funding committed but undrawn equity from Treasury, or debt financing to be provided by Treasury; (3) fund managers will be required to present monthly reports to Treasury regarding legacy securities purchased, disposed, and profits/losses related to such legacy securities; (4) fund managers will not be permitted to purchase eligible assets from sellers that are affiliated with that fund manager or any other fund manager, or with any private investor in the PPIF that has committed at least 10% of the private capital raised by the fund manager; and (5) proceeds received by a PPIF will be divided between Treasury and the relevant Private Vehicle based on equity contributions, but Treasury will take warrants in the PPIF consistent with the requirements under TARP (the terms of which will depend on whether any financing has been obtained from Treasury).

As mentioned above, there is a second aspect of the Securities Program – the expansion of TALF to allow private investors to finance the purchase of legacy assets directly. TALF was created in November 2008, whereby non-recourse loans were offered to the holders of newly issued and eligible AAA-rated asset-backed securities (for a refresher on the specifics of TALF, please see the press release located here: <http://treas.gov/press/releases/hp1292.htm>). Under this aspect of the Securities Program, eligible assets will be included under the realm of TALF and therefore, non-recourse loans will be provided directly to private investors for the purchase of eligible assets. The precise terms of the expanded TALF have not yet been released and will be determined pursuant to discussions with market participants. However, several critical aspects of the program, such as eligibility criteria for borrowers, lending rate, minimum loan sizes, loan durations and collateral haircut requirements, remain to be determined.

For more information regarding the Securities Program, please see the Treasury press release located here: <http://www.treas.gov/press/releases/tg65.htm>.

## Firm News

### Duval & Stachenfeld Announces Establishment of Structured Finance Strategies Practice Group

Based on our belief that our clients will be able to avail themselves of significant opportunities relating to the enormous pool of legacy assets that are stuck on the balance sheets of the world’s financial institutions, we have formed a **Structured Finance Strategies Practice Group** in order to assist our clients in capitalizing on these opportunities. This Practice Group will, among other things, assist our clients with

“public-private” investments with the U.S. government; CMBS and RMBS acquisitions, dispositions and related restructurings; disputes among various tranches of the capital stack; and evaluation of the transaction structure, the underlying assets and the impact of agreements governing rights and remedies among borrowers and various stakeholders, as well as applicable regulatory schemes. Simultaneously, we are pleased to announce that **Christine Spletzer** (a highly respected veteran real estate securitization attorney from Cadwalader, Wickersham & Taft) has joined the Firm as a partner. Ms. Spletzer has nearly 20 years of experience in the area of mortgage-backed securities, asset-backed securities and other structured products including CDOs and grantor trust and owner trust structures, and has participated in numerous public and private transactions involving the issuance of securities in both debt and equity form. The Group will combine the Firm’s expertise in real estate, litigation and insolvency with Ms. Spletzer’s expertise in the real estate structured finance area. The Practice Group will be co-chaired by Ms. Spletzer and Bruce Stachenfeld.

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](#):

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