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TALF for New-Issue CMBS

On May 1st, the Federal Reserve Board (the "Fed") announced that beginning in late June 2009, it will make its Term Asset-Backed Securities Loan Facility ("TALF") available to finance new-issue commercial mortgage-backed securities ("CMBS"). Under the expanded TALF, investors will be eligible to receive low-cost, non-recourse loans, with either three-year or five-year terms, to buy qualifying CMBS. The Fed stated that the addition of CMBS to the TALF will help prevent defaults on economically viable commercial properties, enable current mortgage lenders to make additional loans and facilitate the sale of distressed properties.

The Fed set an initial limit on the total amount of five- year TALF loans at \$100 billion and indicated that it will continue to evaluate that limit. The Fed has yet to announce the terms of a so-called legacy TALF to finance purchases of older CMBS.

Qualifying CMBS must have the following characteristics:

- be issued on or after January 1, 2009 by a non-governmental entity
- evidence an interest in a trust fund consisting of qualifying mortgage loans that are current in payment at the time of securitization
- be denominated in U.S. dollars
- bear interest at a fixed rate or a rate based on the weighted average of the underlying fixed mortgage rates
- entitle holders to payments of principal and interest
- have the highest investment-grade rating from the requisite number of TALF CMBS-eligible rating agencies (to be determined by the New York Fed prior to the initial CMBS subscription date)
- rank pari passu with, or senior to, other securities with claims on the same pool of loans
- have an average life not exceeding 10 years
- if a class is one of two or more time-tranched classes of the same distribution priority, principal distributions must be made on a pro rata basis to all such classes after the credit support is reduced to zero as a result of both actual realized losses and "appraisal reduction amounts"
- the "directing class" must lose its rights to approve, consult or direct the servicing of the underlying mortgage loans after the principal balance of that class is reduced to less than 25% of its initial principal balance as a result of both actual realized losses and "appraisal reduction amounts"
- the underlying documents must provide for sufficient reporting to enable the New York Fed to continuously monitor its position as secured lender
- be cleared through the Depository Trust Company

TALF-eligible CMBS must also be backed by collateral pools that are diversified in terms of loan size, geography, property type, borrower sponsorship and other typical criteria. However, on a case-by-case basis, the New York Fed will consider non-diversified collateral (i.e., such as a single borrower or single asset CMBS).

The underlying mortgage loans must meet the following criteria:

- the loans must be originated on or after July 1, 2008
- the loans must be current in payment at the time of securitization
- the loans must bear interest at a fixed rate
- the loans must be amortizing, with no interest-only period
- the loans must be fully funded
- the loans must have a first priority lien on the property securing each mortgage loan
- the collateral for each mortgage loan must be fee or leasehold interests in one or more income-generating commercial properties located in the U.S. or one of its territories
- the loans must be recently underwritten on the basis of then-current in-place, stabilized and recurring net operating income and property appraisals

Terms of TALF Financing

Terms and Interest Rate. At the election of the borrower, each CMBS TALF loan will have either a three-year maturity or five-year maturity and will bear interest at a fixed rate per annum according to the loan term:

<u>Loan Term</u>	<u>Interest Rate</u>
3 years	100 basis points over 3-year LIBOR swap rate
5 years	100 basis points over 5-year LIBOR swap rate

Haircut. The size of each TALF loan in relation to its CMBS collateral will be determined based on the average life of the CMBS collateral. For CMBS with an average life of five years or less, the collateral “haircut” with respect to the corresponding TALF loan will be 15%. For CMBS with an average life of five to ten years, the collateral “haircut” will increase by 1% for each year of average life beyond five years. . No TALF-eligible CMBS may have an average life beyond ten years. The average life of CMBS will be calculated as the remainder of the original weighted average life determined by the issuer of the CMBS, based on industry-standard assumptions at the time of securitization.

Allocation of Principal Payments. Principal payments received on the CMBS must be applied to reduce the principal amount of the TALF loan in proportion to the TALF advance rate (i.e. if the TALF advance rate was 85%, 85% of the principal payment received on the CMBS must be repaid to the New York Fed).

Allocation of Interest Payments for 5-Year TALF Loans. With respect to a 5-year TALF loan, the excess in any TALF loan year of CMBS interest payments over the amount of TALF loan interest payable is required to be remitted to the TALF borrower until such excess equals 25% (10% in loan year 4 and 5% in loan year 5) of the haircut amount. Any remaining amount will be applied to the repayment of TALF loan principal. The effect of this will be to accelerate amortization of the TALF loan.

Collateral Monitor. The New York Fed will hire a collateral monitor to evaluate TALF-eligible CMBS prior to the making of a TALF loan. The New York Fed has the right, until the issuance of the CMBS, to “kick out” loans from the loan pool. The New York will also have the right to reject any CMBS as TALF loan collateral based on its risk assessment.

Voting Rights. A TALF borrower must agree not to exercise or refrain from exercising any voting, consent or waiver rights under a CMBS without the consent of the New York Fed.

Click [here](#) to review the Terms and Conditions, and [here](#) to read Frequently Asked Questions pertaining to the CMBS program, and [here](#) for the updated TALF Master Loan and Security Agreement. Please note that the general provisions of TALF will also apply to CMBS financed under TALF.

If you have a need for legal advice on any of the above matters, please contact any of the following partners in our [Distressed Real Estate](#) and [Structured Finance Strategies](#) Practice Groups:

Bruce M. Stachenfeld
Co-Chair
Distressed Real Estate
Practice Group
Co-Chair
Structured Finance Strategies
Practice Group
(212) 692-5550
bstachenfeld@dslip.com

Terri L. Adler
Co-Chair
Distressed Real Estate
Practice Group
(212) 692-5533
tadler@dslip.com

Christine A. Spletzer
Co-Chair
Structured Finance Strategies
Practice Group
(212) 692-5557
cspletzer@dslip.com

Please contact Caitlin Velez at (212) 672-3747 or newsletter@dslip.com with any questions or comments.

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