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TO: Commercial Mortgage Securities
Association

FROM: Scott A. Sinder
Rhonda M. Bolton

RE: Legacy TALF Terms and Conditions Announced by Federal Reserve, With
Additional Minor Clarifications for TALF-CMBS Generally and for New CMBS

You have asked us to provide an overview of the Terms and Conditions (“T&Cs”) governing the Federal Reserve’s Term Asset-Backed Securities Loan Facility (“TALF”) for Legacy Commercial Mortgage-Backed Securities (“CMBS”), which were released today. Among CMSA’s particular concerns with respect to TALF for legacy CMBS were the need for additional explanation of the haircut and hyper-amortization mechanisms, as well as more detailed criteria for collateral eligibility and kickouts, inclusion of AM triple-A classes, and concerns about aggregation.

The new T&Cs do provide an example that appears to be along the lines requested by CMSA to explain the haircut mechanism, and offers more detail on the criteria for rejecting legacy CMBS as TALF collateral. However, today’s announcement does not provide any additional information on the hyper-amortization feature, nor does it discuss inclusion of AM

classes, or warehousing. It should be noted, though, that the Fed advises that it is still working on additional terms and conditions for the legacy program, so today's announcement is not a complete recitation of all the terms that will apply and more information may be forthcoming.

The initial subscription date for the Legacy CMBS TALF program will be in late July. Other significant terms are discussed below to the extent they differ from the T&Cs specified for new CMBS.

We note that the Fed has also provided some additional information regarding TALF for CMBS generally, such as the names of the Fed-endorsed credit rating agencies, and on U.S.-origination criteria. And a few additional clarifications were included for new CMBS, although the Fed did not discuss here any of the matters CMSA has raised concerning new CMBS. This additional information is also described below.

Qualifying Legacy CMBS Collateral

The Legacy CMBS collateral qualification criteria track those announced for new CMBS (i.e., those issued after January 1, 2009), with the exception of the following:

- “Legacy” CMBS are those issued before January 1, 2009;
- As is the case for TALF for new CMBS, 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; if the 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.

Legacy CMBS TALF Loan Terms, Haircuts

The Fed had previously announced that the general TALF T&Cs will apply to the CMBS program except as otherwise specified, and the Fed has not altered this approach. Thus, TALF for both legacy and new CMBS will not involve executive compensation restrictions on issuers or borrowers, but will require borrowers' compliance with the H1-B visa restrictions and

requirements of the Employ American Workers Act (“EAWA”). Further, as previously noted, it should be anticipated that most TALF T&Cs announced for new CMBS will apply to Legacy CMBS unless the Fed indicates otherwise.

Terms and conditions unique to Legacy CMBS include the following:

- Terms for Rejecting Legacy CMBS: The Fed advises that the factors it will consider in deciding whether to accept legacy CMBS will include –
 - “Unacceptable” performance of the mortgage loan pool, with high cumulative losses, a high percentage of delinquent loans, loans in special servicing or loans on servicer watch lists, or a high percentage of subordinate-priority loans cited as examples. The Fed advises that it may consider forecasts of pool level losses under “various stress scenarios” in its decisions;
 - “Unacceptable” concentrations, with concentration of borrower sponsorship, property type, and geographic region, on an individual pool basis or considered collectively with others backing other TALF-financed CMBS cited by the Fed as examples;
 - The Fed will use collateral monitors to review legacy CMBS and the underlying loan pools;
- As CMSA was previously advised, the maximum size of a TALF loan for a legacy CMBS will be the current market price of the CMBS minus the base dollar haircut. Specifically, for each CMBS with an average life of five years or less, there will be a base dollar haircut of 15% of par, with the haircut increasing by one percentage point of par for each additional year of average life beyond five years. The Fed explains that this is the equivalent of a collateral haircut equal to the base dollar haircut divided by the current market price, and provides the following example. Assuming a CMBS with a par value of 100 and a seven-year weighted average life, with a base dollar haircut of 17 percent of par:
 - If the market price is 75% of par, the loan amount is 58 (75-17) and the collateral haircut is 23% (17/75);
 - If the market price is 50% of par, the loan amount is 33 (50-17) and the collateral haircut is 34% (17/50).

