

# Clients & Friends Memo

## **UPDATE: TALF for Legacy CMBS: New York Fed Clarifies Requirements and Procedures as Initial Legacy CMBS Subscription Date Approaches**

**July 13, 2009**

On Friday, July 10, the Federal Reserve Bank of New York (the "[New York Fed](#)") convened an informal conference call clarifying aspects of the operation of the Term Asset-Backed Securities Loan Facility ("[TALF](#)") for loans secured by eligible high-quality commercial mortgage-backed securities issued before January 1, 2009 ("[Legacy CMBS](#)").<sup>1</sup>

The initial subscription date for TALF loans secured by Legacy CMBS will be July 16 2009<sup>2</sup>, with a closing date of July 24, 2009. This memorandum summarizes the TALF loan requirements highlighted during the conference call as well as some of the important changes to the Master Loan and Security Agreement ("[MLSA](#)") for TALF loans secured by Legacy CMBS.

For a discussion of the general provisions of TALF, see our Clients & Friends Memo dated March 27, 2009 entitled "[Update: Understanding the Term Asset-Backed Securities Loan Facility \("TALF"\)](#)" and for a discussion of the terms applicable to Legacy CMBS, see our Clients & Friends Memo dated May 20, 2009 entitled "[TALF for Legacy CMBS: New York Fed Releases Terms and Conditions and FAQs](#)". For a discussion of terms applicable to newly issued CMBS, see our Clients & Friends Memo dated May 2, 2009 entitled "[TALF for New Issue CMBS: New York Fed Releases Terms and Conditions, FAQs and Revised TALF FAQs](#)".

### **Legacy CMBS Eligibility**

**Purchase Date Requirements.** The Legacy CMBS to be pledged as collateral must have been recently acquired by the TALF borrower. The borrower must have agreed to purchase the Legacy CMBS on or after the Loan Subscription Date for Legacy CMBS in the calendar month preceding the applicable Loan Closing Date, and the settlement date for such purchase must be on or prior to the Loan Subscription Date for the desired TALF loan. Based on the [MLSA](#), for the July 2009

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<sup>1</sup> Interested persons may listen to a replay of the conference call, which is to be available until July 16, 2009 by calling (800) 475-6701 and entering identification code 107296.

<sup>2</sup> The date is the first subscription date for Legacy CMBS, but is also a subscription date for newly issued CMBS (the first subscription date for newly issued CMBS was June 16, 2009).

subscription, prospective TALF borrowers must have acquired the Legacy CMBS via a secondary market trade with a trade date on or after July 2, 2009 and a settlement date on or before July 16, 2009.<sup>3</sup> Each TALF loan may be secured only by a single CUSIP, however a borrower may acquire the CUSIP in multiple purchases during the period permitted for acquisition.

***Note:** The requirement of a recent purchase date is designed to ensure that the TALF loan will be sized based on the current value of the Legacy CMBS to be financed. In addition to the requirement for recent acquisition, the New York Fed also intends to independently examine the purchase price to determine if it reflects current market prices (as described below). Investors that already hold Legacy CMBS positions acquired outside the permitted period may not pledge them as collateral for a TALF loan, even if they acquire additional amounts in arms-length market transactions for price verification. The New York Fed will require a confirmation dated within the applicable purchase period for all Legacy CMBS to be pledged as collateral for a TALF loan.*

Additional Representations and Warranties. The New York Fed has added borrower representations and warranties to the MLSA confirming compliance with the above and other requirements, such as the requirement that the borrower acquired the Legacy CMBS from an unaffiliated registered United States broker dealer on an arms-length basis. Other representations and warranties affecting Legacy CMBS have also been added or revised as described below.

Possibility of Rejection. The terms of the TALF program have noted since their original publication that the New York Fed may reject any proposed loan for any reason. Two possible reasons for rejection relate to valuation analyses the New York Fed will perform, and are addressed in the most recent (July 2, 2009) publication of frequently asked questions (“FAQ”). One is that the Legacy CMBS may fail under the “stressed valuation” test that the New York Fed will apply to evaluate Legacy CMBS proposed as collateral for a requested TALF loan. The New York Fed, using one or more of its agents, will perform a valuation of the Legacy CMBS under various stress scenarios (the parameters of the scenarios have not been published). If the requested loan amount is greater than the stressed valuation, the New York Fed may reject the loan request. Another, noted in the FAQ, is that the Legacy CMBS may fail the “price validation” process that the New York Fed will apply to compare the purchase price paid by the borrower when it agreed to acquire the Legacy CMBS (trade date) to prevailing market prices on the date of such transaction. According to the FAQ, the New York Fed will reject a loan request with respect to a Legacy CMBS having a purchase price that does not reflect the then-prevailing market prices. As described below, the New York Fed also performs another market price comparison as of the loan subscription date for purposes of determining the TALF loan amount.

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<sup>3</sup> The July 2 date referenced is based on the related representation and warranty in the MLSA. The requirement that the settlement date be on or before the Loan Subscription Date is contained in the MLSA’s definition of “Sales Confirmation”.

