

REMIC Laws Need Updating to Keep Pace with the Evolving Capital Markets

MBA RECOMMENDS

MBA supports real estate mortgage investment conduit (REMIC) modernization for commercial mortgage-backed securities (CMBS) transactions to keep pace with market conventions.

BACKGROUND

The typical structure for the securitization of commercial real estate loans is a REMIC. A REMIC was created by the Tax Reform Act of 1986 that allows the trust to be a pass-through entity which is not subject to tax at the trust level. The CMBS transaction is structured and priced based on the assumption that it will not be subject to tax with respect to its activities and is assumed to be passive; therefore, compliance with REMIC regulations is essential. The law is intended to remove obstacles to issuing multi-class securities collateralized by interests in real estate mortgages. A REMIC structure avoids what would otherwise be double taxation of the income from pooled mortgages. To preserve this benefit, a REMIC must meet a variety of technical requirements. Among the most important of these is the requirement that pools of loans subject to a REMIC structure must remain passive. This means there can be no changes in the computation or nature of the loans in the pool. The only exception is for changes specifically contemplated in the original loan documents or in cases of default or imminent default. The vast majority of CMBS issuances utilizes the REMIC structure and are priced assuming the entity will not be subject to tax, REMIC compliance is critical.

The requirement that a REMIC pool must be passive has been a significant burden on the efficient operation of the commercial mortgage marketplace. The tax code's requirement for passive loan pools results in the prohibition on material changes in the loan once it is in a REMIC pool. Since mortgage loans are long-term assets, borrowers inevitably encounter situations where

changes to the loan terms or the underlying property are necessary. Often these changes cannot be accomplished because of the REMIC restrictions regardless of the often positive impact on the property's economic value and, therefore, the security for the investors. The industry's modernization initiative, which is supported by the Mortgage Bankers Association (MBA), aims at delivering needed flexibility to meet these very common borrower needs and to preserve and enhance property values for the investors.

MODERNIZATION PROPOSAL

On February 7, 2008, an Industry Letter was sent to the Internal Revenue Service commenting on Proposed Regulations for real estate mortgage investment conduits (REMICs). Participating in the Industry Letter was MBA, Commercial Mortgage Securitization Association, the Real Estate Roundtable, American Securitization Forum, Building Owners and Managers Association, International Council of Shopping Centers, national Association of Real Estate Investment Trusts, The Real Estate Roundtable, and the National Association of Realtors. The Proposed Regulations from the IRS would benefit both the bondholders and the property owners by providing borrowers more options and flexibility to manage their properties after the mortgages have been securitized. Given the current severe downturn in the commercial real estate capital market, the added flexibility provided by REMIC modernization would be a welcome development for all market participants.

The two issues that are addressed in the Proposed Regulations — changes in collateral, guarantees or other forms of credit enhancement and changes in the recourse nature of a mortgage loan — go a long way towards facilitating the resolution of issues that arise regularly in the administration of mortgage loans secured by commercial properties. Nevertheless, the industry remains concerned that the Proposed Regulations, if finalized in their current form, would impose new administrative burdens on servicers and borrowers in commercial mortgage-backed securities (CMBS) transactions without a compelling policy rationale or potential for abuse. In addition, MBA believes that changes to the proposed regulation requested in the Industry Letter would provide bright-line, easily-administered tests that would greatly simplify this area of the law.

BENEFITS

The proposed modifications to the REMIC structure would ease technical barriers that have hindered loan modifications to CMBS that would allow them to operate more efficiently. The proposed modifications to the REMIC structure would bring it up to date with current CMBS modification practices that would provide greater servicer flexibility in meeting the needs of borrowers and investors. Providing the flexibility to modify certain loan terms could prevent some commercial loans that are contained within a REMIC structure from defaulting, which will prevent additional stress from being placed on the already challenging commercial real estate market and capital market conditions.



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