



CMSA / MBA Assumption Task Force Report

October 2007

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INTRODUCTION

When a tree falls in the forest, does it make a sound?

Which came first: The chicken or the egg?

Why does the loan assumption process cause servicers and borrowers so many process headaches?

These are the great mysteries of the universe. The first two questions have been tackled by philosophers and theologians. For the third question, the CMSA and MBA joined forces to convene a Task Force of leading CMBS servicing industry participants to unravel this mystery.

The purpose of this paper is to shed some light on the commercial mortgage-backed securities (CMBS) assumption process as a way to inform borrowers – both current and those contemplating assuming a loan – about assumptions and to help establish market expectations.

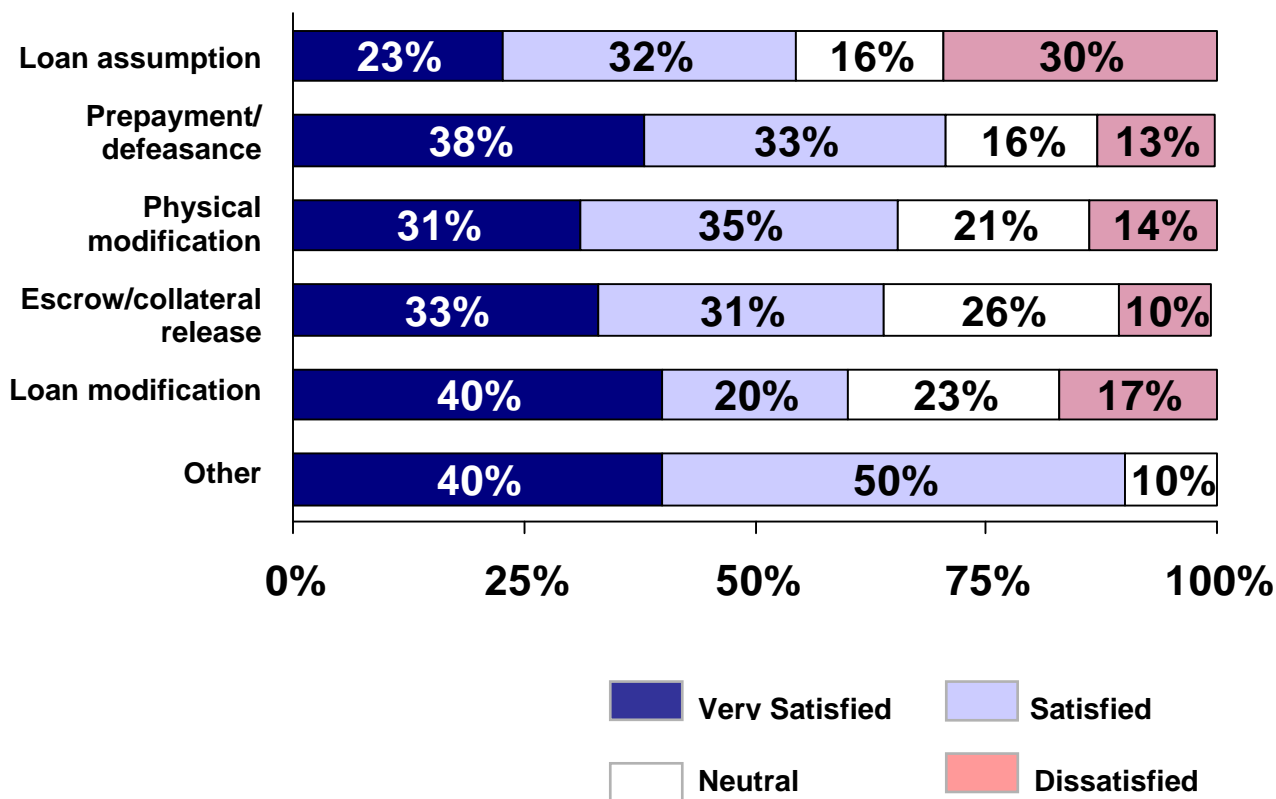
Moreover, we hope this effort creates greater information transparency and addresses some of the concerns identified on the 2005 CMSA/MBA Borrower Satisfaction Survey.¹

Overall, the survey results, affirmed what commercial real estate industry participants had already heard directly from their own clients. The survey clearly indicated that there was concern with the post closing issues that arise in CMBS. Based on the survey, 30% of the borrowers had participated in at least one loan assumption within the past 12 months prior to the survey. Of the borrowers who had participated in an assumption, 30% of them were actually dissatisfied with the assumption process. This was significantly higher than other post closing activities.

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In winter 2005, CMSA and MBA undertook an initiative to survey borrowers. There were 149 responses collected from borrowers who had considered at least two or more lending sources and had closed at least two permanent loans within the prior two years.