***Note:** Despite the apparent difference in the purpose of the evaluation of market prices and in the time as of which the evaluation is made (date of acquisition vs. subscription date), in light of the New York Fed's general reservation of a right to reject any TALF loan, it would appear prudent to assume that the New York Fed may either reject the TALF loan or adjust the loan amount if its evaluation indicates that the purchase price of the Legacy CMBS is not the "market price."*

***Note:** Given the general reservation of a right to reject any TALF loan, there is still the possibility that Legacy CMBS meeting all the other published criteria for TALF eligibility may be rejected. Since borrowers are required to acquire the Legacy CMBS on or before the related subscription date, and since the New York Fed's evaluation occurs after the subscription date, potential borrowers must bear the risk that they will not realize expected levered returns on purchases of Legacy CMBS. Furthermore, rejection of a class of Legacy CMBS by the New York Fed may have a negative effect on the market valuation for such CMBS.*

***Note:** Although the New York Fed has previously indicated that it intends to monitor and manage its commercial real estate exposure, including the concentration of its exposure to property types and geographic areas, there was no discussion on the conference call or in the revised FAQs concerning rejection of otherwise Eligible CMBS on these grounds. However, given the general reservation of a right to reject any TALF loan, the New York Fed would not be precluded from rejecting a Legacy CMBS TALF loan in order to avoid concentrated exposure to property types, geographic regions or otherwise.*

### **Legacy CMBS Valuation and TALF Loan Amount**

Market Price Determination. The maximum amount that may be borrowed under a TALF loan that is secured by Legacy CMBS is the lesser of the dollar purchase price the TALF borrower paid for the Legacy CMBS as shown on the related sales confirmation(s) and the market price as of the applicable loan subscription date (minus, in either case, the applicable base dollar haircut). As a basis for the required determination, the New York Fed will first look to information provided by pricing services. If it determines that such information is not available or is not representative, the New York Fed will then use reasonable efforts to secure price quotations from at least three broker-dealers and will use the arithmetic average of the quotations. If such quotations are unavailable or the New York Fed determines that one or more of them does not adequately reflect the market price of the Legacy CMBS, the market price will be determined by the New York Fed and its agents. By definition in the MLSA, the market price of Legacy CMBS may not be more than par.

\$10 Million Minimum Loan Amount. Because of the potential reduction in the loan amount that may occur as a result of the New York Fed's market price determination, a prospective borrower seeking a loan secured by Legacy CMBS acquired for a price allowing only for the required \$10 million

minimum TALF loan amount (after applying the applicable haircut) may not be able to finance any of such Legacy CMBS with a TALF loan if the market value of such CMBS is determined to be below the sum of the \$10 million minimum loan amount plus the applicable haircut.

**Subscription and Settlement Cycle for Legacy CMBS**

Prior to each monthly subscription process, an investor wishing to obtain a TALF loan must determine that it is an eligible borrower under TALF and establish a relationship with a financial institution that has been designated by the New York Fed as a Primary Dealer<sup>4</sup> by entering into a customer agreement that authorizes the Primary Dealer to execute an MLSA with the New York Fed on the investor's behalf. The process necessary for an investor to access a TALF loan secured by Legacy CMBS is set forth in the following chart:

Action or Event	Dates for July Subscription	Dates for Subsequent Subscriptions
Investor Purchases Legacy CMBS to be pledged. Only Legacy CMBS purchased during this period will be eligible collateral for the related month's TALF Legacy CMBS subscription.	July 2 through July 16	Day following prior month's subscription date through current Subscription Date. Purchases must be settled by Subscription Date.
Investor notifies Primary Dealer of: (i) requested loan amount; (ii) requested interest rate format; and (iii) CUSIP of Legacy CMBS to be pledged. <sup>5</sup>	Prior to July 16	Sufficiently prior to Subscription Date to permit Primary Dealer to make loan request on Subscription Date
<b>Subscription Date.</b> Primary Dealer submits loan requests for review by the New York Fed.	July 16	To be announced monthly by the New York Fed
Primary Dealer submits customary sales confirmation to the New York Fed.	July 17	Business day following Subscription Date

<sup>4</sup> A list of primary dealers may be found on the New York Fed's website at: [http://www.newyorkfed.org/markets/pridealers\\_current.html](http://www.newyorkfed.org/markets/pridealers_current.html)

<sup>5</sup> Unlike TALF loans secured by other types of assets, it is not necessary to provide a copy of the offering materials for the Legacy CMBS.

