

Navigating the Complexities of CMBS Loan Assumptions, Prepayments and Defeasance

Strategies for Counsel to Borrowers, Lenders and Loan Servicers in Refinancing CMBS Loans Nearing Maturity

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Negotiating the Complexities of CMBS Loan Assumptions, Prepayments and Defeasance

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PRESENTATION OUTLINE:

- **Part 1: Guiding Clients through CMBS Loan Assumptions**
 - **Loan Assumptions, generally**
 - **Advantages of loan assumptions**
 - **Disadvantages of loan assumptions**
 - **Unique aspects of CMBS loan assumptions**
 - **Prerequisites**
 - **Process**
 - Notice
 - Consent
 - Organizational Structure
 - UCC /Tax Lien / Judgment Searches
 - Review of new property manager
 - Legal Opinions
 - No-Downgrade Letter
 - Release of existing borrower, guarantor, and indemnitor
 - Assumption Documents
 - Title Policies
 - Insurance
 - **Conclusion**

LOAN ASSUMPTIONS, GENERALLY

- **THE CONCEPT OF A LOAN ASSUMPTION IS FAIRLY WELL-KNOWN. A BUYER OF REAL PROPERTY ASSUMES THE EXISTING FINANCING OF THE SELLER/BORROWER BY “STEPPING INTO THE SHOES” OF THE EXISTING BORROWER ON SUBSTANTIALLY THE SAME TERMS.**
- **LOAN ASSUMPTIONS CAN PROVIDE A VERY ATTRACTIVE OPTION FOR BUYERS OF REAL PROPERTY SEEKING THE FUNDING THEY NEED IN ORDER TO CLOSE DEALS.**

ADVANTAGES OF LOAN ASSUMPTIONS

- **Advantages of Loan Assumptions, generally:**
 - **Time/Money.** Loan assumptions can be fully approved and documented in less than 30 days, in some cases; on the other hand, a newly originated loan may take months to complete.
 - Loan assumptions generally require less documentation than an origination, which can reduce a buyer's administrative and legal expenses.
 - **LOAN ASSUMPTIONS TYPICALLY PERMIT A NEW BORROWER / BUYER TO BENEFIT FROM THE SELLER'S EXISTING INTEREST RATE AND OTHER PRE-NEGOTIATED TERMS, WHICH MAY BE BETTER THAN PREVAILING MARKET RATES AND TERMS FOR AN ORIGINATION.**

DISADVANTAGES OF LOAN ASSUMPTIONS, GENERALLY

■ Disadvantages:

- Requires detailed review of existing documentation; lender will need to confirm that all representations / warranties in the original loan documents are true and correct, that all existing obligations are current / satisfied, and that all existing parties are in compliance with the loan documents;
- Lenders have broad rights to ascertain whether or not a new borrower is qualified; generally speaking, lenders will want to ensure that the new borrower's finances and its operational expertise is equal to or greater than the existing borrower;
- If the existing loan documents do not have a pre-negotiated transfer right, lenders have the ability to alter loan terms; if this is the case, lenders can elect to raise the interest rate, require more stringent oversight or cash management provisions, and / or increase or require borrower reserves, for example.

UNIQUE ASPECTS OF CMBS LOAN ASSUMPTIONS

- Upon the occurrence of certain specified events, primarily a default, the administration of a CMBS loan is transferred to the special servicer. Besides handling defaulted loans, the special servicer also has approval authority over material servicing actions, such as loan assumptions.
 - ✓ **LOAN ASSUMPTION PROVISIONS ARE ALMOST ALWAYS INCLUDED IN THE EXISTING LOAN DOCUMENTS AND THE TERMS ARE USUALLY SPELLED OUT WITH A HIGH LEVEL OF DETAIL. THE ASSUMPTION REQUIREMENTS MIRROR THE REQUIREMENTS IMPOSED UPON THE ORIGINAL BORROWER BY THE ORIGINAL LENDER.**
 - ✓ **THE ASSUMPTION MAY REQUIRE REVIEW BY ONE OR MORE RATING AGENCIES, IN ADDITION TO MULTIPLE SERVICERS AND DIRECTING CERTIFICATE HOLDERS, POTENTIALLY ADDING TIME AND COST TO THE TRANSACTION. SPECIFICALLY, THESE PARTIES MAY REVIEW THE ASSUMPTION TO CONFIRM THE FINANCIAL STRENGTH AND EXPERIENCE OF THE NEW BORROWER IS AT LEAST OF EQUAL QUALITY OF THE PREVIOUS BORROWER.**
 - ✓ **IF THE SECURITIZED LOAN IS PART OF A REMIC TRUST, THE SERVICER'S MOTIVATION MAY BE LIMITED BY REMIC TAX CONSIDERATIONS.**

UNIQUE ASPECTS OF CMBS LOAN ASSUMPTIONS (CONT'D)

- **DECISIONS MADE WILL IMPACT ALL TRUST CERTIFICATE HOLDERS AND, THUS, MUST BE FOCUSED ON LOAN DOCUMENT AND SERVICING AGREEMENT TERMS.**
- **WHILE TYPICALLY NOT SPECIFIED IN THE INITIAL LOAN DOCUMENTS, THE SERVICER'S PARAMETERS AS SET FORTH IN THE POOLING AND SERVICING AGREEMENT (PSA) WILL GOVERN THE SERVICER'S DISCRETIONARY REACTION TO ANY BORROWER REQUESTS.**
- **IN EVALUATING ANY ASSUMPTION TRANSACTION, THE SELLER, BUYER AND LENDER WILL NEED TO BE AWARE OF ALL ASSOCIATED COSTS. THE FOLLOWING FEES AND EXPENSES ARE TYPICAL:**
 - ❖ **ASSUMPTION FEE TO LENDER**
 - ❖ **APPLICATION FEE TO LENDER**
 - ❖ **COST OF UCC, CREDIT AND RELATED REPORTS**
 - ❖ **TITLE AND ESCROW COSTS**
 - ❖ **LENDER'S LEGAL FEES (IF NOT INCLUDED IN ASSUMPTION FEE)**
 - ❖ **BORROWER'S LEGAL FEES (INCLUDING PROVISION OF UP TO THREE OPINION LETTERS)**
 - ❖ **NO-DOWNGRADE LETTER COST**
- **A SAMPLE CMBS ASSUMPTION CHECKLIST IS SHOWN ON SCHEDULE 1 OF THIS PRESENTATION**