Borrower's Overall Satisfaction with Post-Closing Actions (Source: CMSA, MBA)



The assumption process has become a highly scrutinized and criticized process within the CMBS industry. As an example, both Fitch Ratings and Standard & Poor's now require servicers to provide performance statistics as part of their quarterly monitoring and annual servicer review processes.² Among the reasons assumptions receive so much attention are:

1. The large number of assumptions processed annually;
2. The time and effort of multiple parties required to process an assumption;
3. The obligation to protect the interest of CMBS investors; and
4. The high level of borrower dissatisfaction with the assumption process.

To help make the findings of this paper more "actionable", this paper includes sections called "Tension Points." As part of the Task Force conversations, we identified a number of items that cause great frustration with both current and proposed new borrowers during the assumption

² In fact, Fitch has published two research pieces on the CMBS assumption process. See Fitch's research, "What Holds up the CMBS Assumption" from June 9, 2006 and "U.S. CMBS Assumptions: An Update" from June 6, 2007, for additional information. In their research, Fitch noted that there was a greater need for further clarification regarding the CMBS assumption process. As stated in this Introduction, the CMSA and MBA joined forces to publish this piece as a tool for those who may one day find themselves participating in an assumption.

process. By identifying these issues up-front, the Task Force notes that the process has some inherent structural complexities that all the parties must navigate during the process. This report attempts to explain the servicer's perspective on these issues, while recognizing that there may be opportunities for servicers to improve their processes and customer service. Because there are also specific steps the current and proposed new borrower can take to expedite the process, we have also included sections called "Helpful Hints", with the hope that these hints will assist the parties in navigating the assumption process.

Although developing a single industry best practice was discussed during the course of our meetings, it was not the purpose of the group to create a "one-size-fits-all" standardized approach to CMBS loan assumptions. Just as each CMBS originator has a unique approach to the origination, underwriting and closing of loans, each servicer has its own approach to meeting the obligations of managing a CMBS assumption.

We hope you find this paper of value.

CMSA/MBA Assumption Task Force

What is an assumption?

An assumption is the “act of taking over the previous borrower’s obligation of a mortgage note... a buyer’s acceptance of primary liability for payment of an existing note secured by a mortgage or deed of trust”.³ In practice, assumptions are requested when a commercial/multifamily current borrower wishes to sell all or part of his property and the property purchaser agrees to be bound by the existing Promissory Note and Mortgage (and other loan documents, as applicable) as a part of its financing.

The assumption process is complex.⁴ CMBS documents, including the documents related to both the individual loan and its securitization; utilize a variety of regimes to allow a current borrower to sell their property and a proposed new borrower to assume the in-place debt encumbering the property. In its basic form, the life of an assumption is similar to that of a newly originated loan:

1. The parties submit an application requesting that the servicer review and approve the assumption transaction;
2. The servicer provides the parties with a due diligence checklist of required items;
3. The servicer completes its due diligence;
4. The assumption works its way through the labyrinth of required approvals;
5. The assumption is approved and any additional conditions are satisfied;
6. The assumption closes; and
7. The servicing of the loan continues, with the new borrower taking responsibility for loan payments and other obligations required by the loan documents.

Loan Documentation

Servicers and special servicers are bound by the dictates of the individual loan documents and the specific Pooling and Servicing Agreement (PSA). Pursuant to the terms of CMBS loan documents, the current borrower is prohibited from selling its property without the consent of the lender. The ability to grant or withhold such lender consent is assigned to either the Master Servicer or the Special Servicer if the loan is included in a CMBS transaction. The applicable servicer may then allow the sale of the property subject to the assumption of the loan and based on specific conditions set forth in the loan documents and the PSA applicable to the specific CMBS transaction. For these reasons, the servicer becomes the central coordinator in the assumption process.

Tension Point

What Does It Take to Sell My Property?

In most cases, the current borrower (seller) doesn’t have a clear

³ *Mortgage Banking Terms*, 10th Edition, Mortgage Bankers Association, Washington, DC, 2004.

⁴ See *Exhibit A*, the workflow diagram that illustrates the assumption process.

understanding of the process required to seek approval for their assumption request.

Helpful Hints

Before contacting the servicer, review the following information to understand the loan assumption:

- Thoroughly review your loan documents for the current borrower's contractual rights and obligations;
- Designate a key point of contact for working with the servicer on the assumption; and
- Begin gathering from your records the property and current borrower information.

Who are the parties involved?

When a loan is originated, a lender and borrower (and their respective legal counsel) are typically the only parties involved in preparing and approving the terms necessary to close the loan. Once the loan is closed and placed into a CMBS trust, however, additional parties play an active role in the management of the loan and the property.⁵ Many of these parties participate in the assumption process. They include:

Current borrower – The current borrower, also known as the seller, is typically the entity that was formed at the origination of the loan to comply with the Single Purpose Entity (SPE) requirements of the loan documents.

