BENJAMIN S. CROCKER SYMPOSIUM 2009

THE U.S. FINANCIAL REGULATORY SYSTEM OVERHAUL AND ITS IMPACT ON REAL ESTATE

Stuart Gabriel, University of California, Los Angeles (Moderator)
Michael Flynn, U.S. Department of Housing and Urban Development
Melissa Vanouse, Board of Governors of the Federal Reserve System
Lawrence Wolk, Holland & Knight LLP

May 5, 2009

BENJAMIN S. CROCKER SYMPOSIUM 2009

The Federal Response to the Real Estate Crisis

Presented by:
Michael C. Flynn,
U.S. Department of Housing and Urban Development

Housing and Economic Recovery Act of 2008 as amended

- **GSE Reform**
  - 1. New Federal Housing Finance Board (Treasury HUD, SEC, FHFA Director) with full regulatory oversight
- **Housing Tax Incentive**
  - For first time homebuyers, there is a refundable tax credit equivalent to an interest free loan – 10% of the purchase price up to $7,500.

Servicer duties on loan modifications

» 1. Deemed to act in the best interest of all investors and parties if the recovery for investors as a group on the loan modification is greater than the anticipated recovery through foreclosure.

» 2. New proposed legislation passed by House changes safe harbor test.

BENJAMIN S. CROCKER SYMPOSIUM 2009

Housing and Economic Recovery Act of 2008 as amended

- **FHA Modernization (single family)**

- **FHA $300 billion HOPE for Homeowners (H4H) refinance program for troubled loans**
  – 1. Voluntary program, but lenders/servicers under the Making Home Affordable program must try to use Hope For Homeowners if possible.
  – 2. Ginnie Mae authorized to guaranty MBS backed by new FHA-insured loans.
  – 3. Program has gotten almost no uptake.
    - TARP Reform and Accountability Act (H.B. 3915) would eliminate most of the requirements that seem to make program unattractive to lenders.

Housing and Economic Recovery Act of 2008 as amended

- **FHA $300 billion HOPE for Homeowners (H4H) refinance program for troubled loans (cont.)**
  - 5. Program has gotten almost no uptake.
    - TARP Reform and Accountability Act (H.B. 3915) would eliminate most of the requirements that seem to make program unattractive to lenders.
  - 6. *SAFE Mortgage Licensing Act*
    - Requires registration of Loan Officers and State-Licensed Loan Officers.
  - 7. *TILA Disclosures*

RESPA Rule Revisions

- **New Rule published in November 2008. All provisions to be mandatory on January 1, 2010.**
- **Key provisions:**
  - 1. Good Faith Estimate – new mandatory form
    - Requires loan term disclosures (interest rate, ARM adjustments, maximum monthly payment amount, etc.).
    - Requires detailed disclosure of settlement costs.
  - 2. New HUD-1 Closing Statement compares terms on GFE with actual final terms.

Federal Reserve Board: Changes to rules regarding Truth in Lending Act

- **Revised Reg Z**
  - **1. All loans secured by a principal residence:**
    - A. Would include home improvement loans and refi's of existing loans.
    - B. Before TILA disclosures, can only charge for credit report.

    2. Higher priced mortgage loans – Fed will create an index of "average prime offer rate."
- **Other TILA Disclosures in 30 months**
  - 1. Must disclose that "Payments vary based on rate changes".
  - 3. Must give examples with the maximum payment amount and maximum interest rate.
  - 4. Possible combining with RESPA Good Faith Estimate disclosures?
- **TILA and Bankruptcy Cram Down**

Government Conservatorship of Freddie Mac and Fannie Mae

- Create new class of preferred shareholders – requiring firms to refund government money before that of other shareholders in event of bankruptcy.

- New Roles for Freddie and Fannie in supervising the Making Home Affordable mortgage modification program.

Financial Stability Plan

- **Several major programs:**
  - 1. Making Home Affordable – private lender/servicer mortgage modification program.
  - 2. Freddie Mac/Fannie Mae refi programs
  - 3. Stress tests for major financial institutions (whether receiving federal funds or not).
  - 4. The Treasury, the Fed, FDIC and private capital will create a Public-Private Investment Trust.targeted at currently existing troubled loans and related assets.
  - 5. Expand TALF.
  - 6. Expand SBA lending – increase the federally-guaranteed portion of SBA loans.

