



## U.S. Treasury's Public-Private Investment Program for Loans

**March 23, 2009.** A significant amount of distressed loan assets may come to market through the U.S. Treasury's (Treasury) Public-Private Investment Program (PPIP), announced today. The PPIP is part of the current Administration's Financial Stability Plan. Here are some bullet points of what we know, so far, with regard to the PPIP:

- The PPIP has two components, one for Legacy Loans and one for Legacy Securities.
- Treasury will provide up to \$100 billion of capital to fund PPIP, which is expected to be allocated equally for the two programs. This memorandum will only focus on the Legacy Loans program.
- Treasury and FDIC will establish a series of funds with private investors known as a Public Private Investment Fund (PPIF) to purchase troubled and illiquid loans and other assets in substantially sized pools from insured banks and thrifts, under criteria established by FDIC. The program is designed to encourage participation by private investors. Materials provided by Treasury state that "UST [Treasury] and the FDIC will encourage participation by small, veteran-, minority- and women-owned firms."
- The FDIC will be responsible for overseeing the formation, funding, and operation of PPIFs and for overseeing and managing its debt guarantees to the PPIFs.
- ***Participation by selling institutions is voluntary.*** Interested financial institutions (FDIC insured only) will offer loans for sale, with the FDIC determining the ratio of debt to equity for each pool of loans, with no more than a 6 to 1 debt-to-equity ratio. The debt-to-equity ratio will be disclosed to PPIFs prior to the bid.
- Private investors will bid on portfolios through an auction process, and after the FDIC selects a winning bid, the selling financial institution can accept or reject the offer. The FDIC will set a deadline for the seller to accept or reject the winning bid. Proposed financing terms and leverage ratios for each PPIF will be established by the FDIC and disclosed to potential investors as part of the auction process (prior to bid submission)
- If the bid is accepted, then Treasury and the winning bidder will each provide 50% of the equity required for the purchase. The balance of the financing will be through FDIC guaranteed debt issued by the PPIF. That debt will initially be placed with the selling financial institution and credited to the purchase price. The loan pool is essentially sold by the seller for cash and debt guaranteed by the FDIC.

- More details for the Legacy Loan program will be developed over the coming weeks through the rulemaking process which is subject to a comments period. That process will include the development of transaction documentation and disclosure of other operational details.
- **Eligible Selling Institutions:**
  - Insured U.S. Banks or U.S. savings associations are eligible.
  - Interested eligible sellers must consult with their primary federal banking regulators to identify loans and assets for the Loans Program. Once loans are identified, the seller contacts the FDIC. The FDIC consults with Treasury, who will then make the determination of eligibility after consulting the seller's primary federal banking regulator.
  - Sellers will work with the FDIC and its valuation firm to complete due diligence and preparation of marketing materials. When a pool of assets is identified, the FDIC will obtain a valuation from an independent valuation firm to determine the level of leverage and value and adequacy of the bids. The leverage ratio for each pool of assets is expected not to exceed a 6-to-1 debt-to-equity ratio. Investors will be able to compare pools based on the debt-to-equity ratio assigned to each pool.
- **Eligible Investors:**
  - Potential private investors *must be pre-qualified by the FDIC* to participate in an eligible asset pool auction. Investors may include, without limitation, financial institutions, individuals, insurance companies, mutual funds and pension funds.
  - Although the actual legal structure of a PPIF is not known yet, the entity will need to permit multiple equity owners, the issuance of warrants and issuance of debt guaranteed by the FDIC. It is expected that the entity structure will look similar to other private equity investment entities used today for real estate and debt acquisition.
  - PPIFs will need to consider securities issues, including exemptions from state and federal reporting and registration requirements relating to bringing investors into the PPIF.
  - Joint bids will be permitted. However, once an auction has commenced investors may not form groups or share information with new entrants.
  - Private investors and the seller will negotiate servicing agreements with selling institutions, with assets sold either servicing released or retained.
  - PPIF's will also be subject to government oversight through a compliance program that will likely contain certain reporting requirements, risk management and business conduct standards. Residential loan pool buyers will need to consider more stringent regulations relating to the Financial Stability Plan's *Making Home Affordable Program*.