Proposed new borrower – The proposed new borrower, also known as the purchaser, agrees to “step into the shoes” of the current borrower and assumes the loan, subject to the current loan documents. As a rule, the proposed new borrower will create a new SPE to hold the property and to comply with the loan requirements.

Proposed indemnitor and guarantor – The indemnitor signs an environmental indemnity agreement to protect the lender from any environmental hazards on the property. Frequently the indemnitor is a major equity holder in the newly formed SPE. The guarantor signs a limited loan guaranty to protect the lender from any “bad acts” which may occur during the loan period. Typically the indemnitor will also be the guarantor. Most loans are originated with the current borrower providing individuals or “warm body” indemnitors and guarantors. The servicer may therefore require warm body replacements from the proposed new borrower as new indemnitors and guarantors, as part of their approval of the loan assumption.

Key principal – The key principal is a significant equity holder in the current borrower’s organizational structure, usually owning 20% or more equity in the SPE (whether directly or indirectly); they may or may not be the indemnitor or guarantor on the loan. The servicer may also require the identification of a key principal from the proposed new borrower as part of their approval of the loan assumption.

Lender – Following securitization, the ownership of the loan is transferred from the originating lender into a CMBS trust.

CMBS trust – A CMBS trust is established for commercial real estate investors to purchase securities backed by the commercial mortgages held in the REMIC structure.

While the loans are owned by the CMBS trust, the duties of the lender(s), subject to the respective PSAs, are distributed to the parties discussed below.

Trustee – The trustee of the CMBS trust typically does not have any involvement with the approval of a loan assumption. The trustee is primarily responsible for the custodianship of the original loan documents, remitting payments to bondholders, and providing investors information

⁵ While not discussed in this section, a Promissory Note may be split into either a pari passu or subordinate structure (B Notes) and sold to parties outside the CMBS Trust. In these instances, the purchaser of one of these “pieces” may also play a role in the assumption process and have additional consent rights.

about the performance of loans within the CMBS trust. The trustee will play a role after the assumption is closed and will serve as the document custodian for the executed original assumption documentation.

Master servicer – The master servicer is responsible for the remittance and advances of principal and interest payments to the trustee along with responding to borrower requests on performing loan and asset management issues. Under most PSAs, the master servicer serves as the primary point of contact for assumption requests, responsible for collecting all the due diligence items, underwriting the assumption transaction (the assumption package), and closing the assumption once it has been approved by all parties as set forth in the PSA.

Primary servicer – The primary servicer maintains the direct relationship with the borrowers on performing loans. Their role during the loan assumption process is usually limited to assisting the master servicer.

Controlling class representative (CCR) – The CCR typically invests in the lowest-rated, highest-risk bond classes within the CMBS structure. The CCR appoints the special servicer for the CMBS trust and, in the case of loan assumptions, may require the special servicer to obtain their approval.

Special servicer – The special servicer is responsible for material asset management decisions for both performing and non-performing loans in the CMBS trust. Unlike the master servicer, who typically does not invest in the bonds, the special servicer is usually an affiliate of the CCR.⁶ Under a typical arrangement, the special servicer receives the assumption underwriting package from the master servicer with the master servicer's recommendation for approval (with or without conditions to consent) or denial. The special servicer will review the submitted assumption package and the master servicer's recommendation. The special servicer will then render a determination whether or not to approve the assumption.

Rating agencies – The rating agencies are selected by the CMBS issuer to rate the CMBS transaction. Once the CMBS transaction has closed, the rating agencies will perform on-going annual surveillance, monitoring the transaction's performance to ensure that the investors' interests are protected. However, the rating agencies do not review all assumptions as part of their surveillance role. Typically, the rating agencies review any "significant modification" (assumptions are generally deemed by the rating agencies to be a significant modification) to a "major loan" (generally defined as those loans greater than \$20,000,000, 5% or more of the total securitization unpaid balance and/or a top 10 loan within the securitization) that may affect the credit of the overall CMBS transaction. Rating agencies evaluate the transaction to determine that the assumption, in and of itself, will not cause a downgrade of any of the tranches of bonds for the CMBS transaction. Their consent usually takes the form of a letter termed a "Rating Agency Confirmation" (RAC).⁷

⁶ There are certain instances when the CCR engages a third party Special Servicer, in which case the Special Servicer may be required by the CCR to seek their consent to any assumption.

⁷ Rating Agency Confirmation (RAC) is also referred to as a "no downgrade" letter. Other certain types of modifications, such as additional debt or preferred equity, may trigger the need for a RAC.

What is the assumption process?

