

# REAL ESTATE CAPITAL MARKETS ADVISOR

An informational newsletter from Goodwin Procter's Real Estate, REITs & RE Capital Markets Group

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## Recently Announced Financial Stability Plan to Include Support for Purchase of CMBS

In Goodwin Procter's [November 2008 Real Estate Capital Markets Advisor](#), we presented thoughts on the then current economic environment relating to the commercial real estate industry, focusing principally on mortgage debt. In particular, we summarized the state of the CMBS market, outlining (i) the volume of scheduled maturities over the near term; (ii) the relatively modest delinquency rate on CMBS loans at that time; and (iii) the U.S. Treasury's then stated intention to use the Emergency Economic Stabilization Act of 2008 to provide capital infusions into the financial system and not to purchase troubled debt. We also provided input on recent changes in the REMIC provisions relating to RMBS pools, and how similar changes could benefit the CMBS market.

This week Treasury Secretary Tim Geithner introduced a national Financial Stability Plan to stabilize and repair the financial system. The overall plan is described in Goodwin Procter's [February 11, 2009 Financial Services Alert](#). In this Advisory, we address the two parts most directly related to commercial real estate: the forward-looking Consumer and Business Lending Initiative ("CBLI") and, briefly, the Public-Private Investment Fund intended to address legacy troubled loans.

CBLI is a \$1 trillion expanded joint program with the Federal Reserve in which the Federal Reserve's Term Asset-Backed Securities Loan Facility ("TALF") would include credit support for the purchase of CMBS. Prior to this week's announcement the TALF was an unimplemented \$200 billion facility. In addition, the earlier version of TALF did not include purchases of interests in commercial mortgage debt. In short, the CBLI provisions of the Financial Stability Plan and the revised TALF are designed to restore the flow of credit by working around a currently dysfunctional credit market.

The terms and conditions of the expanded TALF program have not yet been promulgated, but based on the terms and conditions of the original TALF program published effective February 6, 2009, the program is intended to focus on newly securitized bonds (generally not earlier than January 2009) supported by newly (or recently) originated loans. The program rules establish various dates by which the underlying auto, student, small business loan and credit card debt must have been originated. The rules that will be established for the expanded program will do likewise for CMBS. It is not apparent whether mortgage pools that were originated but not securitized before the CMBS securitization market shut down in 2008 will be permitted as underlying collateral, but tightened underwriting standards and deteriorated valuations since that time argue against it, particularly given the fact that the TALF credit must be secured by the highest rated bonds.

The backbone of the initiative is the TALF, a credit facility authorized under Section 13(3) of the Federal Reserve Act. The Treasury will provide credit support by absorbing the first losses under the TALF program. TALF loans are expected to have a term of three years, be

non-recourse to eligible borrowers with interest paid monthly, and be secured by eligible collateral. The TALF loans will be freely prepayable.

An “eligible borrower” under the TALF is (i) any U.S. business entity or institution that is organized under the laws of the United States or a political subdivision or territory thereof and conducts significant operations or activities in the United States (regardless of whether the entity has a parent company that is not U.S.-organized), including any U.S.-organized subsidiary of the entity; (ii) a U.S. branch or agency of a foreign bank (other than a foreign central bank) that maintains reserves with a Federal Reserve Bank; or (iii) an investment fund that is U.S.-organized and managed by an investment manager that has its principal place of business in the United States. A U.S. company would not include an entity that is controlled by a foreign government or is managed by an investment manager controlled by a foreign government.

“Eligible collateral” under the TALF includes non-synthetic asset-backed securities, which will include interests in CMBS pools, that have a credit rating in the highest long-term or short-term investment-grade rating category from two or more major nationally recognized statistical rating organizations (NRSROs), and do not have a credit rating below the highest investment grade rating category from a major NRSRO. The ratings may not be based on third-party credit enhancement. The TALF program is not available to finance purchases of bonds by originators of the underlying debt. In addition, the sponsor of the securitization that issues the collateral will be required to comply with executive compensation limits under the TALF program and certify its compliance annually, but the purchaser/borrower need not comply with the executive compensation limits.

In short, and in the context of CMBS offerings, the CBLI working in conjunction with the TALF has been designed in part to restart the flow of credit in a dysfunctional credit market by promoting the issuance of newly structured CMBS with what is likely to be newly originated underlying commercial mortgages by providing credit support to purchasers of certain highly rated CMBS. Of course, the terms and conditions of the TALF are designed to promote new credit while keeping a watchful eye on behalf of the taxpayer on the value of the underlying collateral.

The Public-Private Investment Fund (“PPIF”), which the Treasury Secretary also announced this week, is the conduit through which the Treasury (working with the Federal Reserve and the FDIC) and the private sector will invest in “legacy” troubled loans and other assets currently held by financial institutions. The private sector participants in the PPIF will be the catalyst for determining the value of the troubled assets, thereby protecting the taxpayers from overpaying for the legacy assets, because, to date, there has been no third party validation of the values of those assets. Accordingly, it is the hope of all involved that the integrated approach of the Financial Stability Plan, including the PPIF, CBLI and TALF programs, will strengthen the balance sheet of those financial institutions interested in lending again, and that the CBLI and TALF programs will provide the means through which capital may flow back into the securitization markets, including the CMBS markets.

Given the extreme shortfall in available credit, any program that restarts the securitization of commercial mortgage debt will be extremely helpful to the real estate industry. Relief cannot come quickly enough. First, as we noted in November, approximately \$50 billion in CMBS will mature in 2009 (fixed rate CMBS totaling \$19 billion, floating rate totaling \$31 billion). In addition, a recent Mortgage Bankers Association study has indicated that \$40

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billion in other mortgage-related securitized debt related to the CMBS market (e.g., B-notes and mezzanine loans in CDOs) will also mature in 2009. It remains to be seen how much of this collective \$90 billion can be extended or written off. Second, although the CMBS delinquency rate remains low, the combined effects of a deepening recession and further decline in property values will inevitably drive the delinquency rate higher. S&P recently reported that the overall CMBS delinquency rate could climb from 1.1% as of year-end 2008 to 3.5% by year-end 2009, based in large part on rising unemployment and bankruptcies. S&P has also indicated that the rate of delinquencies has accelerated in the first year of this recession (December 2007 – December 2008) at slightly more than three times the rate of acceleration during the first full year following the start of the previous recession (March 2001-March 2002).

For further information about the issues raised in this newsletter, please contact your usual Goodwin Procter attorney or any of the attorneys listed below.

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