DechertOnPoint

May 2009 / Issue 20

A legal update from Dechert's Finance and Real Estate Group

The Federal Reserve Bank of New York Expands TALF to Include Legacy CMBS

The Federal Reserve Bank of New York (the "New York Fed") expanded the Term Asset-Backed Securities Loan Facility (the "TALF") on May 19, 2009 to include qualifying legacy commercial mortgage-backed securities ("CMBS") issued before January 1, 2009. The first TALF subscription date for legacy CMBS will occur in late July 2009. The New York Fed has released the details discussed below and intends to announce more specific information about the procedures and requirements for legacy CMBS prior to the initial subscription date. In addition, as discussed below, on May 19, 2009, the New York Fed announced revisions to the TALF terms and conditions and frequently asked questions relating to newly issued CMBS.[1]

Qualifying Legacy CMBS

To be eligible for TALF, the legacy CMBS must meet the following criteria:

- **Issue Date:** The legacy CMBS must have been issued before January 1, 2009.
- **Issuer:** The legacy CMBS issuer must not be an agency or instrumentality of the United States or a government-sponsored enterprise ("GSE").
- **Ratings:** The eligible rating agencies for legacy CMBS are Standard & Poor's, DBRS, Inc., Fitch Ratings, Moody's Investors Service, and Realpoint LLC. As of the TALF loan closing date, the legacy CMBS must have a credit rating in the highest long-term investment-grade rating category from at least two TALF legacy CMBS-eligible rating agencies rating the issuance, must not have a credit rating below the highest investment-grade rating category from any TALF CMBS-eligible rating agency, and must not have been placed on a watch list for review or downgrade by any such rating agency. Further, the credit rating of the legacy CMBS must not be based on the benefit of a third-party guarantee.
- **Original Seniority:** Upon issuance, the legacy CMBS must not have been junior to other securities with claims on the same pool of loans. Legacy CMBS that receives principal later than the other most senior CMBS classes, but are otherwise pari passu with such other senior CMBS, will qualify because the exclusion of junior CMBS is a reference to subordination for credit support, not to a later position in the time tranche sequence. This means that subordinate AAA classes, such as "A-J" and "A-M" classes, will not be eligible. Time tranched senior classes will be eligible only if principal distributions switch to pro rata distributions once the credit support is reduced to zero based on realized losses.

[1] For a full description of the TALF for qualifying newly issued CMBS, *see* the May 2009 *DechertOnPoint* "The Federal Reserve Bank of New York Expands TALF to Include New Issuances of CMBS" located at www.dechert.com/library/Finance_and_Real_Estate_05-09_19_Federal_Reserve_Bank_on_NY.pdf.

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- **Legacy CMBS Payment Terms:**
  - The legacy CMBS must pay principal and interest (i.e., it cannot be an interest-only or principal-only class).
  - The legacy CMBS must bear interest at a pass-through rate that is fixed or based on the weighted average coupon of the underlying fixed mortgage rates.
  - The legacy CMBS must be U.S. dollar denominated, must not be synthetic, and must not be backed by other CMBS or other securities.
  - The legacy CMBS cannot be backed by interest rate swap or cap instruments, or other hedging instruments.
- **Settlement:** The legacy CMBS must be cleared through the Depository Trust Company.

Qualifying Mortgage Loans Underlying Legacy CMBS

In order for legacy CMBS to qualify for TALF financing, the underlying mortgage loans must also meet certain criteria:

- **General Parameters:** Each mortgage loan must be a fully funded commercial mortgage loan.
- **U.S. Collateral:** As of the TALF loan subscription date, at least 95% of the mortgaged properties, by related loan principal balance, must be located in the United States or one of its territories.
- **Fee or Leasehold:** The security for each mortgage loan must include (or, if payments due under the loan have been defeased, the security for the loan or its predecessor must have previously included) a mortgage or similar instrument on a fee or leasehold interest in one or more income-generating commercial properties.
- **Participation Interests/B-Notes:** A participation or other ownership interest in a loan will be considered a mortgage loan if, following a loan default, the ownership interest is senior or *pari passu* with all other interests in the same loan in right of payment of principal and interest. This means that loans can be split into *pari passu* notes or participations and senior/junior notes or participations, but junior notes or junior participations cannot be included in a CMBS pool backing legacy CMBS.
- **Risk Assessment/Exclusion of CMBS:** Any legacy CMBS may be rejected by the New York Fed based on its risk assessment. The New York Fed will engage a collateral monitor and pay particular attention to legacy CMBS mortgage pools with large historical losses, concentrations of loans that are delinquent, in special servicing or on servicer watch lists or concentrations of subordinate-priority mortgage loans, and legacy CMBS mortgage pools that are not diversified with respect to loan size, geography, property type, borrower sponsorship, and other characteristics. The New York Fed may also consider in its decision forecasts of pool level losses under various stress scenarios.

TALF Loan Terms for Legacy CMBS

Loans made by the New York Fed for legacy CMBS under the TALF must meet the following criteria:

- **Lender:** Federal Reserve Bank of New York.
- **Eligible Borrower:** As set forth in the general TALF terms and conditions, any U.S. company that owns eligible collateral may borrow from the TALF provided the company maintains an account relationship with a primary dealer. An entity is a U.S. company if it is (1) a business entity or institution that is organized under the laws of the United States or a political subdivision or territory thereof (U.S.-organized) and conducts significant operations or activities in the United States, including any U.S.-organized subsidiary of such an entity; (2) a U.S. branch or agency of a foreign bank (other than a foreign central bank) that maintains reserves with a Federal Reserve Bank; (3) a U.S. insured depository institution; or (4) an investment fund that is U.S.-organized and managed by an investment manager that has its principal place of business in the United States. An entity that satisfies any one of the requirements above is a U.S. company regardless of whether it is controlled by, or managed by, a company that is not U.S.-organized. Notwithstanding the foregoing, a U.S. company excludes any entity, other than those described in clauses (2) and (3) above, that is controlled by a foreign government or is managed by an investment manager, other than those described in clauses (2) and (3) above, that is controlled by a foreign government.

- **Initial Subscription Date:** The first TALF subscription date for legacy CMBS will occur in late July 2009. Subscriptions for CMBS and ABS TALF loans will take place in separately scheduled operations, with the subscription and settlement cycle for legacy CMBS occurring in the latter part of each month.

- **TALF Loan Term:** Eligible Borrowers may elect a three- or five-year term. The Federal Reserve Board indicated in a press release dated May 1, 2009 that up to $100 billion of TALF loans could have five-year maturities and that it will continue to evaluate this limit. The entire $100 billion, however, will not be available exclusively for CMBS.

- **TALF Loan Interest Rate:** A three-year TALF loan for legacy CMBS will bear interest at a fixed per annum rate equal to 100 basis points over the three-year LIBOR swap rate. A five-year TALF loan for legacy CMBS will bear interest at a fixed per annum rate equal to 100 basis points over the five-year LIBOR swap rate.

- **TALF Loan Amount:** The maximum size of a TALF loan secured by legacy CMBS, based on the terms and conditions released by the New York Fed, will be the dollar purchase price of the CMBS less a base dollar haircut. Legacy CMBS will not be eligible collateral for a TALF loan if its dollar purchase price is less than its base dollar haircut.

- **Base Dollar Haircut:** The base dollar haircut for legacy CMBS with an average life of five years or less will be 15% of par value. For CMBS with an average life beyond five years, base dollar haircuts will increase by one percentage point for each additional year of average life beyond five years.[2]

- **Principal Payments:** Any payment of principal on the legacy CMBS must be used immediately to reduce the principal amount of the TALF loan in proportion to the haircut (i.e., if the haircut is 15%, 85% of each principal payment must be remitted to the New York Fed to pay down the outstanding principal balance of the TALF loan).

- **Hyper-Amortization:** For the first three years of five-year TALF loans, the excess of the legacy CMBS interest distributions over the underlying TALF loan interest payable will be remitted to the TALF borrower only until such excess equals 25% per annum of the haircut amount in the first three loan years, 10% in the fourth loan year, and 5% in the fifth loan year, and the remainder of such excess will be applied to the TALF loan principal. For a three-year TALF loan for legacy CMBS, such excess will be remitted to the borrower in each loan year until it equals 30% per annum of the haircut amount, with the remainder applied to the TALF loan principal.