Prerequisites

- **For successful management of the process and an executed assumption, the borrower (i.e. seller) should let the primary (aka “master”) servicer know as early as possible that a sale of the property may occur. At that point, the servicer and borrower’s team (which may include the original mortgage banker, attorney, consultant, buyer or other intermediary) should discuss the following information:**
 - **Establish a realistic timeframe from initial point of contact and the request for assumption to closing. A borrower and buyer may believe that the assumption request will be a brief process since the action may be provided for in the original loan documentation;**
 - **Instruct the borrower to review the controlling legal documents, with counsel, to clearly understand the transfer and consent requirements; Know your loan documents -- Not submitting required items by due dates and making changes to the borrower structure or property without approval can delay future draw requests and even create technical events of default.**

Prerequisites

- **Reviewing the assumption provisions early on will allow the borrower to address unresolved or unknown items of specific importance to the lender or servicer, without linkage to the forthcoming assumption request. It should also give the lender or servicer an opportunity to raise issues, separate from the assumption, that have historically delayed such transactions. These may include the following:**
- **Outstanding monetary or non-monetary defaults, such as:**
 - **Delinquent principal and/or interest payments**
 - **Real estate tax or insurance deficiencies**
 - **Outstanding late charges**
 - **Reserve fund deficiencies**
 - **Unauthorized actions that required prior written lender consent**
 - **Other issues per the loan documents**

Prerequisites

- **Non-compliance with other covenant requirements, such as:**
 - **Current evidence of acceptable insurance or insurance policies, as required**
 - **DSCR or other loan performance defaults**
- **Advise the borrower that complete information about the property, the transaction and the assuming borrower, as well as principals controlling and/or owning significant interests in such parties, will be needed as early as possible in the transaction. The borrower should request the servicer provide a comprehensive list of materials it will require to administer the assumption review. In some cases, a servicer may not begin reviewing a request until it has received all required information.**

Prerequisites (Cont'd)

- **Inform the borrower that there may be multiple parties with consent or review rights as well as economic interests regarding any sale of the collateral and assumption of the mortgage loan. The review time for these parties may add to the servicer's overall review period;**
- **Submit a detailed request letter that answers any concerns that may come up regarding the transaction. It is always better to disclose all information up front. The assumption request will not proceed through the approval process until all questions are answered.**

Prerequisites (Cont'd)

- **Engage lender's legal counsel early in the process. Lender's counsel can:**
 - **Sort through any structural issues up front that could delay the process down the road.**
 - **Assist with any modifications needed to the loan documents to account for the proposed structure.**
 - **Provide a clear legal explanation and opinion of the transaction that may assist the approval parties with their review.**
- **Submit all required items, including any review fees, in order to avoid processing delays.**
- **Confer regularly with your assigned analyst with the special servicer, who is the best source for information related to your loan, loan documents, and the process surrounding a loan event. Your analyst can provide estimated time frames and background on the parties involved and reports on the status of your pending loan event**

Prerequisites

- **Remind all parties that REMIC rules may present contractual limitations affecting the assumption. Due to the tax structure of the securitized pools, which is governed by REMIC law, it can be difficult for a borrower to make significant changes or additions to the property unless it is contemplated up front and included in the loan documents. Originating lenders are doing a better job of incorporating language to allow for these types of loan events, if the events are known at origination. If done post-securitization, the process can be lengthy, often requiring an amendment of the loan documents and a REMIC opinion that ensures that the pool's tax status won't be compromised by the changes. If not known at origination, the requests will likely still need to be underwritten, submitted through multiple Servicers for review, and may still be declined.**

Process

- **Required Notice**

- **Property owners desiring to have their loans assumed by a buyer should carefully review their mortgage instruments to determine how much prior notice they must give the Noteholder. Notice requirements will generally vary from 30 to 90 days. Usually the written notice is required to include certain preliminary information with respect to the proposed buyer and, in many instances, an application or similar fee.**

- **Consent**

- **Standards for approval of a prospective buyer will be expressly provided in the applicable loan documents and must be complied with to consummate the proposed assumption. CMBS loan documents typically allow assumptions subject to the Noteholder's right to approve or disapprove the prospective buyer. In some instances, the loan documents require that the lender abide by a "reasonableness" standard in making its approval determination. In certain instances, the loan documents specifically list certain criteria upon which the lender is to base its determination (e.g., buyer's financial strength, experience with respect to properties similar to the mortgaged property, previous history with mortgage lenders, etc.). In certain instances, the lender is obligated to allow a "one-time" assumption but is not obligated to permit subsequent assumptions.**

BUYER'S ORGANIZATIONAL STRUCTURE

- **All of the same lender requirements relating to the initial borrower's organizational structure will be relevant in an assumption with respect to the buyer's organizational structure. Clearly, mutual understanding should be sought with respect to the following specific issues:**
 - ❖ **Is the prospective buyer in fact a single-purpose entity?**
 - ❖ **Does the buyer have (or is it feasible for it to obtain) organizational document covenants with respect to separateness?**
 - ❖ **Does the buyer's managing member, general partner, or other second-tier entity satisfy these same concerns?**
 - ❖ **Are independent directors in effect or required?**
- **Typically, the assumption requirements will mirror the requirements imposed upon the initial borrower by the conduit lender.**
- **To the extent a non-consolidation opinion is required the buyer's organizational structure and operating arrangement will need to allow for the provision of such an opinion**

UCC/Tax Lien/Judgment Search/ Credit Review

- **The buyer and its principal investors will be subject to a credit review process as well as the normal array of UCC/tax lien/judgment searches.**
- **All of these searches are typically provided by the identical third-party vendors that provided those services at the initiation of the original conduit loan.**
- **Due to the necessary time lag involved in obtaining the search results (particularly in certain jurisdictions) and the inevitable questions that may arise once the initial search is completed, ordering the reports should be done as soon as possible in the assumption transaction.**