Start of an Assumption Process – Current Borrower Application

As with most commercial real estate transactions, an assumption begins with the current borrower initiating the process by submitting an executed application to the servicer.⁸ The application phase of the assumption process can be the first place in the process where there are misaligned expectations. While the current borrower generally thinks that the assumption process begins with their initial contact with the servicer; that is not the case. A servicer will not consider an assumption request as “started” until all the preliminary requirements are satisfied.⁹

Upon receipt of the application, the servicer first reviews the submission to ensure that all the requested information and deposits have been provided.

Tension Point

When does an Assumption actually begin?

For Servicers, an assumption has not truly begun until:

- Servicer receives an executed application;
- Servicer receives a deposit on the fees due; and
- Servicer receives the entire package of requested due diligence documentation.

Helpful Hints

Monthly Billing Statement – The servicer’s monthly billing statement can serve as a helpful reference tool for the current borrower when completing the assumption application as the statement contains:

- The servicer’s designated loan number
- The property name and address on record with the servicer

Working Parties List – At the beginning of the assumption transaction it is important to create a working parties list so that everyone involved with the

⁸ The application is submitted to either the primary or master servicer. As a note, the proposed new borrower cannot initiate the assumption process as they are not in privity with the servicer and are not a party to the contract (loan documents). The commencement of the assumption process must begin with the current borrower.

⁹ As noted in the two Fitch research pieces, it takes on average between 33-38 days for the servicer to receive all the necessary information from the current borrower and proposed new borrower; it is only after this time period that the servicer considers the assumption “started.”

transaction will know who is representing the various parties. This will also assist in creating accountability of the parties as the transaction moves through the process.

Due Diligence and Information Requests

As important as it is for the servicer to actively manage the due diligence, approval and closing phases of the assumption; it is equally important for current borrowers to understand the critical role they play in the assumption process.

Helpful Hints

The General Requirements to Sell a Property - For the process to work smoothly, the current borrower should thoroughly review their own loan documents to understand the process. The loan documents set forth the general requirements under which a property can be sold, which include (but are not limited to):

- The loan is not in default.
- The current borrower provides advance written notice to the servicer of its desire to sell the property (generally, in the form of the borrower application).
- The proposed new borrower is a suitable purchaser in the servicer's determination.
- Suitable proposed substitute indemnitors and guarantors (acceptable to the servicer) are provided.
- The proposed new borrower agrees to assume all obligations under the existing loan documents (including but not limited to, payment of debt) and delivers and executes all necessary assumption documentation.
- The proposed new borrower delivers all necessary opinions.
- The servicer receives all the rating agencies' approvals, as specifically required.
- Either the current borrower or the proposed new borrower assumes all cost associated with the servicer's approval.
- The payment of an application fee.
- The payment of an assumption fee.

The motivations, timelines and understanding of the assumption process are sometimes not the same for the current borrower and the proposed new borrower and the onus is on the current borrower to keep the proposed new borrower engaged and actively involved. For example, delays in the proposed new borrower providing all the due diligence documentation, or the submission of inadequate or insufficient information, creates time delays in the assumption approval process. Additionally, negotiations between the current borrower and the proposed new borrower can cause the parties to lose their focus on the assumption process thereby delaying things further.

It should also be understood that each servicer has its own specific assumption due diligence checklist.¹⁰ These servicer checklists were developed based on the requirements of the various loan documents that they service, the requirements of the various PSAs to which they have been a party, a review by their legal counsel and input from the respective special servicers and rating agencies that also review and approve assumptions. The fact that each servicer has its own checklist may frustrate borrowers, but, in general all checklists have four basic categories of requested items that all servicers require as part of the assumption due diligence process:

1. Current borrower information;
2. Property performance information;
3. Proposed new borrower and proposed indemnitor and guarantor information; and
4. New property management information.

Tension Point

Variances in the Servicer Checklists – Current borrowers, especially in multiple loan assumption transactions with multiple servicers, receive a number of different assumption checklists and can't rely on the checklists being the same/similar from one servicer to another.

Helpful Hints

Kick-off Call – Once the executed applications and deposits are delivered and the checklists received, the parties should have a kick-off call with all parties to discuss the upcoming assumption, the information required and the approval and closing process (including identifying all parties with consent rights) and setting realistic timelines. This is an excellent time to confirm the parties working on the transaction to ensure that the working

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As stated in the Introduction of this paper, there was no effort on the part of the task force to try to standardize the assumption process. However, it became clear during our discussions that there were more similarities in the various checklists than differences. Moreover, during the initial phase of the assumption each Servicer delivers their respective checklist to the parties involved, so any differences should have minimal impact.

parties list is accurate and complete.

From the current borrower's perspective, the servicer not only asks for information during the assumption process, but the servicer often asks for information that they should already have on hand. This is especially true of information requested from current borrowers who have fully satisfied the requirements of their loan documents and regularly delivered all the required information. For current borrowers meeting their contractual obligations, it is extremely frustrating to be asked (again) for information.