- **Voting, Consent, and Waiver Rights:** The TALF borrower must agree not to exercise or refrain from exercising any voting, consent, or waiver rights it has with respect to legacy CMBS without the consent of the New York Fed.

- **Limitation on Volume of TALF Loans:** The New York Fed may limit the volume of TALF loans secured by legacy CMBS and is considering whether to allocate such volume via an auction or other procedure.

- **Agents:** The New York Fed will utilize the services of one or more agents in connection with the review of legacy CMBS and the loan pools that back them.

- **Other Requirements:** The New York Fed is in the process of establishing other requirements that will apply to legacy CMBS, including the requirement that TALF loans for legacy CMBS be used to fund recent secondary market transactions between unaffiliated parties that are executed on an arm's length basis. The New York Fed is also considering a process for price validation of such secondary market transactions.

Updates and Changes to TALF for Newly Issued CMBS

On May 19, 2009, the New York Fed published revised terms and conditions and frequently asked questions with respect to TALF for newly issued CMBS. Updates and changes to the program include the following:

- The New York Fed named the following as eligible rating agencies for newly issued CMBS: Standard & Poor's, DBRS, Inc., Fitch Ratings, Moody's Investors Service, and Realpoint LLC.

- The New York Fed announced that the initial newly issued CMBS subscription date is June 16, 2009.

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2 The average life of the CMBS is calculated using the remainder of the original weighted average life determined by the related issuer. However, the New York Fed is considering requiring that the weighted average life be adjusted to take into account default-related circumstances.

- The New York Fed confirmed that a five-year TALF loan for newly issued CMBS will bear interest at a fixed rate per annum equal to 100 basis points over the five-year LIBOR swap rate.

- The New York Fed clarified that, as of the TALF loan closing date, the newly issued CMBS must have a credit rating in the highest long-term investment-grade rating category from at least two TALF CMBS-eligible rating agencies. The required number of TALF CMBS-eligible rating agencies was previously not specified.

- The New York Fed announced that it will require the sponsor of a newly issued CMBS to hire a nationally recognized certified public accounting firm that is registered with the Public Company Accounting Oversight Board to provide assurance indicating that a newly issued CMBS is TALF eligible. The form and level of assurance to be required are currently under review by the New York Fed.

- The New York Fed announced that 95% or more of the dollar amount of the credit exposures underlying the CMBS must be exposures that are originated by U.S.-organized entities or institutions or U.S. branches or agencies of foreign banks.

- The New York Fed stated that the weighted average life for newly issued CMBS is based on the assumption that each loan amortizes according to its amortization schedule, and prepays in full on the first date that prepayment is permitted without penalty.

- The New York Fed explained that it may reject a CMBS pool, or a specific loan in a newly issued CMBS pool, based on factors including, but not limited to, the following: (i) the newly issued CMBS or the individual loans do not meet the explicit requirements stated in the TALF terms and conditions; (ii) while pools containing loans from a single borrower or limited to a single asset class are not ineligible per se, they will be subject to a higher level of scrutiny and to the expectation that the increased concentration of the pool will be reflected in the higher creditworthiness of the pool collateral and/or in the level of credit support; (iii) if the collateral composition or the level of credit support do not satisfy the New York Fed, the pool will be rejected; (iv) newly issued CMBS that represent interests in pools that, alone or considered together with loan pools backing other TALF-financed newly issued CMBS, possess one or more concentrations (such as borrower sponsorship, property type, and geographic region) considered unacceptable to the New York Fed may be rejected; and (v) one or more of the loans in the pool is defaulted, delinquent in payment, or in special servicing. The New York Fed may accept the pool upon changes in the collateral composition or level of credit support. All of these details had not previously been announced.

- The New York Fed announced that it will utilize the services of one or more agents in connection with the review of newly issued CMBS and the loan pools that back them.