New Property Management

- **Frequently, a sale of the mortgaged property also results in a change in property management. The Noteholder will want to evaluate and review both the new prospective property management company and property management agreement. As a condition to the assumption, many Noteholders will require that the new property manager execute a consent and/or subordination agreement to recognize the payment priority of the loan and manager's fees and to govern the new property management contract if a foreclosure occurs.**

No-Downgrade Letter

- **Frequently, the Noteholder is entitled to condition its approval of the transfer of the property on the delivery of a “No-Downgrade Letter” from the applicable rating agency or rating agencies. The necessity or perceived necessity for these letters will usually be governed by the size of the loan in relation to the overall pool of loans. The rating agencies themselves may require a No-Downgrade Letter in assumption transactions for any loan in excess of a particular percentage threshold over the then current pool balance (e.g., 2%).**

Legal Opinions

- **Three types of legal opinions are commonly required as a prerequisite to assumption transactions:**
 - (1) **Enforceability/authority opinion,**
 - (2) **Non-Consolidation opinion, and**
 - (3) **REMIC (real estate mortgage investment conduit) opinion.**
- **The enforceability/authority opinion is almost always required and is likely to be similar in format to that provided by the initial borrower at the origination stage. This opinion should state that the loan documents, as assumed, are enforceable and that the borrowing entity as well as any new indemnitor are legally authorized to execute the assumption agreement and related documents. Any nonconsolidation opinion required will need to address the new buyer's organizational structure. The servicer may also require a REMIC opinion to provide comfort that the assumption transaction will not cause the REMIC to fail to qualify as such or result in the imposition of any tax on a "prohibited transaction" or "contribution" or cause the loan to cease to be a "qualified mortgage".**

Substitute Indemnitor

- **As a part of the assumption transaction, the buyer may be providing a substitute “warm body” indemnitor to stand behind the new single-purpose borrower’s recourse carve-outs. Any such substitute indemnitor will need to: (1) satisfy any mandated financial strength requirements, and (2) be willing to execute the indemnity agreement and the environmental indemnity agreement as required by the lender. The indemnity documents executed by the initial indemnitor will usually serve as the basis for the new indemnity agreements.**

Release of Borrower/Indemnitor

- **The Seller will desire to extricate itself from any ongoing liability from the recourse carve-outs in the original loan documents. Toward that end, a release of liability may be provided to the original borrower and indemnitors if the other conditions to the assumption have been satisfied. The point of contention in this document typically relates to any ongoing responsibility the original borrower or indemnitors may have based on acts or circumstances occurring prior to the sale. To the extent the loan includes potential “springing recourse” of the borrower or indemnitor as to principal and interest, the borrower’s concern as to any ongoing liability will be heightened.**

Assumption and Related Documents

- **While typically not problematic, the original borrower, new buyer and lender must agree upon an assumption agreement in addition to the other documents described above. This document should be in recordable form and specifically reference the original mortgage and other loan documents to facilitate the delivery of a proper title endorsement to the existing loan policy by the title company. The buyer will also be required to execute new UCC financing statements and some other, more incidental, documents that will vary by lender and state requirements.**

Title Policy Endorsement and Escrow

- **The Noteholder will require that the existing ALTA Loan Policy (or local equivalent) be endorsed to reflect the assumption transaction in the manner typical for that jurisdiction. A title company will also serve an escrow function with respect to the sale transaction and, as a part of that escrow function, handle assumption documents and payment of any required assumption fee.**

Insurance

- **Typically, a sale to a new party will also result in new insurance policies being put in effect and a termination of the existing policies. The Noteholder will require the standard mortgagee protection from the new casualty insurer as well as an approval of the insurer and the policy limits. Particularly in the context of larger loans, a specified rating of the insurer may be required.**

Conclusion

- It is important to remember that there are three parties to assumption transactions. Each of the three parties must have a clear understanding of the conditions, requirements and expectations to ensure a successful conclusion to the assumption.
- Hopefully, the initial loan documents will lay out the ground rules for the assumption in enough specificity to avoid confusion.
- Clear communication among the three parties with respect to each of the requirements described above and particular attention to the lead time items will go a long way to ensuring a successful assumption transaction.