Tension Point

Redundancy of Information Requested – Asking the current borrowers to provide information that they have previously provided to the servicer.

Going Back to the Current Borrower for Additional or New Information – Servicers can process upwards of hundreds of assumptions and the current borrower is in the best position to provide the most current information on a property's performance.

Sometimes the servicer does not collect all the critical information that the other parties (special servicer, rating agency, or CCR) find necessary to properly review the borrower application in its entirety prior to giving their consent to the assumption which may require a request for additional information.

Helpful Hints

Information Previously Provided to the Servicer – Information, like property performance details, is critical to the loan assumption. Notwithstanding the fact that the current borrower may have previously delivered this information to the servicer, it is a good idea to keep a file of submissions to the servicer for at least the prior 12 months and simply make a copy of the information for the assumption application.

Additional or New Information – Servicers should inform the current and proposed new borrowers at the outset of the assumption that additional information may be requested during the approval process as required by the special servicer, CCR or rating agencies.

What information is required?

Current Borrower Information

Does the servicer really need this information? As an example, the current borrower's organizational chart is very helpful and is not always provided at the loan closing; therefore, this may be the first opportunity that the servicer has to receive information regarding the current borrower's organizational structure. Moreover, this may be the only time a servicer can identify changes in the current borrower's organizational structure that may be pertinent to the assumption and may have occurred during the loan term without the servicer's consent.

Property Performance Information

Assuming that the servicer is being diligent in the performance of its ordinary servicing duties and the current borrower (or its agent) is cooperating and delivering to the servicer the information normally required in the loan documents in a timely manner, there is the potential for servicers to request information during the assumption process which should already be in the servicers' possession, particularly as it relates to the property's performance.¹¹

Current borrowers have expressed frustration when they feel that servicers ask for the same information more than once. To them, it appears that the right hand does not know what the left hand is doing (or in this case, collecting). An example is when the servicer requests updated property performance information that the current borrower has been delivering quarterly since the loan closed.

While it may be cumbersome for the current borrower to receive a request from the servicer for information they have already delivered, servicers have internal structural issues that in fact may slow down the assumption process if they have to search their records or databases for the requested information. For example, servicers collect thousands, if not tens of thousands, of quarterly property operating statements submitted by borrowers and those statements will go through a review, analysis and normalization process. Attempting to retrieve this information, while in the financial statement analysis process, can be a daunting task. Therefore, it is often easier and more efficient for the current borrower to re-submit the information, along with the other items on the checklist, in order to facilitate the building of the servicers assumption due diligence file. While this is not the answer most borrowers want to hear, it is the reality facing many CMBS servicers. Bearing that in mind, servicers can do a better job attempting to utilize the information they already have to ease the burden on current borrowers. Moreover, servicers can do a better job of communicating with the current borrowers and proposed new borrowers regarding the need for the information and ask the parties if they would prefer the servicer to locate and use the information previously provided by the current borrower with the understanding by the parties that the process may take longer.

¹¹ In the event the current borrower (or its property manager or agent) has not delivered the required information in a timely basis during the normal course of the loan servicing process, the assumption becomes an opportunity for the servicer to collect missing information it needs to adequately service and evaluate the loan performance.

Helpful Hint

Age of Information in the possession of the Servicer – As part of its due diligence, the servicer will require the most current information regarding the property and its performance.

If the current borrower has not been delivering the required property financial information, the servicer is going to require the current borrower to deliver the property performance information it deems necessary to re-underwrite the property.

If the last site inspection for the property is older than 6 months, the servicer will likely require a new site inspection of the property.

New Property Management Information

It is critical that the servicer understand who will serve as the new property manager and how the property will be managed after the assumption closes. The servicer will evaluate the experience of the proposed new borrower's designated property manager (e.g., are they a local, regional or national firm, with experience managing the specified property type) and the terms of the property management agreement. If the property will be managed by the proposed new borrower or an affiliate of the proposed new borrower, the servicer will use the same evaluation tools as if the property were managed by a third party.

Helpful Hints

Terms of Property Management Agreement – The borrower application should include information on the proposed new borrower's requested property manager (including but not limited to):

- Company name
- Company location
- Company key principles
- Company experience
- Staff experience (noting the experience with properties that are of a similar property type)
- Costs associated with hiring the property management
- Contractual terms of working with the property manager

Certified Documents – how and where to certify?

Some servicers require the current and/or proposed new borrower to provide certified copies of the documents in the borrower application, for example the financial statements or operating statements; others require a general certification of the entire assumption application package (a blanket statement of the veracity of the information); and some require both individual certifications and a general certification. Because the request for certified copies can delay the current and/or proposed new borrower getting documents to the servicer, requesting one blanket certified statement in the borrower application package may cut down on delays.