<b>Action or Event</b>	<b>Dates for July Subscription</b>	<b>Dates for Subsequent Subscriptions</b>
The New York Fed: (i) confirms purchase date; (ii) confirms purchase from U.S. registered broker-dealer; (iii) determines whether purchase price reflects current market price; and (iv) performs stressed valuation.	Prior to July 22	Prior to two business days before Closing Date
The New York Fed confirms to Primary Dealer: (i) approved loan amount; and (ii) amount of administrative fee for each loan request made by Primary Dealer.	July 22	Two business days prior to Closing Date
<b>Closing Date.</b> Borrower delivers to the New York Fed: (i) administrative fee; and (ii) collateral.	July 24	To be announced monthly by the New York Fed

### **Legacy CMBS MLSA Changes**

The New York Fed published a revised form of MLSA on July 2 in anticipation of the first TALF subscription for Legacy CMBS: [http://www.newyorkfed.org/markets/mlsa\\_070209.pdf](http://www.newyorkfed.org/markets/mlsa_070209.pdf). Although most of the basic terms of the MLSA remain unchanged, there have been various changes to reflect business terms applicable to Legacy CMBS and new-issue CMBS as well as the alternate mechanics envisioned for both categories of collateral. The following discussion highlights some revised business terms for borrowings secured by Legacy CMBS that are not otherwise discussed above.

Credit Support Depletion Event. The revised MLSA provides that, following a Credit Support Depletion Event, all cashflow received from Legacy CMBS collateral is applied to pay debt service on, and then to prepay, the related TALF Loan, with distributions to the Borrower occurring only following the repayment in full of the TALF loan. A "Credit Support Depletion Event" occurs upon the depletion of all credit support to the pledged Legacy CMBS by application of actual losses as well as appraisal reductions to subordinated classes supporting such Legacy CMBS.

Borrower Representations and Warranties. Borrowers pledging Legacy CMBS as collateral for TALF loans will be required to make representations and warranties generally similar to those contained in the prior versions of the MLSA, but certain modifications have been made for Legacy CMBS.

- *Representations Regarding Acquisition of Legacy CMBS.* The revised MLSA requires borrowers to make certain representations designed to establish that the cash purchase price paid by the borrower for the Legacy CMBS was a current market price. These include:
  - The Legacy CMBS was not acquired directly or indirectly from an affiliate;
  - The purchase was made on an arms-length basis within the applicable permitted acquisition period;
  - There were no terms or conditions of the purchase other than payment of the purchase price and delivery of the Legacy CMBS;
  - The seller did not retain any rights or risks of ownership of the Legacy CMBS;
  - The purchase price paid for the Legacy CMBS was in cash in the amount reflected in the applicable sales confirm;
  - The borrower did not receive any consideration, or discharge of any obligation, as an inducement to purchase the Legacy CMBS and the borrower was not obligated to purchase or repurchase the Legacy CMBS prior to the applicable permitted purchase period; and
  - The seller of the Legacy CMBS and its affiliates are not retaining any risk of ownership of the Legacy CMBS through derivatives contracts, insurance or other similar arrangements.
- *Eligibility.* As with other types of TALF collateral, borrowers will be required to represent that the collateral being pledged is eligible for TALF, based on its review of applicable offering documents. For Legacy CMBS, this representation is required to be made additionally on the basis of a review of servicer and/or trustee reports. This additional requirement for review of periodic reports seems logical, since offering materials will only disclose the characteristics of Legacy CMBS as of their issue date and the periodic reports should disclose significant changes occurring after issuance, but prior to pledge under TALF, some of which could impact TALF eligibility (such as a ratings downgrade).

Primary Dealer Representations and Warranties. Primary dealers will be required to make the same representations and warranties for Legacy CMBS TALF borrowings as for other types of borrowings, with one significant difference: primary dealers will *not* be required to represent that Legacy CMBS collateral is eligible collateral for TALF borrowings.

Permitted Loan and Collateral Transfers. As with other types of TALF loans, loans secured by Legacy CMBS are transferable together with the related collateral, subject to satisfaction of certain specified conditions, including the consent of New York Fed, which can be withheld for any reason and any period of time. Assignees are required to assume obligations of the assignor under the

applicable MLSA, and must make the same representations and warranties with respect to the Legacy CMBS. With regard to the borrower's representations as to collateral eligibility, the revised MLSA indicates that an assignee will be required to make this representation based on the ratings in effect on the date of transfer. This seems to mean that, although downgrades of Legacy CMBS following the applicable subscription date will not render the downgraded collateral ineligible for the initial borrowing, it will render the related TALF loan non-transferable. Also, for Legacy CMBS TALF loans, the revised MLSA specifically provides that the New York Fed may condition its consent on the assignee making additional representations and warranties specified by the New York Fed at the time.

**Questions and Comments**

The New York Fed has not instituted a formal process for the public to submit comments and questions with respect to the most recent changes to the TALF program. However, the New York Fed directs general questions regarding TALF to the New York Fed's Public Affairs department: 212-720-6130 or via email to [TALF@ny.frb.org](mailto:TALF@ny.frb.org).

**Additional Resources**

[CWT Financial Recovery Resource Center](#)

[TALF Terms and Conditions, July 2, 2009](#)

[Frequently Asked Questions, July 2, 2009](#)

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Please feel free to contact any of the following attorneys if you have any questions about this memorandum.

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