- The New York Fed provided details about the use of appraisals and stated that: (i) CMBS pooling and servicing agreements generally require that the special servicer obtain an appraisal within a specified period following the occurrence of a “servicing transfer event” (that is, an event that requires a problem loan to be placed in special servicing) with respect to the related loan; (ii) under some CMBS arrangements, other interested parties (for example, the holder of a subordinate note serviced under the pooling and servicing agreement, but not held by the CMBS trust fund) were permitted to obtain competing appraisals, and there existed arbitration-like mechanisms to determine the appraised value that would be used to calculate the appraisal reduction amount; and (iii) newly issued CMBS arrangements may not provide for such multi-appraisal arrangements.

Comparison of TALF-Eligible Legacy CMBS and TALF-Eligible Newly Issued CMBS

The table attached to the end of this update compares TALF-eligible legacy CMBS to TALF-eligible newly issued CMBS.

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A Comparison of TALF-Eligible Legacy CMBS and TALF-Eligible Newly Issued CMBS

Requirement	TALF-Eligible Legacy CMBS	TALF-Eligible Newly Issued CMBS
CMBS Issuance Date	Before January 1, 2009	On or after January 1, 2009
First Subscription Date	Late July 2009	June 16, 2009
CMBS Interest Rate	CMBS must bear interest at a pass-through rate that is fixed or based on the weighted average of the underlying fixed mortgage rates	Same
CMBS Issuer	A U.S. agency or instrumentality or a GSE, such as Fannie Mae or Freddie Mac, is not eligible	Same
Rating Agencies and Ratings for the CMBS	Standard & Poor's, DBRS, Inc., Fitch Ratings, Moody's Investors Service, and Realpoint LLC. As of the TALF loan closing date, the CMBS must have a credit rating in the highest long-term investment-grade rating category from at least two TALF CMBS-eligible rating agencies rating the issuance, must not have a credit rating below the highest investment-grade rating category from any TALF CMBS-eligible rating agency, and must not have been placed on a watch list for review or downgrade by any such rating agency. Further, the credit rating of the CMBS must not be based on the benefit of a third-party guarantee.	Same
CMBS Settlement	Depository Trust Company only	Same

Requirement	TALF-Eligible Legacy CMBS	TALF-Eligible Newly Issued CMBS
CMBS Seniority	Upon issuance, the CMBS must not have been junior to other securities with claims on the same pool of loans	Same
Time-Tranched Senior AAA CMBS Classes	Eligible only if principal distributions switch to *pro rata* distributions once the credit support is reduced to zero based on realized losses	Eligible only if principal distributions switch to *pro rata* distributions once the credit support is reduced to zero based on both realized losses and imputed losses through appraisal reduction amounts
CMBS Average Life	Legacy CMBS with an average life greater than 10 years qualify for the TALF program; the New York Fed is considering requiring that default-related circumstances be considered in calculating the weighted average life of a legacy CMBS but has not announced details.	Newly issued CMBS with an average life greater than 10 years do not qualify for the TALF program; the weighted average life for newly issued CMBS is based on the assumption that each loan amortizes according to its amortization schedule, and prepays in full on the first date that prepayment is permitted without penalty
PSA Requirement for Post-Securitization Property Appraisals	No specific TALF requirement	Post-securitization property appraisals may not be recognized for any purpose if the appraisal was obtained at the demand or request of any person other than the servicer for the related mortgage loan or the trustee
PSA Requirement for Loss of Control Based on Appraisal Reduction Amounts	No specific TALF requirement	Loss of control must be based on both actual realized losses and appraisal reduction amounts; if actual realized losses and appraisal reduction amounts allocated to a class exceed 75% of the initial principal amount of such class, control shifts
Seller's Representations and Warranties	No specific TALF requirement	Market driven; expected to include long list, but must represent that the improvements at the mortgaged properties are in compliance with the law
PSA Requirement for Financial Reporting	No specific TALF requirement	Market driven and must also satisfy New York Fed