Helpful Hints

Sample Certification Language - Generally, the below sample certification language likely will be satisfactory in most instances:

"The financial statements and other data and information supplied by Assuming Obligor's and their affiliates in connection with Assuming Borrower's request to assume the Loan or otherwise supplied in contemplation of the assumption of the Loan by Assuming Obligors and their affiliates were in all material respects true and correct on the dates they were supplied, and since their dates no material adverse change in the financial condition of Assuming Obligors has occurred, and there is not any pending, or to the knowledge of Assuming Obligors, threatened litigation or proceedings against Assuming Obligors or their affiliates which could reasonably impair to a material extent the business or financial condition of Assuming Obligors."

Both the current and the new proposed borrower should be prepared to offer a certification to the information they provided in the borrower application package.

How is the decision made?

The servicer's on-going responsibilities in any assumption process include, but are not limited to:

1. Enforcing the loan document terms;
2. Safeguarding the property; and
3. Protecting the interest of CMBS investors.

In practice, the assumption is viewed with an eye toward its potential impact on the performance of the securitization with the mind set to "do no harm" toward its CMBS investors.

Protecting the CMBS Trust

The existence of a CMBS trust significantly impacts the approval process for assumptions. Generally, a CMBS transaction consists of many single mortgage loans that are placed in a CMBS trust. The CMBS trust issues a series of bonds that investors purchase and the trust holds the mortgages on behalf of the CMBS investors. A CMBS trust is created for each securitization and is possible, in part, based on tax law. The tax benefit for a CMBS trust that qualifies as a Real Estate Mortgage Investment Conduit (REMIC) is that the trust is not subjected to an entity-level tax on its income.¹² Thus, only the income earned by the investors that hold the bonds issued by the CMBS trust is subjected to tax. In order for a CMBS trust to qualify as a REMIC, it can only hold qualified mortgages and permitted investments.¹³

If a REMIC holds a qualified mortgage that is modified in an economically significant manner, the CMBS trust will suffer adverse tax consequences. Assumptions of non-recourse mortgages without any changes to the terms of the loans generally will not be deemed a significant modification. However, if in the context of an assumption, the loan is modified to change collateral, add credit guarantees or other economic terms are modified, the modification may be deemed significant and therefore the mortgages may not continue to satisfy the qualified mortgage requirement. If the CMBS trust were to hold a mortgage that is no longer qualified, a 100% tax will be imposed on any income received from such a loan. In addition, the CMBS trust will no longer qualify as a REMIC unless the non-qualified loan only represents a de minimis amount of the REMIC's assets. If the CMBS trust is no longer a REMIC, the income of the CMBS trust will be subject to tax at the entity level which results in double tax and the structure is no longer viable.

Given these consequences the servicer must avoid consenting to a significant modification. As a result, each PSA governing the servicer's rights and obligations with respect to a particular CMBS trust requires that a servicer obtain a "will" level REMIC opinion¹⁴ as a condition to

¹² For more information on CMBS and the trust structure, review the [CMSA/MBA Borrower Guide to CMBS](#).

¹³ For purposes of this discussion, a qualified mortgage is any mortgage that the CMBS trust holds at securitization that is debt principally secured by real property.

¹⁴ A REMIC Opinion is an opinion from an attorney confirming that (i) the loan assumption, and often the substitution of the Indemnitors, will not cause the Loan to be considered other than a "qualified mortgage," and (ii) the securitization will not fail to qualify as a REMIC for tax purposes

consenting to an assumption to ensure that the prohibition against significant modifications is not breached.

Helpful Hints

Loan Modifications – A modification is, essentially, any change to the loan.

If the loan documents provide the current borrower or the lender with a right to change the terms of the loan, and that right is not restricted to require any approval or consent, then exercising that right will not be considered a modification, so long as any and all conditions set forth in the loan documents are satisfied.

A modification, alone, is not a problem unless it rises to the level of a “significant modification”. The regulations define a significant modification as one that affects the legal rights or obligations of the parties in a manner that is economically significant. Some examples of significant modifications include:

- a change in the term
- a change in the interest rate
- priority or recourse nature of the debt
- a release, substitution or addition of a substantial amount of collateral
- a change in a payment Guarantor on a nonrecourse debt instrument

However, even a modification that would otherwise be considered significant may be permissible, such as an assumption.¹⁵

Multiple Approvals Required

Unlike a new loan origination, which generally only goes through an internal credit approval process, an assumption has potentially six different parties involved in the approval process;

1. The primary servicer (if the loan is sub-serviced);
2. The master servicer (if different than the primary servicer);
3. The special servicer;
4. In certain circumstances the special servicer may also need the consent of the CCR;
and

and subject the CMBS trust to income tax resulting from on a “prohibited transaction” pursuant to Section 860F(a)(2)(A) of the Internal Revenue Code of 1986.