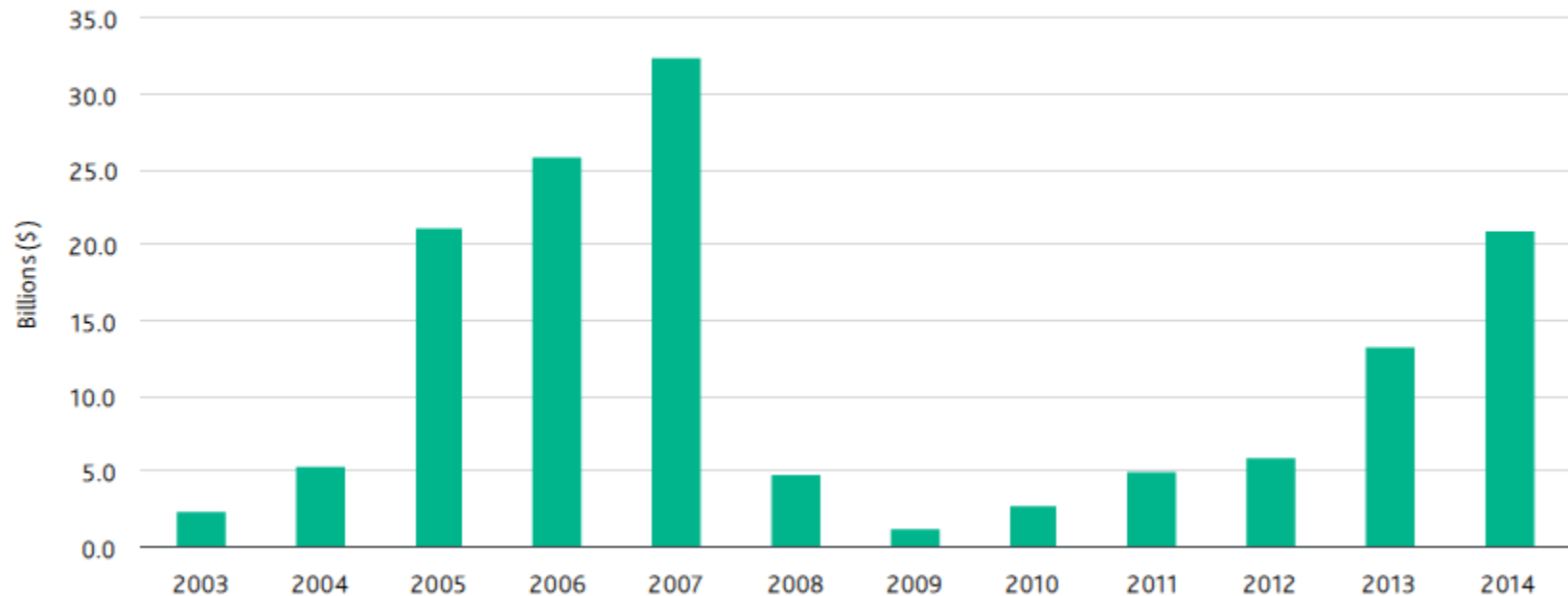
Defeasance In A Nutshell

Loans originated for CMBS conduit transactions generally limit a borrower's ability to prepay a loan before maturity. Defeasance allows a borrower to substitute the US government securities sufficient to satisfy all debt service payments in place of the existing real estate collateral. The loan remains in the trust and the bond holders receive an uninterrupted payment stream from the defeased loan. The real estate that originally served as collateral for the loan is released which allows the borrower to refinance or sell the property.

Historical Defeasance Volumes

EXHIBIT 1

Annual Defeasance, 2003-14



Source: Moody's Investors Service, based on data from defeasance consultants

Moody's 2014 Defeasance Report (3-2-2015)

- 1275 loans were defeased in 2014, up from 888 loans in 2013.
- In 2014 Defeasance Increased 58% over 2013
- Defeasance Activity in 2014 was \$20.9 billion the highest level since 2007 (\$32.4 billion)
- 2014 was comparable to 2005 levels of defeasance
- Conditions are ripe for further increases in 2015 due to competitive CMBS loan origination market, continuing borrower concern over rising rates, and a large proportion of outstanding loans nearing maturity.
- Moody's predicts \$25 billion in Defeasance Activity in 2015
 - (and \$110 billion of CMBS issuance)

What is Defeasance?

- Collateral Substitution
 - U.S. government securities instead of real estate; and
- Loan Assumption
 - New “successor borrower” SPE (usually an affiliate of the defeasance consultant) assumes the loan and existing borrower is released going forward.

End Result of Defeasance

- Proceeds from a sale or refinance are used to purchase a portfolio of U.S. government securities sufficient to make all of the remaining debt service payments
- At the end of the day, the REMIC trust will be left with the same note making the same monthly payments, but the borrower and the collateral have changed

REMIC Rules Applicable to Defeasance

- CMBS loans are transferred to a trust that makes a tax election to be treated as a real estate mortgage investment conduit or “REMIC”.
- The REMIC trust issues certificates that are backed by the debt service payments from the mortgage loans. The REMIC Trust receives favorable tax treatments so long as it holds qualified loans.
- Under a special tax rule, the REMIC Trust can release the real property collateral, IF the the release passes a *four prong test*.

REMIC Four Prong Test Applicable to Defeasance

A REMIC trust may release its lien on real property that secures a qualified mortgage provided:

1. The loan documents allow for defeasance
2. The release does not occur within two (2) years of the REMIC's startup day
3. The borrower pledges qualified Government Securities; and
4. The lien is released to facilitate the disposition of the property or any other customary commercial transaction (i.e. such as a sale or refinance) and is not an arrangement designed to collateralize the REMIC Trust with obligations that are not real estate mortgages)

Defeasance Collateral

- Must constitute “government securities”, as defined in Section 2(a)(16) of the Investment Company Act of 1940, as amended (15 USC §80a-1)
 - Treasuries
 - Direct obligations backed by the full faith and credit of United States
 - Agencies
 - Fannie Mae/Freddie Mac
 - FHLB Consolidated Debt
- Book Entry Securities Transferred Electronically (“blips on a screen”)

Defeasance is a Transaction, Not a Payoff

- Original Borrower must comply with the conditions for a defeasance set forth in the Loan Documents (Servicer is obligated to enforce documents as written except for non-material waivers)
- Original Borrower must engage a defeasance consultant & a lawyer
- Original Borrower takes title to book-entry securities for an instant in time in order to grant a security interest to the REMIC trust
- Original Borrower must maintain its current existence until the defeasance closes
- Original Borrower must provide due diligence, including a title commitment, organizational documents and a legal opinion
- Original Borrower must execute a set of defeasance documents, making reps and warranties in favor of the REMIC trust

Defeasance Parties (Page 1 of 6)

■ Loan Servicer

- Enforces the Loan Documents as written (except for non-material changes)
- Is Bound by REMIC (tax) Rules and Pooling and Servicing Agreement for the REMIC trust
- Engages Legal Counsel to process Defeasance
- Refunds real estate-related escrows after closing
- Continues to service defeased loan after Defeasance closes

Defeasance Parties (Page 2 of 6)

- Servicer's Legal Counsel
 - Drafts Defeasance Documents
 - Reviews all required Due Diligence
 - Coordinates Closing
 - Issues specialized Legal Opinions required from Borrower
 1. Perfection
 2. REMIC
 3. New York Enforceability (if not provided by borrower)

Defeasance Parties (Page 3 of 6)

- Original Borrower
 - Complies with Loan Documents
 - Provides Due Diligence
 - Executes Defeasance Documents
 - Take Title to Securities for an Instant in Time to Pledge Securities
 - Released from obligations under Promissory Note and Defeasance Documents – Going Forward
 - Mortgage is released

Defeasance Parties (Page 4 of 6)