Financial Stability Plan

- **Making Home Affordable (modifications of both private lenders and Freddie/Fannie loans):**
  - 1. Expected to cover 3-4 million mortgages.
  - 2. Mandatory for lenders/servicers taking TARP II money.
  - 3. Freddie and Fannie (under oversight of Treasury and FHFA) will establish loan level data collection protocols and monitor servicers' compliance.
- **Refi's of Freddie Mac and Fannie Mae loans**
  - 1. Expected to cover 4-5 million mortgages.
  - 2. Covers mortgage backed securities and whole loans in Freddie and Fannie portfolios.
- **TARP (Troubled Asset Relief Program created by the Emergency Economic Stabilization Act of 2008)**

Financial Stability Plan

- **TALF (Term Asset-Backed Securities Loan Facility created by Federal Reserve)**
  - 1. Federal Reserve credit facility designed to facilitate the issuance of asset backed securities to promote credit markets for consumers and small businesses.
    - A. ABSs were to include student loans, auto loans, credit card debt and loans guaranteed by the SBA.
  - Announced on May 1 that TARP will definitely include Commercial Mortgage Backed Securities.

BENJAMIN S. CROCKER SYMPOSIUM 2009

Financial Stability Plan

- **Yet Other Programs. Examples:**
  - *Federal Reserve purchases of Freddie Mac, Fannie Mae and Ginnie Mae debt and mortgage backed securities* – up to $600 billion.
  - *Money Market Investor Funding Facility* (MMIFF), Federal Reserve.
  - *Commercial Paper Funding Facility* (CPFF), Federal Reserve.
  - *Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility* (AMLF), Federal Reserve.
  - *Term Securities Lending Facility* (TSLF), Federal Reserve.
  - *Transaction Account Guaranty Program* – FDIC insures non-interest bearing transaction deposit accounts.

Proposed TARP Reform and Accountability Act (H.R. 384)

- A. Expands mortgage relief programs
- B. “Fixes” HOPE for Homeowners program (see also HR 1106).
- C. Would allow Treasury to have a member on the Board of Directors of TARP recipients.
- D. For TARP recipients, increased public reporting requirements, increased supervision, agreements with Treasury on how TARP funds will be used.

Proposed Anti-Predatory Lending Law (H.R. 1728)

- **A. “Duty of Care”**
  - 1. Borrower to be presented a range of “appropriate” options.
  - 2. If a refi, must be a “net tangible benefit” to the borrower.
  - 3. Must disclose conflicts of interest.
  - 4. Disclose a comparison of offered options.
  - 5. Presumption for a qualified 30 year mortgage.

- **B. Penalty**
  - 1. 3 times compensation or gain received.
  - 2. Rescission remedy.

Public-Private Investment Program (PPIP)

Presented by:
Lawrence Wolk,
Partner
Holland & Knight
Former Assistant General Counsel
Resolution Trust Corporation/Federal Deposit Insurance Corporation

Public-Private Investment Program Overview

- What is PPIP?
  - A 500 billion to $1 trillion plan to purchase Legacy Assets
- Which government agencies are involved?
  - The U.S. Treasury Department (Treasury) in conjunction with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve
- How will PPIP be funded?
  - Equity: $75 billion to $100 billion in Troubled Assets Relief Program (TARP) capital
  - Debt: Purchase money financing for acquisition of assets by PPIF is guaranteed by FDIC (Legacy Loans Program) and provided by Treasury (Legacy Securities Program)
- What are Legacy Assets?
  - 1. *Legacy Loans:* real estate loans and other assets held on the books of banks
  - 2. *Legacy Securities:* commercial mortgage-backed securities and residential mortgage-backed securities issued prior to 2009, originally rated AAA, or equivalent

PPIP Overview

- Why is PPIP needed?
  - Banks hold Legacy Assets which creates uncertainty around their balance sheets, compromising their ability to raise capital and to increase lending activities.
- What are PPIP's primary objectives?
  - Draw private capital into the Legacy Assets market by providing government equity co-investment and attractive public financing or guarantees of financing
  - Facilitate higher market pricing of Legacy Assets
  - Encourage financial institutions to engage in increased lending activities
  - Enhance the ability of financial institutions to raise new capital from private investors

PPIP Overview

- Leveraging the Impact of the Government Funds
  - Government (guaranteed) financing and co-investment of equity by Treasury and private investors will leverage government resources and incentivize private investment.
- Sharing of Both Risk and Profits With Private Investors
  - PPIP enables private investors to invest along with the government. Private investors' loss is capped at their equity investment but they will share in profits along with the government.
- Private Sector Sets Pricing
  - Private investors will bid against one another in auctions to establish the price of the asset pools and securities.

Legacy Loans Program
The Goal

- Assist banks in ridding balance sheets of Legacy Loans by attracting private capital to purchase eligible Legacy Loans and other assets from participating banks through the provision of FDIC debt guarantees and Treasury equity co-investment.