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Other permissible significant modifications often include modifications after a loan default or after a reasonably foreseeable default.

5. The two or more rating agencies that rated the CMBS transaction.¹⁶

Tension Point

Multiple Approvals Required to Close an Assumption – Multilayer approval process with different, unrelated parties participating in the review process, each with different timeframes to complete their approval.¹⁷

Each party may have a different perspective on the assumption and may ask different questions or have different criteria for their approval.

Helpful Hints

Servicer Initial Assumption Letter– Most servicers provide information about the process and the approval timing in the initial assumption letter that is sent along with the borrower assumption package.

Kick-off Call – Also, as described earlier, an assumption kick-off call is the earliest opportunity in the assumption transaction cycle to ask questions and hear an explanation of the parties and the process involved to review and approve the assumption. On the call, the servicer will provide their perspective, explain the roles of the other parties involved in the approval and under what authority they are involved.

Current Borrower vs. Proposed New Borrower

For servicers, assessing the credit-worthiness of the proposed new borrower is one of the most difficult challenges of the assumption due diligence and approval process. Some refer to this as the “Bill Gates” problem. That is to say, if a CMBS servicer had Bill Gates as a sponsor, indemnitor and guarantor, there would be no possible buyer that would be an equal substitute. At the same time, the current and proposed new borrowers are looking for the servicer to evaluate the proposed new borrower and proposed indemnitor and guarantor on their own merits – without regard to the credit-worthiness of the current borrower and current indemnitor and guarantor.

Given the servicer’s responsibility to act in the best interest of the CMBS investor, the comparison of the current to the proposed principals is inevitable.

¹⁶ Generally, CMBS transactions are rated by two rating agencies, however, certain CMBS transactions may be rated by more than two rating agencies. As stated earlier, the PSA will identify which loans require rating agency review and the threshold guidelines.

¹⁷ As noted in the two Fitch research pieces, it takes an average of 24 days for the servicer to receive the necessary approvals from all the required parties.

Tension Point

Difference between the Current Borrower and the Proposed New Borrower – The proposed new borrower is an unknown entity and must be thoroughly reviewed.

Helpful Hints

The general rule is that if the property is performing well and the proposed new borrower has satisfactory experience, net worth and liquidity, then they will be acceptable as a replacement for the current borrower.

However, if the property is performing poorly, or the proposed new borrower does not have sufficient experience, net worth or liquidity, most servicers will work with the parties using a variety of alternative structures, such as additional indemnitors, true third party property management, or additional reserves to structure around the issues and successfully mitigate the risk identified by the servicer.

It is important to note, the proposed new borrower is assuming the transaction as it was originally closed, not the transaction that would be originated today if the loan was newly originated. Moreover, the ability to renegotiate loan terms may be deemed a significant modification under REMIC rules and would therefore be prohibited.

In addition to the traditional due diligence and review of the parties, a higher standard of review in recent years has been implemented as a result of the requirements of the USA Patriot Act of 2001. In response to the terrorist events of September 11, 2001, the United States Government has increased the obligations of financial institutions to “know their customer,” requiring servicers, during the assumption process, to run extensive background searches on both individuals and entities to an assumption.

Tension Point

Higher Level of Review of the New Parties to an Assumption – The USA PATRIOT Act of 2001 requires financial institutions to assist in the fight against money laundering and terrorist financing, both domestically and internationally, by:

- Mandatory reporting of suspicious activity,
- Verification of customer identification,
- Enhanced due diligence of banking customers,

- A prohibition on conducting business with individuals or companies that appear on the US Department of Treasury's Office of Foreign Asset Control (OFAC) list,
- A prohibition on correspondent accounts with shell banks (banks without a physical address),
- Voluntary information-sharing about potential crimes and perpetrators with peers and law enforcement.

Helpful Hints

Information Necessary for Patriot Act Compliant Searches – All applicable parties (as determined by the servicer's internal compliance policies) to the assumption should supply the below information early in the process in order to expedite the search process.

- For Individuals:
 - First and Last Name
 - Address
 - Date of Birth
 - Social Security Number
 - Country of Residence
- For Entities:
 - Company Name
 - Address
 - Tax Identification Number
 - Country and State of Incorporation
 - Type of Corporate Entity

How is the approval executed?

End of an Assumption Process – Assumption Closing

The assumption closing process is very similar to the loan origination closing process. The process consists of the following steps:

- Issuance of the conditional approval letter,
- Review and approval of closing deliverables and due diligence items, and
- Drafting and execution of assumption closing documents.