- Defeasance Consultant
 - Coordinates transaction with all parties
 - Identifies securities and coordinates delivery of securities to Intermediary at closing
- Successor Borrower
 - Assumes obligations under Promissory Note and the Defeasance Documents
 - Typically, alter ego of Defeasance Consultant (not always)
 - Servicer or Originating Lender may have the right to designate the Successor Borrower

Defeasance Parties (Page 5 of 6)

- **Securities Intermediary**

- Maintains custody of the Securities in a Pledged Collateral Account (establishes control of securities in order to perfect security interest under UCC Article 8)
- Distributes funds from Pledged Collateral Account to Servicer's Collection Account for monthly payments and balloon payment due at maturity

- **Accountant**

- Issues verification report confirming that the Securities are sufficient to satisfy the debt service payments under the Note

Defeasance Parties (Page 6 of 6)

- **New Lender**
 - Delivers funds into escrow in conjunction with sale or re-finance
- **Title Company/Escrow Agent**
 - Provides title commitment
 - Coordinates gap closing
 - Disburses funds from sale or re-finance to purchase the Securities and pay other defeasance costs
 - Records mortgage release documentation after the defeasance closes
- **Rating Agencies (on large loans)**
 - Provides affirmation that the defeasance (in and of itself) will not cause a downgrade of the REMIC trust (“RAC” Letter)

Standard Defeasance Documents

1. Pledge Agreement (grants security interest in the defeasance securities to the REMIC Trust)
2. Account Agreement (describes how Intermediary will hold the defeasance securities and make payments going forward)
3. Assignment, Assumption and Release (transfer the securities and the rights and obligations from Original Borrower to Successor Borrower and releases the Original Borrower going forward)
4. Defeasance Certificate (confirms conditions have been met)
5. Waiver (waives non-material defeasance requirements)
6. Mortgage Release
7. UCC Terminations

Defeasance Closing Timeline

- Typically Loan Documents Require 30-60 days' notice
- Traditional "Three Day" closing process
 - Day 1 - "Circle" Securities on Day 1
 - Day 2 - Close underlying transaction/fund into escrow
 - Day 3 - Close the Defeasance by delivering the funds and the securities to the Intermediary
- Condensed "Two Day" Process
 - Circle Securities and Fund Into Escrow on the Same Day
- Funding on Day 3 is Discouraged unless Very Early Funding Can be Ensured

Defeasance Closing Process – Day 1

- Servicer's Counsel confirms that all defeasance requirements have been satisfied (including all original signatures and opinions delivered to Servicer's Counsel in escrow)
- Borrower authorizes Defeasance Consultant to “circle” Securities (Borrower is now obligated to close and will be responsible for securities breakage costs if defeasance doesn't close)
- Defeasance Consultant purchases Securities for delivery at closing and circulates final numbers
- Servicer's final escrow instruction letter circulated
- Release documents are sent to Title Company in escrow

Defeasance Closing Process – Day 2

- The refinance or sale transaction closes
- The sale or refinance funds are delivered into escrow at the Title Company

Defeasance Closing Process – Day 3

(The Defeasance Documents are dated as of Day 3)

- Borrower takes title to Securities for an instant in time in order to pledge Securities to REMIC trust, then title to Securities is transferred to Successor Borrower
- Book Entry Securities sent to Intermediary via electronic transfer subject to a security interest in favor of the REMIC Trust
- Securities Intermediary confirms receipt of Securities
- Servicer's Counsel instructs Title Company to wire funds to Intermediary to settle securities trade (funding wire is time sensitive thus funding into escrow on Day 3 is discouraged) (sometimes Securities are delivered first and funds are delivered second)
- Securities Intermediary confirms receipt of both funds and Securities and Defeasance is considered closed
- Servicer's counsel authorizes Title Company to release and record mortgage release and UCC terminations

Defeasance Costs

- **Government Securities Purchase Price**
 - Price changes daily based on bond market
 - Increases in bond yields lowers the cost to defease; decreases in bond yields increases the cost to defease
- **Transaction Costs**
- **Defeasance calculators on consultants' websites provide estimates**

Defeasance Transaction Costs*

<u>Parties</u>	<u>Fee Range</u>
Defeasance Consultant	\$ 8,000 - \$10,000
Servicer	\$ 7,500 - \$30,000
Servicer's Counsel	\$15,000 - \$20,000
Rating Agencies	\$ 0 - \$15,000
Accountant	\$ 3,500
Securities Intermediary	\$ 4,000 - \$ 6,000
Successor Borrower Formation/ Counsel	\$ 4,000 - \$10,000
Borrower's Counsel	\$10,000 - \$20,000

*Prices are subject to change and are only approximate price ranges.

NOTE: Average transaction costs are approximately \$50,000.

NY Style Defeasance

1. Used in states with high mortgage registration tax - NY, FL, VA (saves tax on new loan - used more in Re-fi)
2. More complicated and time-consuming (higher legal fees)
3. Different Set of Defeasance Documents
4. New Lender must be a party to Defeasance Documents
5. Servicer must pull collateral file
6. Original Loan Documents will be delivered to New Lender in escrow in conjunction with the defeasance closing (new Defeasance Note is issued)
7. Additional Tax Opinions required outside of New York

Partial Defeasance

1. Used to release a portion of the property from Mortgage
2. Must be permitted by Loan Documents
3. Loan is split into two loans -
 - Defeased Loan - Secured by Securities
 - Undefeased Loan - Secured By Remaining Real Estate
4. Defeased loan amount is established by the Loan Documents (usually 110% to 125% of the Allocated Loan Amount of release property)
5. Conditions in Loan Documents must be satisfied (LTV and DSCR tests)
6. Servicer must determine the monthly payment amounts for the defeased and undefeased loan and provide new AM schedules for the defeased and undefeased portions of the loan

Defeasance Issues in Loan Origination

1. Right to defease through Open Date
2. Right to use Agency Paper instead of U.S. Treasury Paper
3. Right to designate Successor Borrower
4. Right to NY-style assignment in lieu of release
5. Limitation on required legal opinions for Defeasance

CMBS Loan Repayment Strategies

For Lenders and Servicers:

- Remind your Borrower of upcoming maturity date
- Prepare or obtain a Payoff Statement
- Special considerations for States with High Mortgage tax (e.g., New York)

For Borrowers:

- Read your Loan Documents and know your options
- Be Proactive

CMBS Loan Repayment Strategies: LOAN REPAYMENT ON MATURITY DATE

– Sample Loan Agreement Language:

- ❖ Payment on Maturity Date: The Loan shall mature on the Maturity Date. Borrower shall pay to Lender on the Maturity Date the Outstanding Principal Balance, all accrued and unpaid interest and all other amounts due under the Loan Documents.