Legacy Loans Program
Funding the Acquisition of Assets

- **Equity:** Treasury capital and private investor capital will be invested proportionately at the same time in each PPIF
  - Treasury initially intends to provide 50% of equity capital for each PPIF
  - Treasury and private investors will share profits and losses in proportion to equity invested
  - Private investors may not participate in any PPIF that purchases assets from sellers that are affiliates of such private investors or that represent 10% or more of the aggregate private investor capital in the PPIF
- **Debt:** Each PPIF will issue debt financing payable to the Participant Bank guaranteed by FDIC

Legacy Loans Program
Passive Private Investors

- The Administration is encouraging the inclusion of the following groups as private investors:
  - Small, veteran-, minority-, and women-owned firms
  - Mutual funds, pension plans, insurance companies, and other long term investors
  - Individual investors
- Private investors must be pre-qualified by FDIC
- Joint bids from private investor groups are acceptable
- Government materials indicated that executive compensation restrictions will NOT apply to passive private investors

Legacy Loans Program
Participant Banks/Eligible Assets

- Participant Banks may include any insured U.S. bank or U.S. savings association
- Participant Banks must demonstrate to Treasury and FDIC that the proposed asset pools meet certain minimum requirements to be established by Treasury and FDIC
- Asset managers, subject to FDIC oversight and prequalification, will retain control of servicing
- Assets comprising each Eligible Asset Pool (Eligible Assets) and any collateral supporting those assets must be situated predominantly in the U.S.

Legacy Loans Program
FDIC Oversight and Implementation

- A third party valuation firm selected by FDIC will analyze each Eligible Asset Pool and advise FDIC on, among other matters, the supportable leverage of the Eligible Asset Pool, bid structure and asset valuation
- The FDIC-guaranteed debt-to-equity ratio will in no event exceed 6-to-1
- FDIC has completed the notice and comment period and is working to finalize details of the program and to establish a start date

Legacy Loans Program Auctions

- FDIC will conduct the Eligible Asset Pool auction
- Prior to bid submission, FDIC will disclose the proposed financing terms and leverage ratio that it has established for each Eligible Asset Pool
- Pre-qualified private investors will bid for the opportunity to contribute 50% of the equity for the PPIF (the PPIF's Private Capital Component), with Treasury contributing the remainder of the equity for the PPIF
- Each bid must be accompanied by a refundable cash deposit (Deposit) for 5% of the bid value

Legacy Loans Program
FDIC Guarantee of Financing

- FDIC will determine terms of the financing to be guaranteed by FDIC
- Financing will be non-recourse
- FDIC debt guarantee will be secured by the Eligible Assets
- Debt will initially be placed at the Participant Bank, which will have the right to resell the debt

Legacy Loans Program
Agencies Share Responsibility

- Treasury will oversee and manage its equity investment in each PPIF
- FDIC will:
  - Oversee and manage its debt guarantees
  - Oversee the formation, funding, and operation of each PPIF
    - Approve Eligible Asset Pools from Participant Banks
    - Determine Eligible Asset Pool leverage levels
    - Conduct Auctions

Legacy Securities Program
The Goal

- Stimulate the currently dormant market for Legacy Securities, allowing banks and other financial institutions to free up capital and encourage the extension of new credit.

Legacy Securities Program
Expanding TALF for Legacy Securities

- **Intention:** To expand the Term Asset-Backed Securities Loan Facility (TALF) program to include Legacy Securities
- **Funding Purchase of Legacy Securities:** Non-recourse loans will be made available by Treasury to investors to fund purchases of legacy securitization assets
- **Legacy Securities are Not "Toxic" Assets:** They include mortgage-backed securities that were originally rated AAA or its equivalent

Legacy Securities Program
Treasury Co-Investment

- **Legacy Securities PPIFs**
  - Treasury will make co-investment in order to partner with private investors and support the market for Legacy Securities
- **Qualified Fund Managers:**
  - Private asset managers will apply to be pre-qualified to raise private capital to invest in Legacy Securities PPIFs with Treasury
  - Treasury originally expected to approve 5 Qualified Fund Managers with a proven track record – that number is expected to increase

Legacy Securities Program
Criteria for Fund Mgr. Pre-Qualification

- Capacity to raise at least $500 million of private capital
- Experience in investing in targeted Legacy Securities
- A minimum of $10 billion of targeted Legacy Securities under management
- Required operational capacity
- Headquarters located in the United States
- **The above threshold criteria will likely be reduced**