LLB&L Client Alert

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TALF Program Expanded to Include CMBS

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History of the TALF Program

U.S. asset-backed securities (ABS) markets historically have funded a substantial share of consumer credit and U.S. Small Business Administration (SBA) guaranteed small business loans. In June of 2008, reacting to an ABS market that had been under strain for some months, the Federal Reserve announced the creation of the Term Asset-Backed Securities Loan Facility (TALF), a facility designed to help market participants meet the credit needs of households and small businesses by supporting the issuance of ABS collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration. Under the TALF, the Federal Reserve Bank of New York (FRBNY) was scheduled to lend up to $200 billion on a non-recourse basis to holders of certain AAA-rated ABS backed by newly and recently originated consumer and small business loans.

Under the TALF program, the FRBNY lends an amount equal to the market value of the ABS less a haircut and is secured at all times by the ABS. The U.S. Treasury Department, under the Troubled Assets Relief Program (TARP) of the Emergency Economic Stabilization Act of 2008, provides $20 billion of credit protection to the FRBNY in connection with the TALF. Under the TALF, the Federal Reserve Bank of New York (FRBNY) provides non-recourse funding to any eligible borrower owning eligible collateral. On a fixed day each month, borrowers are able to request one or more three-year TALF loans, the proceeds of which are disbursed to the borrower, contingent on receipt by the FRBNY's custodian bank (custodian) of the eligible collateral, an administrative fee, and margin, if applicable. As the loan is non-recourse, if the borrower does not repay the loan, the FRBNY will enforce its rights in the collateral and sell the collateral to a special purpose vehicle (SPV) established specifically for the purpose of managing such assets.

CMBS Under TALF

Originally, eligible collateral for the TALF program consisted of investment grade U.S. dollar-denominated ABS composed of credit exposures to U.S. domiciled obligors in the form of auto loans, student loans, credit card loans, or small business loans that were fully guaranteed as to principal and interest by the SBA. The Federal Reserve Board on Friday May 1, 2009, announced that, starting in June, commercial mortgage-backed securities (CMBS) and securities backed by insurance premium finance loans will be eligible collateral under the TALF.

Qualifying Securities

Commencing in June 2009, eligible collateral for a TALF loan will include U.S. dollar-denominated (CMBS) issued on or after January 1, 2009, as to which all of the following conditions are satisfied as of its date of issuance (except as the context otherwise requires):

Assets

The assets underlying the CMBS must satisfy the conditions described under "Qualifying Assets" below.

Pooling and Servicing Agreements

The pooling and servicing agreement and other agreements governing the issuance of the CMBS and the servicing of its assets must satisfy the conditions described under "Pooling and Servicing Agreements" below.

Current Ratings

As of the TALF loan closing date, the CMBS must have a credit rating in the highest long-term investment-grade rating category from the required number of TALF CMBS-eligible rating agencies and must not have a credit rating below the highest investment-grade rating category from any TALF CMBS-eligible rating agency. Eligible collateral will not include a CMBS that obtains such credit ratings based on the benefit of a third-party guarantee or a CMBS that a TALF CMBS-eligible rating agency has placed on review or watch for downgrade.

Payment Terms

The CMBS must entitle its holders to payments of principal and interest (that is, must not be an interest-only or principal-only security). The CMBS must bear interest at a pass-through rate that is fixed or based on the weighted average of the underlying fixed mortgage rates. The CMBS must not be junior to other securities with claims on the same pool of loans.

Issuer

The issuer of the CMBS must not be an agency or instrumentality of the United States or a government-sponsored enterprise.

Settlement

Each CMBS must be cleared through the Depository Trust Company.

Qualifying Assets

Asset Types

Each CMBS must evidence an interest in a trust fund consisting of fully-funded, first-priority mortgage loans that are current in payment at the time of securitization, and not other CMBS, other securities or interest rate swap or cap instruments or other hedging instruments. A participation or other ownership interest in such a loan will be considered a mortgage loan and not a CMBS or other security if, following a loan default, the ownership interest is senior to or pari passu with all other interests in the same loan in right of payment of principal and interest. All mortgage loans must be fixed-rate loans. No mortgage loan may provide for interest-only payments during any part of its remaining term.

Property Types

The security for each mortgage loan must include a mortgage or similar instrument on a fee or leasehold interest in one or more income-generating commercial properties. Each property must be located in the United States or one of its territories.