CMBS Loan Repayment Strategies: VOLUNTARY PREPAYMENTS

Voluntary Prepayments (*i.e.*, before maturity)

Sample Loan Agreement Language:

Except as otherwise provided herein, Borrower shall not have the right to prepay the Loan in whole or in part prior to the Stated Maturity Date. Subject to Section XX hereof, **on the Prepayment Lockout Expiration Date, and on any Business Day thereafter, Borrower may, at its option and upon not less than thirty (30) days prior notice to Lender, prepay the Outstanding Principal Balance in whole only with payment of the Yield Maintenance Premium;** provided, however, that, subject to Section _____ hereof, **payment of the Yield Maintenance Premium shall not be required if the prepayment occurs on or after the Open Prepayment Date.** A notice of prepayment may be revoked by Borrower if written notice of such revocation is delivered by Borrower to Lender on or before the date that is five (5) Business Days prior to the prepayment date set forth in the notice of prepayment. If Borrower delivers to Lender notice of prepayment and subsequently revokes such notice prior to prepayment, Borrower shall promptly reimburse Lender for all costs and expenses incurred by Lender (including any attorneys' fees) due to such revoked notice or otherwise in connection with the anticipated prepayment. Any prepayment received by Lender under this Section shall be accompanied by: (a) all interest which would have accrued on the principal amount prepaid through, but not including, the next occurring Monthly Payment Date (or, if such prepayment occurs on a Monthly Payment Date, through, but not including, such Monthly Payment Date), (b) all other sums due and payable under the Loan Documents, and (c) all reasonable out-of-pocket costs and expenses incurred by Lender in connection with such prepayment.

CMBS Loan Repayment Strategies: PREPAYMENT ALTERNATIVES FOR CMBS LOANS: DEFEASANCE, YIELD MAINTENANCE AND OPEN PERIOD

- **Defeasance**

- **Yield Maintenance**

- **Sample Loan Agreement Language:**

- ❖ **“Yield Maintenance Premium”** shall mean, as of any Tender Date, an amount equal to **the greater of** (i) one percent (1%) of the Outstanding Principal Balance, or portion thereof, being prepaid or satisfied unless as of such Tender Date an Event of Default shall have occurred and then be continuing, in which event, five percent (5%) of the Outstanding Principal Balance, or portion thereof, being prepaid or satisfied, and (ii) an amount equal to the **present value of a series of payments**, in each case, each equal to the Payment Differential as of such Tender Date and payable on each Monthly Payment Date over the **remaining original term of the Note until the Stated Maturity Date** and on the Stated Maturity Date, **discounted at the Reinvestment Yield as of such Tender Date for the number of months remaining from such Tender Date to each Monthly Payment Date until the Stated Maturity Date.**

- **Open Period / Permitted Prepayment Date**

- **Sample Loan Agreement Language:**

- ❖ **“Permitted Prepayment Date”** means the Payment Date that is three (3) months prior to the Scheduled Maturity Date.

What happens if the Loan is not Repaid on or before the Maturity Date?

■ Event of Default

– Sample Loan Agreement Language:

- ❖ if any monthly installment of principal and/or interest due under the Note or any payment of Reserve Funds due under this Agreement or the payment of the Obligations due on the Maturity Date is not paid when due;

■ Late Charges

– Sample Loan Agreement Language:

- ❖ If any principal, interest or any other sum due under the Loan Documents, including the payment of principal due on the Maturity Date, is not paid by Borrower on the date on which it is due, **Borrower shall pay to Lender upon demand an amount equal to the lesser of five percent (5%) of such unpaid sum or the maximum amount permitted by any Legal Requirements,** in order to defray the expense incurred by Lender in handling and processing such delinquent payment and to compensate Lender for the loss of the use of such delinquent payment. Any such amount shall be secured by the Mortgage and the other Loan Documents.

What happens if the Loan is not Repaid on or before the Maturity Date? (Cont'd)

■ Default Interest

– Sample Loan Agreement Language:

- ❖ Default Rate. In the event that, and for so long as, any Event of Default shall have occurred and be continuing, the Outstanding Principal Balance and, to the extent permitted by law, overdue interest in respect of the Loan, shall, at Lender's election, accrue interest at the Default Rate, calculated from the date the Default occurred which led to such Event of Default, without regard to any grace or cure periods contained herein. Interest at the Default Rate shall be paid immediately upon demand, which demand may be made as frequently as Lender shall elect.

CMBS REFINANCE STRATEGIES FOR BORROWERS, LENDERS AND LOAN SERVICERS

■ Strategy

- As the next wave of commercial mortgage backed securities (CMBS) real estate loans mature from the downturn of 2008, commercial investors should start thinking now of refinance or workout strategies especially if their property is “underwater” (i.e., the loan balance exceeds the property value). Approximately \$1.4 trillion in commercial mortgages will mature between 2014 and 2017, with CMBS representing about one fourth of the total, according to Trepp, LLC, a provider of analytics to the CMBS and banking industries.

■ REAL ESTATE MARKET TRENDS

- The magnitude of upcoming loan maturities is overwhelming, and the solutions for commercial property owners are quite complex, especially when dealing with distressed properties. Luckily, the changes in the Commercial Real Estate market have been quite encouraging, considering the 58% dive it took from 2007 to 2010. rents have strengthened, demand and issuance for CRE and CMBS loans has increased markedly and many banks have maintained attractive spreads even as rates are positioned to rise in December.

