May 4, 2009

# CLIENT ALERT

## FEDERAL RESERVE EXTENDS MATURITY OF CERTAIN TALF LOANS

On May 1, 2009, in response to recommendations from the commercial mortgage-backed securities (CMBS) sector, the Federal Reserve Bank (FRB) announced that, starting in June, five-year loans will be available under the Term Asset-Backed Securities Loan Facility (TALF) for the purchase of CMBS and insurance premium finance loans. The FRB currently intends to make up to $100 billion available for TALF loans with five-year terms. It will continue to evaluate that limit, however.

### CMBS QUALIFICATIONS

To be eligible for TALF financing, a CMBS must be issued on or after January 1, 2009, and must evidence an interest in a trust fund consisting of fully funded, first-lien priority, fixed interest rate mortgage loans (or participations therein). Underlying mortgage loans must—

- have been current in payment at the time of securitization
- require payment of interest and principal
- be secured by income-producing commercial properties located in the United States or one of its territories; and
- have been originated on or after July 1, 2008, and underwritten or re-underwritten recently prior to the issuance of the CMBS generally on the basis of then-current stabilized net operating income and property appraisals

### *Pooling and Servicing Agreement Requirements*

The pooling and servicing agreements governing the issuance of CMBS and the servicing of its assets must contain the following provisions—

- where there are two or more time-tranched classes of investors having the same distribution priority, pro rata distributions of principal to all classes of investors having the same distribution priority once the credit support is reduced to zero as a result of actual realized losses and "appraisal reduction amounts"
- no control over servicing by investors in a subordinate class once the principal balance of that class is reduced to less than 25 percent of its initial principal balance as a result of actual realized losses and "appraisal reduction amounts"
- no consideration of post-securitization property appraisals unless made at the request of a person other than the servicer for the related mortgage loan or the trustee
- representation by the mortgage loan seller that the improvements securing the loan were, at loan origination, in material compliance with applicable law; and
- reporting requirements sufficient to enable the New York Federal Reserve Bank ("NY FED") to monitor and assess its position as a secured lender.

### *Credit Rating Requirements*

When the TALF loan closes, the CMBS must have a credit rating in the highest long-term investment grade rating category from the required number (as yet undetermined) of TALF CMBS-eligible rating agencies and may not have a credit rating below the highest investment-grade rating category from any of such agencies or be on any rating agency review or downgrade watchlist. The NY FED is in the process of reviewing rating methodologies of all rating agencies that have expressed an interest in rating TALF-financed CMBS and will release a list of eligible agencies shortly. Credit ratings for TALF-financed CMBS may not rely on third-party guarantees.

### *Issuance and Payment Terms*

Eligible CMBS may not be issued by an agency or instrumentality of the United States or any government-sponsored enterprise. Holders must be entitled to receive payments of principal and interest, and the interest must be at a fixed rate or a rate based on the weighted average of the underlying fixed mortgage rates. The CMBS may not be junior to other securities with claims on the same loan pool. Each CMBS must be cleared through the Depository Trust Company.

## UNIQUE LOAN TERMS APPLICABLE TO CMBS

### *Loan Subscription Cycle*

The cycle for CMBS loan subscriptions and settlements is expected to begin in late June and to continue to occur in the latter part of subsequent months. In contrast, the cycle for non-CMBS TALF loans will continue at the beginning of each month. The NY FED is contemplating the initiation of a reservation system for borrowers interested in securing TALF loans collateralized by CMBS for a monthly fee.

### *Collateral Pool Diversification*

The NY FED prefers collateral pools to be diversified in terms of loan size, location and type of the mortgaged properties and borrower sponsorship. It plans to engage an outside firm to monitor the collateral. NY FED will reserve the right to exclude specific loans from a pool prior to the issuance of the CMBS and to reject any CMBS as loan collateral based on risk assessment. Borrowers will not be permitted to exercise or refrain from exercising any voting, consent or waiver rights under a CMBS without the consent of the NY FED.

### *Interest Rates*

The interest rates on TALF loans secured by CMBS will be 100 basis points over (i) the three-year LIBOR swap rate for three-year loans, and (ii) the five-year LIBOR swap rate for five-year loans. For each CMBS having an average life of five years or less, the collateral haircut will be 15 percent. Collateral haircuts will increase by one percentage point for each additional year of average life in excess of five years. CMBS with an average life in excess of 10 years are not eligible for TALF financing. "Average life" of a CMBS will be the remainder of the original weighted average life determined by the issuer using industry standard assumptions.

### *Mandatory Principal Repayments*

All remittances of principal on the CMBS must be used to pay down the principal of the TALF loan in proportion to the TALF advance rate. In addition, for five-year TALF loans, the borrower must remit to the NY FED at the end of each loan year an amount equal to the excess, if any, of CMBS interest distributions over interest payable on the TALF loan until such excess equals 25 percent (10 percent in the fourth loan year and 5 percent in the fifth loan year) of the haircut amount. The remainder of such excess will be applied against principal on the TALF loan.

## CONTACT INFORMATION

We also invite you to visit the firm's Economic Recovery Resource Center for news and analysis concerning the government's economic recovery programs and their impact on business and the law.

If you have any questions concerning this alert, please contact—

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