The Fed explains that under this formulation, the size of the haircut increases with the size of the price’s discount from par, reflecting a recognition that large discounts from par generally indicate credit concerns.

- With respect to the weighted average life of a legacy CMBS, the Fed notes that it is considering imposing a requirement that default-related circumstances be considered in calculating the weighted average life of a legacy CMBS, but details concerning such adjustments will be announced at a later date;
- There has been no change in the “turboing” features that were previously announced, meaning they apply to both new and legacy CMBS. No additional details are provided on how the mechanism will work, for example, whether the haircut amount is re-set monthly to reflect the original haircut amount or reset monthly to reflect its paydown over time;
- The Fed advises that it may limit the volume of TALF loans secured by legacy CMBS, and is considering whether to allocate volume via an auction or other procedure;
- Finally, the Fed acknowledges that it is still in the process of working out additional terms for the Legacy CMBS program, including specifically, terms for rejecting legacy CMBS as collateral; a requirement that Legacy CMBS TALF loans be used to fund “recent secondary market transactions between unaffiliated parties that are executed on an arm’s length basis,” and a process for price validation of any such secondary market transactions. These further terms will be announced at a later date, but “well in advance” of the initial subscription in late July.
- The Fed did not mention issues regarding warehousing or aggregation.

Clarifications Regarding General Terms for CMBS TALF

With respect to the T&Cs for CMBS generally, today’s Fed announcement has added the following terms and clarifications:

- As of the TALF loan subscription date, at least 95% of the credit exposures underlying the CMBS, by dollar amount of loan principal balance, must be exposures that are originated by U.S.-organized entities or institutions or U.S. branches or agencies of foreign banks, on properties located in the U.S. or one of its territories;
- The T&Cs now specify two as the number of “TALF CMBS-Eligible Rating Agencies” that have, as of the TALF loan closing date, given the CMBS a credit rating in the highest long-term investment-grade rating category. The TALF CMBS-Eligible Rating Agencies are DBRS, Inc., Fitch Ratings, Moody’s Investors Service, Realpoint LLC, and Standard & Poor’s;

- The T&Cs now specify that each CMBS (presumably legacy and new) must be cleared through the Depository Trust Company;
- The exclusion of “junior” CMBS is a reference to subordination for credit support, not to a later position in the time tranche sequence, such that CMBS that receive principal later (e.g., Class A-2) than the other most senior CMBS classes (e.g., Class A-1) but are otherwise pari passu with such other senior CMBS, qualify for TALF financing;
- The Fed specifies that for ABS *other than CMBS*, TALF’s restrictions on hedging transactions would not prohibit a primary dealer from entering into an interest rate swap with an ABS trust if it is intended solely to create a floating-rate security based off of fixed-rate receivables, provided that the swap agreement is entered into at a fair price, because the potential borrower is not a party to the swap agreement. Thus, such transactions apparently will continue to be prohibited for CMBS;

Clarifications Regarding TALF for New CMBS

Finally, today’s announcement includes a few clarifications of the T&Cs for new CMBS (none of which touch on issues raised by CMSA concerning new CMBS):

- For the weighted average life for newly issued CMBS, the determination 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 Fed 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. Sponsors intending to participate in the June subscription can contact the New York Fed Compliance Function via e-mail at talf.compliance@ny.frb.org for additional information;
- The Fed may implement a process allowing interested issuers to reserve prospective funding of TALF loans secured by newly issued CMBS. The 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. All of the requirements of the TALF program relating to eligible collateral and eligible borrowers will continue to apply if a reservation is awarded. No reservation will extend beyond the last CMBS subscription. More details on the reservation process will be announced at a later date.