Refinancing Approach

Generally, owners of properties consider four possibilities when contemplating refinancing:

- 1. Payoff the loan**
- 2. Refinance the loan, or,**

If the property is distressed:

- 1. Giving the property back to the lender**
- 2. Restructure the existing loan**

Variations / Options:

There are innumerable variations to these options and the specific characteristics of each loan may inform the viability of any one strategy. For instance, if the current loan is non-amortizing (i.e., interest or minimum payment only has been paid) or was heavily over-leveraged as in the case of many loans originating from 2005-2007, refinancing may just simply not be an option absent a large injection of new equity to recapitalize the asset. Unfortunately, most property owners do not have a pre-planned refinancing strategy or other alternative in place in anticipation of their upcoming loan maturity. If the property is underwater, this could be quite alarming.

Performing Loans

If your property is performing, take a cautious approach when it comes time to refinance. The competition for performing properties is fierce as myriad financial institutions, not just traditional portfolio and CMBS lenders, are keen to take a piece of the predictable yields and credit worthiness that healthy properties in need of refinancing now offer.

Non-Performing Loans (w/ emphasis on CMBS Loans)

■ Modifications:

- The Borrower can seek to negotiate a loan modification that may include a (temporary) lower coupon, principal forgiveness, or term extension. These options may be viable for properties whose values appear to be recovering and additional time may allow for eventual refinance or sale at favorable terms. CMBS special servicers have wide latitude to exercise these types of modifications, but experience has shown they favor taking the collateral via foreclosure over workouts even if foreclosure may not present the option that maximizes value per the servicing standard.
- Note that once a foreclosure is completed and the asset turns into a “real-estate-owned” (REO) asset, the bond holders in the trust still bear the risk of further property value declines. Property value declines often increase after the asset management is put under receivership. Losses to the trust are realized only when the asset is liquidated, often years after the special servicer takes the collateral into REO via foreclosure, and the CMBS bond holders have paid for management and maintenance.

Deed-in-Lieu

If the special servicer is unwilling or unable to execute a modification, the borrower may seek to negotiate a deed-in-lieu of foreclosure. This option would allow the special servicer the collateral as REO, and the borrower has no further liability to perform under the loan. While this option relieves the borrower of further payment and performance obligations, they forgo all returns from its investment of both time and money, which is especially relevant for an asset whose performance is about to improve. Furthermore, in the event a non-recourse carve-out is violated, the special servicer may pursue a deficiency from the borrower and any guarantors even though virtually all CMBS loans are non-recourse or limited recourse.

Discounted Payoff / Short Sale

- **A CMBS Borrower may also seek a “short-sale” or discounted payoff. With the special servicer’s approval, the borrower can sell the asset or pay an amount less than the debt in exchange for a release. Once again, the recourse nature will have an impact on the viability of these alternatives. Additionally this option causes a loss to the CMBS bond holders, similar to a liquidation of reo collateral. If the loan suffers a maturity default, the special servicer may seek to enforce its remedies through traditional litigation and foreclosure processes. Depending on the state laws of the property location, the process could move very quickly, or it could stall in the court system for months or years.**

Chapter 11

- **Chapter 11 can provide the borrower with the ability to restructure the loan in a court-supervised environment. Through a chapter 11 plan, a borrower can seek to restructure the term and interest rate of the loan. This process could allow for a three-to-seven year term at favorable interest rates. Chapter 11 is not without risk and expense, however. Traditional Chapter 11 restructuring cases have been on the decline for many reasons; including the time, cost and risk associated with the process. Most non-recourse CMBS loans contain “bad-boy” carve-outs, which impose personal liability on the guarantors in the event of a Chapter 11 filing. The contents of these guaranties have migrated over the years to include both “true bad actions” and other items of liability that are not triggered by a bad action by the borrower or the guarantor; they are simply risk allocations to the guarantor (*i.e.*, non-payment of insurance premiums or ad valorem taxes). All of these factors need to be considered when determining if Chapter 11 is a viable option for a borrower.**

**LOAN ASSUMPTION
CLOSING CHECKLIST**

**Assumption of loan in the original principal amount of \$ _____
originally made by _____ to _____, as assumed
by _____**

DESCRIPTION OF PARTIES

_____ not in its Individual capacity but solely in its capacity as Trustee for the registered holders of _____ Commercial Mortgage Trust, Commercial Mortgage Pass-Through Certificates, Series _____	“Lender” (“L”
c/o [NAME OF SERVICER] _____ _____	
Re: Loan No.	
[INSERT NAME]	“Special Servicer” (“SS”)
[INSERT NAME]	“Special Service’s Counsel (“SSC”)
[INSERT NAME]	“New Borrower” (“B”

**LOAN ASSUMPTION
CLOSING CHECKLIST**

[INSERT NAME]	“New Borrower Counsel” (“BC”)
[INSERT NAME]	“Seller” (“S”)
[INSERT NAME]	“Seller’s Counsel” (“SC”)
[INSERT NAME]	“Title Company” (“TC”)

<u>Assumption Documents</u>	<u>Responsible Party</u>	<u>Status</u>
Note and Mortgage Assumption Agreement among Seller, New Borrower and Lender	SSC	_____
New Guaranty from person(s) or entities acceptable to Lender (collectively, "New Indemnitor(s)")	SSC	_____
New UCC Financing Statements for: a) _____ County, [state] State of formation of New Borrower	SSC	_____
Assignment of Management Agreement	SSC	_____
Amendment to Cash Management Agreement or other document to establish new accounts (if applicable)	SSC	_____

**LOAN ASSUMPTION
CLOSING CHECKLIST**

<u>Assumption Documents</u>	<u>Responsible Party</u>	<u>Status</u>
Note and Mortgage Assumption Agreement among Seller, New Borrower and Lender	SSC	_____
New Guaranty from person(s) or entities acceptable to Lender (collectively, " New Indemnitor(s) ")	SSC	_____
New UCC Financing Statements for: a) _____ County, [state] State of formation of New Borrower	SSC	_____
Assignment of Management Agreement	SSC	_____
Amendment to Cash Management Agreement or other document to establish new accounts (if applicable)	SSC	_____
Closing Statement	SSC	_____
Rating Agency Approvals (if required)	SS	_____
Underwriting Approval - Subject to Compliance with items on this Checklist	SS	_____
Compliance Summary Report	SS	_____
Form W-9 for New Borrower	B/BC	_____

