PCI MEMO

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To: John Ervin

From: Michael G. Nathans *215-860-9953*

Date: June 21, 1996

Dear John:

At your request of yesterday afternoon, this memo summarizes PCI's contact with BlackRock and Goldman in connection with HUD's note sale opportunities, as well as other relevant information heard on the street.

In advance of HUD's SE MF note sale, PCI solicited due diligence, advisory, and loan work out servicing for EAA from Goldman's Whitehall Fund. My initial contacts at Goldman, Teresa Clarke Booker and Kelly Wachowicz were not involved with the Whitehall Fund, and my contacts for this initiative were made with Stuart Rothenberg and Kevin Naughton. They were not interested.

I contacted GECC on behalf of Cargill after the SE note sale, to try to purchase the loans that Cargill bid on from GECC. I do not know if Goldman and GECC had made an agreement in advance of the bid date for the winner to sell some loans to the other. However, even though Cargill made a prompt offer to buy a number of the loans from GECC, Demitri Stockton at GECC told me that they were negotiating with another party to sell a number of the loans, and it appeared as if GECC did sell a number of the loans they purchased from HUD to Goldman even before Cargill had a chance to make their offer.

On 10/6/95, I called Kevin Naughton to talk about EAA's SF PFSP in connection with HUD's SFLS #1. Kevin referred me to Steve Feldman who referred me to Bob Criste, who in turn referred me to Pete Briger. I was told that Pete was in charge of bidding on HUD SF notes for Goldman. I called Pete, but got his voice mail and left a message. He did not return my call.

I was told later that day by Jeff Toll at Citicorp that Goldman was involved in a bidding consortium for HUD's SFLS #1 with a team comprised of Ocwen/Berkley, Cargill/Fairbanks, and Security National.

On 10/16/95, I called BlackRock to talk about bidding on HUD multifamily notes, and was connected with Chris Haspel. We talked about EAA's background and capabilities. Chris said he would pass the information along within his group.

Later that day, I was introduced to Wes Edens, COO of BlackRock Capital Finance, LLP by Stacey Berger of Midland Loan Services. Stacey had been

soliciting BlackRock for loan servicing and he initiated this introduction by telephone conference call, for the purpose of discussing the possibility of Midland and EAA teaming to provide loan servicing and special servicing of HUD assets purchased by BlackRock

Wes indicated that BlackRock was bidding on HUD SFLS #1 and I informed him of EAA's interest in providing due diligence and PFSP. Wes indicated that he was very concerned about conflicts, antitrust, and collusion, and that he was very hesitant to talk to EAA prior to the bid date. However, he mentioned that BlackRock was looking for servicers, and requested that I send information about EAA, and indicated he might consider EAA's services if they won.

On 10/25/95, John and Lucy called to discuss HUD's possible sale of MF notes to State HFAs, and indicated BlackRock was a possible player, and that PCI should contact BlackRock to see if they might want to work with EAA.

On 10/31/95 I called Wes Edens to discuss EAA and State HFAs. Wes indicated that they had bid on SFLS #1 with Goldman, and that although they were awaiting notification, they were highly confident about winning. Wes said they were very interested in HUD's loan sales to State HFAs, and that BlackRock was working with Goldman on these opportunities. Wes said that he wanted EAA and PCI to meet with him and Goldman, at Goldman's offices in NY within the next 10 days. He requested that we give him three possible dates to choose from. I did, and a meeting was scheduled for 11/7 at 2 PM in Goldman's offices.

In the interim, I spoke with Terry DeWitt at J-Hawk who told me that Jeff Parker at Cargill told him that after Hamilton received the SFLS #1 bids, Hamilton called the Goldman bidding group to encourage them to raise their offer by $0.02 to $0.74, but did not tell Goldman why, only that if they raised their offer, they would be the winner. Terry said they refused, and that Cargill dropped out of the Goldman bidding group (see comments later).

On 10/31, I learned from Henry Fan at Hamilton, that 10,000 SF loans were sold, and the balance were being re-offered on 11/6, which provided only seven days for bidders to evaluate the left over loans, and re-bid, making it very difficult to submit a new bid.

On 11/2 I learned from Russ Appell at CS First Boston that the Goldman/Cargill SFLS #1 bidding team spent $750k in due diligence, and $250k in legal fees to form their bidding partnership.

On 11/7 EAA, PCI, BlackRock, and Goldman met in Goldman's NY offices to discuss HUD MF loan sales to State HFAs. At that meeting, John Ervin, Lucy Du, and I were introduced to the Goldman group consisting of Pete Briger, Michael Offit, and Alan Sherman, and the BlackRock group consisting of Wes Edens, Randal Nardone, and Mark Begeny.

At that meeting we were told that when it came to HUD, we should consider the Goldman and BlackRock groups as the same entity because they work on everything regarding HUD together.

John and Lucy explained EAA's background with HUD and experience with servicing HUD MF loans, the HUD note sale opportunities, and how EAA would like to assist Goldman and BlackRock deal with the borrowers and the real estate issues associated with the loans they might purchase from HUD through State HFAs or otherwise.

Wes asked how much equity EAA would contribute to such a relationship, and we were told Goldman had other partners like JE Robert that could put up $20 million in equity per deal. John laid out EAA's financial position and indicated a willingness to put up a significant percentage of his company's net worth (approx. $1 million) to demonstrate significant risk on a relative basis, but indicated EAA's value was not in the money it could bring to such a transaction, but rather the knowledge and experience with effectively managing the real estate issues associated with this class of HUD asset (affordable housing), as well as the borrowers and property managers who own and manage it. John indicated his desire to be compensated on a basis that covered overhead as a base, but profit through performance wherein the real estate would be properly maintained and the property managers would be properly supervised.

