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NEWSLETTER OF THE BANKING AND SPECIALTY FINANCE PRACTICE GROUP OF MANATT, PHELPS & PHILLIPS, LLP

Manatt Closes One Of The First Loan Portfolio Sales In The Current Market: Lessons Learned On How To Manage A Transaction In Today's Environment

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It seems nowadays that every morning when you pick up the newspaper, there are more and more stories about financial institutions failing, or at least reporting billion-dollar losses. As a result, federal regulators, shareholders and investors alike are taking an ever increasing interest in the balance sheets of financial institutions. And these institutions are looking for ways to reduce their credit exposure in order to satisfy their regulators and shareholders. While the federal government's initiative to purchase certain mortgage and mortgage-related assets from financial institutions undoubtedly will impact the market for distressed assets, we continue to view private portfolio sales as a viable and important alternative for a bank trying to adjust its exposure to mortgage-related credit risk. One regional banking institution (the "Bank") was recently able to accomplish just that and serves as an example to other financial institutions of how to take aggressive action in cleaning up one's balance sheet. With the assistance of Manatt, Phelps & Phillips, LLP ("MPP") and Le Plastrier Development Consulting, Inc., the Bank sold a residential development loan portfolio comprised of multiple acquisition and construction loans, as well as real estate owned (REO) property. This was one of the first successfully completed sales of what is expected to be many portfolio dispositions for the financial industry in this volatile market.

While the considerable expertise of our lawyers in portfolio sales proved to be very helpful, in the course of advising the Bank in connection with this transaction, we also learned

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many valuable lessons about how to successfully navigate the current market, as follows:

- **Adding Credibility**. The current market is a lot more volatile than that of the 1990s, the most recent significant similar industry experience. There presently seems to be an underlying sense of "distrust" in lenders, perhaps due to the subprime mortgage disaster. This distrust unfortunately has spread beyond the residential mortgage lenders to financial institutions and banks generally. The first step was to select a team of highly credible consultants who know the current market to work with the seller.

- **Assembling the Right Team**. Assembling the right team is vitally important to ensuring successful completion of the transaction. Most sellers do not have a great deal of experience with all aspects of a portfolio sale and will look to their team of consultants to lead them through the process. That team needs to have experience in evaluating assets, preparing files, marketing portfolios and successfully closing a transaction in today's marketplace.

- **Composition of Portfolio**. The next step was to put together a portfolio with a good mix of collateral quality, borrower and geographic markets in order to attract prospective bidders. In addition, there was a lot of discussion regarding the optimal size of a portfolio that would allow the Bank to achieve its goals of improving its balance sheet and, of course, that would be most likely to yield a good price.

- **Full Disclosure**. Another key to the success of this sale was assembling and providing well-organized and thorough files and disclosures for review by prospective bidders. This makes it easier for prospective bidders to evaluate the portfolio and actually submit a bid. It also allows prospective bidders to accurately assess the risk (and thereby, the price) of the portfolio. The process of preparing the files and disclosures requires the Bank (and its team) to do its own due diligence on the files and on the collateral to anticipate and resolve concerns of prospective bidders before they arise. Based on information received regarding other unsuccessful portfolio sales offered by non-MPP clients, it seems clear that the lack of full, accurate and consistent disclosures with respect to the loans and the underlying collateral was a critical factor in the failure to close at optimal pricing.

- **Selection of Bidders**. The selection of prospective bidders has become a critical path item given today's challenging combination of economic, real estate, credit market and regulatory pressures. This is not a market

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in which the bidding can be opened up to just anybody. Bidders must not only be sophisticated enough to assess and understand the deal, but also must have the funds to close the sale within a very compressed time frame.

- **Flexibility in Reviewing Bids**. Unlike the 1990s, this is, without a doubt, a buyer's market and will remain so as more and more financial institutions realize that portfolio sales may be the only way for them to restructure their balance sheets. Banks need to understand that bidders are aware of their relative leverage in the marketplace and that sellers may not be able to dictate the rules of the offering. For instance, bidders are likely to submit offers only on the assets they want even if the seller's bid instructions require prospective purchasers to bid on all of the assets in the portfolio. It is important to manage the expectations of the seller, as the bid evaluation process is no longer just a review of the bottom-line purchase price, but often requires asset-by-asset comparisons in order to get the best outcome for the seller.

- **Negotiating the Sale Contract**. New rules are emerging in today's market as best exemplified in the negotiation of the sale contract governing the transaction. Provisions that were standard in the deals of the 1990s are now negotiated and buyers are looking to avoid committing to a deal, either financially or contractually, until they are comfortable that they are going to close the deal.

- **Post-Closing Risk**. Unlike in the past when a seller could walk away from the sale with little or no post-closing risk or liability, in this market, a seller is generally not so lucky. Buyers expect sellers to take on a part of their risk and at times even expect a seller to be willing to take back loans months or years after the sale has occurred. Sellers need to be aware of this and should assess, prior to negotiating the sale contract, what post-closing risk they are willing to accept and for how long.

The Bank's aggressive actions to reduce its credit exposure were on the cutting edge of the financial industry and its sale was one of the first of what is expected to be many portfolio dispositions for the industry in this market. And with our role in the sale, Manatt, Phelps & Phillips has gained valuable and relatively rare practical market knowledge about how such deals are priced and managed in today's environment and how to bring such deals to a successful conclusion.

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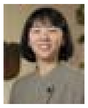

Adria I. Cheng Ms. Cheng's practice focuses on real estate and complex financial transactions. She has represented major banks, insurance companies and other financial institutions in all aspects of asset-based and mortgage financings, mezzanine financings, participation loans, bond financings and capital market transactions, including extensive experience in the origination of commercial mortgage loans throughout the United States for institutional lenders (both for their own account and for sale into the capital markets), secured by all real estate product types.

Steve Edwards Mr. Edwards is Of Counsel in the Orange County office. He has a broad background in real estate and real estate law, including in-house experience in the real estate industry. Mr. Edwards has been active in virtually all aspects of the acquisition, sale, exchange, financing, ground leasing, leasing, and development of improved and unimproved real estate for both individual and institutional clients. His practice has emphasized the representation of both developers and capital providers in the formation of joint ventures, limited partnerships, and limited liability companies for the acquisition and development of housing and commercial properties. Mr. Edwards has also been active in representing lenders in providing financing to residential developers.

Clayton B. Gantz Mr. Gantz is the Co-Administrative Partner in the San Francisco office. His diversified practice emphasizes financial and real estate transactions, including corporate and commercial lending, asset-based finance, mortgage finance, joint venture finance, affordable housing development and financing (including tax-exempt bond transactions and transactions involving the low-income housing tax credit), mezzanine and other highly leveraged financings, public finance, loan restructurings and capital markets transactions (including commercial mortgage loan securitizations and mortgage loan portfolio purchases and sales), real estate development, community redevelopment and public-private partnerships.

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