



CLARIFICATIONS AND CHANGES TO THE REMIC RULES

The changes to the REMIC Rules addressing CMBS loan modifications issued by the IRS have garnered significant attention and commentary from CMBS industry participants and spectators, sparking a conversation among borrowers, lenders, servicers, investors, and industry groups about the practical effect these changes will have on their business. While the Revenue Procedure and Regulations relax certain constraints on modifying mortgage loans held in REMICs, it is not clear how significant an impact these changes will have in practice.

1. The flexibility incorporated into the changes in the REMIC Rules may allow modifications to be made earlier without incurring adverse tax consequences if the servicer reasonably believes that there is a significant risk of default. These changes do not, however, accelerate the timing of transfers to the special servicer, allow for modifications not in the best interest of the certificate holders, negate the need for special servicer or controlling class holder approvals, or amend any terms of the servicing agreements governing servicing of the loan. Therefore, the impact of the new REMIC guidelines in existing transactions will not be significant.
2. As has always been the case, borrowers should work with their servicers when they have questions or concerns.
 - (a) The primary servicer remains the initial point of contact for the borrower. The borrower most likely sends loan payments and financial statements to the primary servicer and the primary servicer is the day to day contact for the borrower. The most effective means of communication with the servicer is by providing a specific written request with supporting documentation regarding the status of the loan, collateral property and market. The changes to the REMIC Rules do not change this.
 - (b) Under the Pooling and Servicing Agreement (“PSA”), it is the primary and master servicers who are responsible for the loan while it is performing, and the special servicer will, in most cases, take over responsibility should the loan go into default or be at risk of imminent default. The changes to the REMIC Rules do not change this.
 - (c) The provisions of the PSA determine whether the special or master servicer will work with the borrower on a proposed amendment or extension. In virtually all cases, the special servicer is responsible for these matters. In general, it is the master servicer, governed by the terms of the PSA, which determines if and when a loan should be transferred to the special servicer. The changes to the REMIC Rules do not change this.

- (d) A borrower's and lender's rights and obligations with respect to the loan are set forth in the loan documents. Any change or modification to the loan documents must be agreed to by the lender and borrower. Once a loan is securitized, the servicer represents the collective interests of the Trust. The changes to the REMIC Rules do not mean that a lender/servicer is required to agree to any modification, amendment or waiver of the terms and conditions of the loan documents.
 - (e) All servicers must adhere to the servicing standard (the "Servicing Standard") which places a responsibility on the servicer to act in the best interests of the investors under the trust and other interest holders in the loan. If the loan becomes troubled, and the servicer concludes a modification is the route to the highest recovery on a net present value basis for the collective interest of the bond holders and other interest holders, it will be pursued. If a foreclosure is the best route, it will be pursued. The changes to the REMIC Rules do not change this.
- 3. While the REMIC Rules play an important part in the overall structure of the commercial mortgage-backed securities market, the REMIC Rules and the recent clarifications and changes to the REMIC do not change:
 - (a) The terms of:
 - (i) the mortgage loan documents governing the loan;
 - (ii) the PSA that specifies the responsibilities and duties of the loan servicers, the rights and priorities of investors and the timing of transfers to the special servicer. Generally transfers can only occur in the case of a default or imminent default which will not be cured within a specified period of time. This is not the same as a "reasonably foreseeable default" as described in the Revenue Procedure
 - (b) The Servicing Standard is the criteria servicers must use when evaluating potential extensions or other loan modifications. It remains the same and servicers still cannot change the terms of a loan unless the changes, taken as a whole, benefit the investors and other interest holders of the Loan.
- 4. The REMIC Rule changes loosen some tax restrictions and enhance opportunities for discussion of loan extensions or other modifications without concern that such actions would threaten the REMIC status of the trust. Now, if, based on all the facts and circumstances, the servicer reasonably believes that there is a significant risk of default upon maturity of the loan or at an earlier date, then the IRS will not challenge the REMIC status of the trust if the loan is modified, provided the balance of the requirements set forth in the REMIC Rules are met. This, however, does not mean that under any PSA a loan can be modified simply because the tax rules permit modification.
- 5. If a borrower believes a significant risk of default exists and wants to request a loan modification or extension, the borrower generally should:

- (a) Conduct a review of the loan documents to determine their contractual rights and obligations.
- (b) Carefully analyze their property condition, performance and outlook to determine what factors indicate a significant risk of default, and make an assessment of the best plan to enable the borrower to perform its obligations under the loan.
- (c) Prepare a written request outlining the results of the assessment, together with a proposal for the lender to consider. Factors generally considered by servicers in reviewing such a request include the original use of the mortgage proceeds, the current condition of the property and its income stream, projections regarding how that income stream will change over the course of the remaining loan term, significant lease non-renewals or terminations, the number and timing of refinance applications and rejections, equity infusions or contributions the borrower is prepared to make, and other factors affecting the requested loan modification or extension, including guarantees or additional collateral. It is important to provide evidentiary back up to support forecasts, conditions and assumptions.
- (d) Communicate in writing with the servicer to which the borrower submits its monthly debt service and financials reasonably in advance of the perceived events creating risk of default.