Our meeting was interrupted by a call from Hamilton notifying Goldman and BlackRock that they had been awarded the HUD SF loans that they bid on the re-offer. Both groups were jubilant. It was hard to get their attention back on our meeting.

When our meeting resumed, we were told that they were meeting with the PA State HFA people in Harrisburg that Thursday, and that they would promote the idea of teaming with EAA with the PA State HFA people. Edens and Briger commented that before they would do a large deal with EAA, especially if EAA was not contributing a large amount of capital, a smaller getting to know you deal like the State HFAs would be a good way to understand EAA's capabilities and compatibility with BlackRock/Goldman.

John talked about re-structuring loans purchased through State HFAs with good owners and borrowers. Wes and Pete indicated an interest in grabbing the real estate. John mentioned that the borrower's resistance wouldn't be worth the aggravation, time, and cost, especially if HUD contributes to borrower defaults by not renewing Section 8 contracts or by reducing subsidies. John emphasized the primary importance of preserving affordable housing for the tenants living in these projects, avoiding tenant displacement, and that EAA's objective as an asset manager is not to fight with the borrowers unless they are bad owners and managers, are in violation of the regulatory agreement, and should be foreclosed on because they are hurting the real estate, the tenants living there, and the lender.

My follow up call to Wes Edens on 11/13/95 went unreturned. I learned about a week later from John and Lucy that in fact, the BlackRock/Goldman Group "submarined" EAA with the PA State HFA. Apparently, rather than promote EAA's involvement, BlackRock/Goldman told the PA State HFA that all EAA was interested in was "collecting fat fees", and that EAA brings no value to the process.

On 1/9/96, Harvey Lederman at Fitch told me that BlackRock was the advisor to Hamilton and HUD on the Partially Assisted N-Series offering with respect to structuring and placing the bonds.

The capital structure of the Partially Assisted N-Series sale was made particularly complex by HUD's financial advisors that included BlackRock- considering the objective of the sale, coupled with most rated special servicer's general lack of understanding and uncertainty about renewal of project-based Section 8 assistance contracts on these assets. The fact that the servicers eligible to participate (requiring ratings from two agencies- on short notice) limited the competition to only 10 in the entire country- most without HUD experience.

As I understood the overall capital structure from BlackRock's presentation at HUD's Bidder's Conference in March, a Class A equity bidder would be heavily favored (competitive) if they were partnered with a bond (debt) bidder because of the bond bidder's ability to lower the rate on the debt after the equity bid was finalized. The possibility that the bond bidder could also <u>raise</u> the rate, thereby lowering the return on equity after the equity bidder was locked in, created such risk and uncertainty for the equity bidders, that only equity bidders teamed with bond bidders like Goldman/Goldman's Whitehall/JE Robert equity fund could be competitive because these equity bidders would have advance knowledge of what their debt-bidder-partner would do on the rate (presumably lower it- or most likely restructure the debt altogether) before locking in their equity bid.

Because of BlackRock's stated relationship with Goldman, I was surprised that Goldman was allowed to bid on the Partially Assisted sale without a conflict of interest problem because their partner in the other HUD note sales, BlackRock, was serving as HUD's advisor in structuring this very complex offering. Of course I was not surprised that Goldman won both the bonds and the equity in the Partially Assisted sale.

On 2/5/96 Glen Minkoff at Bankers Trust told me that Cargill withdrew from the BlackRock/Goldman SFLS #1 bidding consortium after their first bid was thrown out because of an "ego clash" of the BlackRock/Goldman personalities with the Cargill people. Reportedly, the Cargill/Fairbanks people were so offended by being treated like midwest farmers by the New York Wall Streeters at BlackRock and Goldman, that they did not participate in the re-offering- even after all the due diligence and legal costs they expended to participate in the BlackRock/Goldman bidding consortium.

In this same conversation, Glen indicated that he still did not understand or "believe in" the optimization model, and asked me to fax him another copy of Hamilton's mathematical description Glen just couldn't accept and/or believe the fact that all or nothing bids are heavily favored by the bid award system because Henry Fan assured him that HUD was not set on selling all of the loans if they can maximize proceeds from a combination of bids, and because of the ads Hamilton placed in the WSJ encouraging lenders to finance smaller biders.

On 5/1/96 I spoke with from Marvin Markus from Paine Webber about teaming with EAA to assist State HFAs acquire and service HUD loans. Marvin told me that BlackRock/Goldman had the State HFAs tied up, but didn't think they would be successful buying anything because BlackRock was looking for 26% IRRs, and that was too much profit for HUD to tolerate as a seller of these loans.

On 5/3/96 I spoke with Deborah Kooney at Asset Strategies who told me that Hamilton's bidding award system on the SF notes heavily favors the "big boys" like "BlackRock/Goldman". Further, Deborah told me that Asset Strategies put HUD and Hamilton on notice that they disagreed about the fairness of the SF note sale program that Hamilton had come up with, and resigned from their contract Hamilton when HUD and Hamilton ignored their comments.

On 5/3/96 Jeff Parker indicated that the Cargill team lost the HUD SFLS #2 bid by only 17 basis points, and that Cargill was very frustrated with spending a lot of time and money on the HUD note sales, only to come up dry three times.

After all the HUD product that BlackRock has won and has to digest from a servicing standpoint, I was surprised by Solomon Brothers' Bob McGinnes' comments that BlackRock was boasting on the street that they expected to win the next two HUD SF loan sales as well.