- Affiliated transactions will be prohibited. A PPIF cannot purchase an asset if a private investor representing 10% or more of the private equity capital for the PPIF is affiliated with the seller.
- **Eligible Assets:**
  - Commercial and residential real estate related assets including loans. Treasury documents reference loans and “other assets” but only limited information is available regarding eligibility. It is expected that more information will be forthcoming during the rulemaking process.
  - Loans and the collateral for those loans must be situated “predominantly in the United States.”
  - Potential sellers are encouraged to make comments during the rulemaking process to guide the FDIC in developing effective guidelines for identifying appropriate assets for inclusion.
- **Equity Investment & Debt Financing:**
  - A successful bidder will share equally the capital investment with Treasury. Investors can choose to take less Treasury equity subject to a minimum to be determined. There may be other arrangements forthcoming.
  - The Treasury will receive a warrant in the PPIF. The terms of the warrant are yet to be determined.
  - The FDIC will guarantee the debt issued by the PPIF to the financial institution, with the amount of debt based on the leverage ratio. The debt will be non-recourse to the PPIF and collateralized by the PPIF’s assets which will be only the loans and assets acquired through the Loans Program.
  - The FDIC is expected to publish an “FDIC Guaranteed Secured Debt for PPIF Term Sheet” with more details regarding debt terms. The FDIC will establish a rule proposal that will be subject to a comment period.
  - The FDIC guaranteed debt may be sold to third parties, with more specific rules forthcoming in the rulemaking process.
- **Fees, Deposits for Bidding & DCR:**
  - The PPIF will pay to the FDIC an administrative fee to cover the FDIC’s costs of managing the program, plus an annual fee for the guarantee of the debt.
  - A refundable cash deposit of 5% of the bid value will be required with each bid.
  - The PPIF will be required to maintain a minimum DCR with income and assets received by the PPIF subject to an escrow account capture if the coverage ratio falls below the minimum requirements.

**Sample Investment  
Under the Legacy Loans Program (Provided by Treasury)**

**Step 1:** If a bank has a pool of real estate mortgages with \$100 face value that it is seeking to divest, the bank would approach the FDIC.

**Step 2:** The FDIC would determine, according to the above process, the appropriate leverage (up to a 6-to-1 debt-to-equity ratio).

**Step 3:** The pool would then be auctioned by the FDIC, with several private sector bidders submitting bids. The highest bid from the private sector – in this example, \$84 – would be the winner and the bidder would form a Public-Private Investment Fund to purchase the pool of mortgages.

**Step 4:** Of this \$84 purchase price, the FDIC would provide guarantees for \$72 of financing, leaving \$12 of equity.

**Step 5:** The Treasury would then provide 50% of the equity funding required on a side-by-side basis with the investor. In this example, Treasury would invest \$6, with the private investor contributing \$6.

**Step 6:** The private investor would then manage the servicing of the assets and the timing of the disposition of assets on an ongoing basis – using asset managers approved by, and subject to oversight by, the FDIC.

More details on the PIPP can be found here <http://www.financialstability.gov/> including PDF white papers and term sheets.

*For more information or other real estate questions, contact:*

Patrick Valentino, CCG Real Estate Team  
**Corporate Counsel Group LLP**  
505 Montgomery Street, 11th floor  
San Francisco, California 94111  
Tel: 415.567.8025  
Fax: 415.520.9870  
patrick@corp counselgroup.com  
www.corpcounselgroup.com

*The information provided in this Alert is general in nature and therefore, i) should not be considered legal advice, and ii) may not be applicable to your situation. Do not act on this information without legal advice tailored to a particular set of facts and circumstances.*