Requirement	TALF-Eligible Legacy CMBS	TALF-Eligible Newly Issued CMBS
Mortgage Loan Funding Status	Loans must be fully funded	Same
Priority of Underlying Mortgages	No specific TALF requirement, but legacy CMBS backed by pools with high concentrations of subordinate priority loans may be rejected by the New York Fed	First priority
Mortgage Loan Splitting	Permitted, however, junior notes and junior participations are not permitted to be included in the CMBS trust	Same
Mortgage Loan Origination Date	No specific TALF requirement. However, CMBS must be issued before January 1, 2009	On or after July 1, 2008
Mortgage Loan Amortization	No requirement	Amortizing only
Mortgage Loan Originator	The general TALF guidelines state that all or substantially all of the credit exposures underlying eligible ABS must be exposures that are originated by U.S.-organized entities or institutions or U.S. branches or agencies of foreign banks. However, this is not specifically addressed in the legacy CMBS TALF guidelines	95% or more of the dollar amount of the credit exposures underlying the CMBS must be exposures that are originated by U.S.-organized entities or institutions or U.S. branches or agencies of foreign banks
Location of Underlying Real Estate	As of the TALF loan subscription date, at least 95% of the mortgaged properties, by related loan principal balance, must be located in the United States or one of its territories	Each mortgaged property must be located in the United States or one of its territories
Mortgage Loan Underwriting Method	No specific TALF requirement	Recently underwritten generally on basis of then-current in-place, stabilized and recurring net operating income and then-current property appraisals
Mortgage Loan Level Financial Reporting	No specific TALF requirement	Market driven and must be acceptable to New York Fed

Requirement	TALF-Eligible Legacy CMBS	TALF-Eligible Newly Issued CMBS
Right to Kick Out Mortgage Loans from Pool	Not applicable	Available to B-piece buyer and New York Fed
TALF Loan Interest Rate	A three-year TALF loan for CMBS will bear interest at a fixed per annum rate equal to 100 basis points over the three-year LIBOR swap rate. A five-year TALF loan for CMBS will bear interest at a fixed per annum rate equal to 100 basis points over the five-year LIBOR swap rate	Same
TALF Loan Amount	The dollar purchase price of the legacy CMBS less the base dollar haircut (from par)	The lesser of the par or market value of the newly issued CMBS minus a haircut. If market value is above par, the New York Fed will lend an amount equal to the market value—subject to a cap of 110% of par value—minus a haircut
TALF Loan Haircut	The base dollar haircut for legacy CMBS with an average life of five years or less will be 15% of par value; for legacy CMBS with average lives beyond five years, base dollar haircuts will increase by one percentage point of par for each additional year of average life beyond five years	The collateral haircut for newly issued CMBS with an average life of five years or less will be 15%; for newly issued CMBS with average lives beyond five years, collateral haircuts will increase by one percentage point for each additional year of average life beyond five years
TALF Loan Hyper-Amortization	For the first three years of five-year TALF loans, the excess of legacy CMBS interest distributions over the underlying TALF loan interest payable will be remitted to the TALF borrower only until such excess equals 25% per annum of the haircut amount in the first three loan years, 10% in the fourth loan year, and 5% in the fifth loan year; for a three-year TALF loan, such excess will be remitted to the borrower in each loan year until it equals 30% per annum of the haircut amount, with the remainder applied to loan principal	For the first three years of five-year TALF loans, the excess of newly issued CMBS interest distributions over the underlying TALF loan interest payable will be remitted to the TALF borrower only until such excess equals 25% per annum of the haircut amount in the first three loan years, 10% in the fourth loan year, and 5% in the fifth loan year

Requirement	TALF-Eligible Legacy CMBS	TALF-Eligible Newly Issued CMBS
Auction Procedure to Limit Volume of TALF Loans	The New York Fed may limit the volume of TALF loans secured by legacy CMBS and is considering whether to allocate such volume via an auction or other procedure	No auction procedure specified
TALF Loan Reservation	Not specified	The New York Fed is considering a process to permit issuers, through a process to be determined, to reserve prospective funding of TALF loans secured by newly issued CMBS; the New York Fed expects that each potential issuer to which such a reservation is awarded will pay a monthly reservation fee, assessed as a fraction of the amount reserved, while the reservation is outstanding; no reservation will extend beyond the last TALF loan subscription date for newly issued CMBS