Origination Dates

All mortgage loans must have been originated on or after July 1, 2008.

In-Place Underwriting

All mortgage loans must have been underwritten or re-underwritten recently prior to the issuance of the CMBS, generally on the basis of then-current in-place, stabilized and recurring net operating income and then-current property appraisals.

Pooling and Servicing Agreements

The pooling and servicing agreement and other agreements governing the issuance of the CMBS and the servicing of its assets must contain provisions to the following effect:

- If the class of the CMBS is one of two or more time-tranched classes of the same distribution priority, distributions of principal must be made on a pro rata basis to all such classes once the credit support is reduced to zero as a result of both actual realized losses and “appraisal reduction amounts.”
- Control over the servicing of the assets, whether through approval, consultation or servicer appointment rights, must not be held by investors in a subordinate class of CMBS once the principal balance of that class is reduced to less than 25 percent of its initial principal balance as a result of both actual realized losses and “appraisal reduction amounts.”
- A post-securitization property appraisal may not be recognized for any purpose under such agreements 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.
- The mortgage loan seller must represent that, upon the origination of each mortgage loan, the improvements at each related property were in material compliance with applicable law.

Loan Terms, Haircuts and Other Conditions

The general terms and conditions of the TALF program apply to TALF loans that are secured by a CMBS described above, except as modified by the following terms and conditions:

- The FRBNY expects collateral pools to be diversified with respect to loan size, geography, property type, borrower sponsorship and other characteristics, but will consider CMBS backed by non-diversified collateral on a case-by-case basis.
- The FRBNY will engage a collateral monitor and will reserve the right, until the issuance of the CMBS, to exclude specific loans from each pool. In addition, the FRBNY will retain the right to reject any CMBS as TALF loan collateral based on its risk assessment.
- The FRBNY expects the agreements governing the issuance of each CMBS and the servicing of its assets, and the terms and conditions of its underlying loans, to permit, and to provide in effect for, reporting that is sufficient to enable the FRBNY to monitor and evaluate its position as secured lender.
- Each TALF loan secured by a CMBS will have a three-year maturity or five-year maturity, at the election of the borrower. A three-year TALF loan will bear interest at a fixed rate per annum equal to 100 basis points over the three-year LIBOR swap rate. A five-year TALF loan is expected to bear interest at a fixed rate per annum equal to 100 basis points over the five-year LIBOR swap rate.

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- The collateral haircut for each CMBS with an average life of five years or less will be 15 percent. For 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. No CMBS may have an average life beyond 10 years.

- The average life of a CMBS will be the remainder of the original weighted average life determined by its issuer employing industry-standard assumptions.

- Any remittance of principal on the CMBS must be used immediately to reduce the principal amount of the TALF loan in proportion to the TALF advance rate. For example, if the TALF advance rate was 85 percent, 85 percent of any remittance of principal on the CMBS must immediately be repaid to the FRBNY. In addition, for a five-year TALF loan, the excess, in any TALF loan year, of CMBS interest distributions over TALF loan interest payable will be remitted to the TALF borrower only 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, and the remainder of such excess will be applied to TALF loan principal.

- 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 FRBNY.

- The initial CMBS subscription date will be in late June. The specific date will be announced shortly. The subscription and settlement cycle for CMBS will occur in the latter part of each month, whereas the cycle for non-CMBS ABS TALF asset classes and premium finance ABS will remain at the beginning of the month.

- The framework for an issuer/sponsor certification and auditor certification is being developed and will be announced shortly.

- The FRBNY is considering a process to permit interested issuers, through a process to be determined, to reserve prospective funding of TALF loans collateralized by new issue CMBS. The FRBNY expects that each potential issuer to which such a reservation is awarded will pay a monthly reservation fee as a fraction of the amount reserved for every month that the reservation is outstanding until the CMBS is issued. Funding of a TALF loan in connection with such a reservation will be subject to satisfaction of all of the requirements of the TALF program relating to eligible collateral and eligible borrowers. No reservation will extend beyond the last CMBS subscription. If implemented, details of this process will be announced shortly.

About the Authors

Douglas P. Faucette is a banking attorney in LLB&L's corporate department and co-head of the TARP Group. Mr. Faucette has more than 30 years of experience representing publicly and privately held companies in a variety of corporate and securities transactions.

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Jennifer S. Beer is a partner at LLB&L. She concentrates her commercial real estate practice on lending with an emphasis on the hospitality industry and mixed-use properties.

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