**LOAN ASSUMPTION
CLOSING CHECKLIST**

<u>Authority Documents for Seller, New Borrower and New Indemnitor(s)</u>	<u>Responsible Party</u>	<u>Status</u>
1. Current Certificates of Good Standing for Seller and Seller's Sole Member, as applicable from the states of formation	SC	_____
New Borrower Organizational Chart	B	_____
Certificates of (i) New Borrower and New Borrower's Managing Member/General Partner and (ii) New Indemnitor(s), as applicable (form attached), attaching:	BC	_____
Certified copy of Articles of Incorporation, Certificate of Limited Partnership or Certificate of Formation/Articles of Organization, as appropriate	BC	_____
Bylaws, Limited Partnership Agreement or Operating/Limited Liability Company Agreement, as appropriate	BC	_____
Resolutions (authorizing purchase/sale and assumption transactions and execution of Assumption Documents described herein)	BC	_____
Certificates of Good Standing for New Borrower, New Borrower's Managing Member/General Partner and New Indemnitor(s), as applicable from the states of formation	BC	_____
Certificate of Good Standing - Foreign Entity for New Borrower and New Borrower's Managing Member/General Partner, if applicable, from Louisiana Secretary of State	BC	_____

**LOAN ASSUMPTION
CLOSING CHECKLIST**

<u>Legal Opinions</u>	<u>Responsible Party</u>	<u>Status</u>
1. Legal Opinions of Counsel to Seller and Seller's Sole Member, as applicable: Enforceability, Due Formation and Authority, No Litigation, No Conflict (form attached)	SC	_____
Legal Opinions of Counsel to New Borrower, New Borrower's Managing Member/General Partner and New Indemnitor(s), as applicable: Enforceability, Due Formation, Authority, No Litigation, No Conflict and Assumption Agreement is in proper form for recording (form attached) Non-consolidation Opinion (if required) Delaware single member limited liability company Opinions (if required)	BC BC BC	_____ _____ _____
REMIC Opinion (if necessary)	SSC	_____
Such other Legal Opinions as required by Lender and/or the Rating Agencies	BC/SC	_____

**LOAN ASSUMPTION
CLOSING CHECKLIST**

<u>Title Documents and Searches</u>	<u>Responsible Party</u>	<u>Status</u>
1. Pro Forma Mortgage Title Insurance Policy or Pro Forma Endorsement to the Existing Mortgagee Title Insurance Policy (" Existing Title Policy ")	BC/SC/TC	_____
Copies of Title Exceptions <u>not shown</u> in Existing Title Policy	BC/SC/TC	_____
Assignment of Mortgage to Lender	SS	_____
Power of Attorney from Lender to Special Servicer	SS	_____
Insured Closing Letter (if agent rather than title company is issuing Title Policy or Endorsement)	BC/SC/TC	_____
Escrow Instruction Letter from Lender's counsel, acknowledged by Title Company	SSC/TC	_____
State UCC search on Seller for state in which property is located and for state of formation	BC/SC/TC	_____

**LOAN ASSUMPTION
CLOSING CHECKLIST**

<u>Insurance</u>	<u>Responsible Party</u>	<u>Status</u>
Evidence of Insurance (as required by attached provisions from Mortgage) and paid receipt for one (1) year's premium from date of closing	B	_____
Insurance certificates must be on Accord Forms 25 and 28 and be addressed to Lender at the address shown on page one hereof and must contain all of the following:		
1. Reflect the Lender as loss payee and mortgagee		
Name New Borrower entity as the insured owner		
Must specifically state that Terrorism Insurance is included		
Notice of Cancellation Endorsements		
Lender's Loss Payee Endorsement		
Please note that review and approval of insurance generally takes at least 10 business days from initial receipt of all required insurance certificates.		

**LOAN ASSUMPTION
CLOSING CHECKLIST**

<u>Project Documents</u>	<u>Responsible Party</u>	<u>Status</u>
1. Rent Roll	B/S	_____
Management Agreement – must provide that it is terminable, without cause or a termination fee, on 30 days written notice	B	_____
Tenant Estoppels, if any obtained by New Borrower, certified to Lender* (required for single tenant property)	B	_____
Current Engineer's/Property Inspection Report, if any, obtained by New Borrower, certified to Lender*	B	_____
Current Environmental Assessment, if any obtained by New Borrower, certified to Lender*	B	_____
Current As-Built Survey, if any obtained by New Borrower, certified to Lender*	B	_____
Such other documents as Lender or Special Servicer may reasonably request or are required by the Rating Agencies	B	_____
<p>*If New Borrower is not obtaining these items, Lender will require a representation in the assumption agreement to that effect.</p>		

**LOAN ASSUMPTION
CLOSING CHECKLIST**

<u>Conveyance Documents</u>	<u>Responsible Party</u>	<u>Status</u>
1. Purchase and Sale Agreement and all assignments and amendments	B/S	_____
Satisfactory evidence of the closing of purchase and sale of the Property described in the Purchase Agreement	BC/SC	_____
Act of Cash Conveyance	BC/SC	_____
Bill of Sale	BC/SC	_____
Assignment and Assumption of Tenant Leases	BC/SC	_____
Assignment and Assumption of Operation and Easement Agreement	BC/SC	_____
Buy/Sell Closing Statement	BC/SC	_____
Rent Escrow Agreement (in form approved by Lender)	BC/SC	_____
<u>Fees</u>	<u>Responsible Party</u>	<u>Status</u>
1. Application Fee	B/S	_____
1. Assumption Fee (0.5% of outstanding principal balance)	B/S	_____
Special Servicer's Attorneys' Fees and Costs	B/S	_____
Other Costs (insurance review fee of \$400, credit review fee of \$1,500 (estimate), flood determination fee of \$15, administrative fee of \$125, and any Master Servicer processing fees)	B/S	_____