Conditional Approval Letter

Once the necessary parties approve the loan assumption, a conditional approval letter is issued.¹⁸ The conditional approval letter is a simplified version of a term sheet and provides the specific conditions required to close the assumption. The standard conditions include the requirements that:

1. The proposed new borrower, new indemnitor and/or new guarantor assume the current borrower, indemnitor and/or guarantor obligations;
2. The appropriate parties approve the organizational structure and documents of the proposed new borrower and its constituent entities; and
3. The servicer receives satisfactory lien and credit searches for the proposed new borrower.

The letter may also include any additional requirements that are based on terms and conditions of the specific loan documents or the property's unique set of circumstances. Examples of the types of additional requirements found in the conditional approval letter include the requirement to hire a third party property manager, the requirement to submit certain legal opinions, the satisfaction of specific closing conditions, such as the completion of any deferred maintenance items and/or an adjustment in required escrow amounts.

Closing Deliverables and Due Diligence Items

Once the conditional approval letter has been issued, the servicer's closing counsel will provide a final deal-specific closing checklist. The checklist will identify the closing deliverables and due diligence items that the proposed new borrower, new indemnitor and new guarantor must deliver to the servicer and/or servicer's counsel for approval prior to closing. The items subject to review and approval typically include the following:

New title policy or endorsement to current policy – The proposed new borrower must cause an acceptable title company to issue an acceptable title endorsement to the existing lender's policy or a new policy in the same form as the existing policy.

¹⁸ The servicer may issue the conditional approval letter prior to receiving approval from all of the required parties, in which case, the additional approvals will be one of the conditions set forth in the approval letter.

Bankruptcy, judgment and UCC searches – If not completed in connection with the approval process, the servicer and/or servicer’s counsel must receive and review bankruptcy, judgment and UCC searches for the proposed new borrower and indemnitor and the sponsors of each.

Purchase and transfer documents – Servicer’s counsel must review and approve the purchase and transfer documents between current borrower (seller) and proposed new borrower (buyer) to insure that the real and personal property are properly transferred to the proposed new borrower and to insure that the terms of the purchase and sale are consistent with those earlier provided to the servicer.

Due diligence items – Servicer and/or servicer’s counsel must review and approve all required third party reports and deliverables, which may include environmental reports, surveys, certification of financial documents (rent rolls and operating statements) and tenant estoppel certificates.

New insurance certificates – The proposed new borrower must provide new insurance certificates that evidence insurance is in place and that insurance complies with the terms of the loan documents.

Property management agreement – The proposed new borrower must submit the new property management agreement to the servicer and/or servicer’s counsel for review.

Organizational documents – The organizational documents of the proposed new borrower and its constituent entities must satisfy the requirements in the loan documents and provide similar protections as the organizational structure of the current borrower.

Legal opinions – The proposed new borrower must provide all required legal opinions, including, authority opinions, enforceability opinions and non-consolidation opinions. If the borrower is a single member limited liability company then a Delaware single member opinion must be provided. In addition, servicer’s counsel will provide a REMIC opinion, confirming that the assumption will not cause a REMIC violation.

Execution and Closing

Once the loan assumption receives the final credit approval, the assumption is effectuated by the execution and delivery of the requisite loan assumption documentation.¹⁹ In an assumption, all the specific terms of the transaction are incorporated into the assumption documentation. Although the particular forms of assumption documents may vary from servicer to servicer, the terms and content of the documents are very similar. The primary documents provide for the following:

¹⁹ As part of the closing process, servicer’s counsel will confirm with the Trustee that all assignment documents have been completed. The assignment documents evidence the transfer of the loan from the original lender to the CMBS trust. It is important for servicer’s counsel to confirm such assignment early in the assumption process because if the loan has not been properly assigned to the CMBS trust, having to do so late in the assumption process will create additional delays in closing.

1. Consent to the transaction by the servicer (who has first obtained the requisite other approvals, as described earlier in the Report);
2. Representation and warranties by the current borrower and proposed new borrower;
3. Assumption by the proposed new borrower, new indemnitor and/or new guarantor of the respective obligations of the current borrower, indemnitor and/or guarantor;
4. Release of current borrower and indemnitor from their respective obligations as identified parties under the loan documents for acts occurring on or after the date of the assumption;²⁰
5. Acknowledgment of indebtedness and escrow amounts; and
6. Modifications to the existing documents to reflect any specific terms of the transaction, if necessary.

Tension Point

As previously mentioned, the proposed new borrower is assuming the transaction as it was originally closed, not the transaction that would be originated today in a new origination. As such, the servicer has very little latitude to make changes to the underlying loan document terms. Moreover, certain modifications to the current loan terms may be deemed a significant modification under REMIC rules and would therefore be prohibited.

Similarly, the terms of the servicer's form documents satisfy industry and rating agency standards. As such, the servicer and servicer's counsel have limited ability to deviate from the form assumption documents.

Helpful Hints

The proposed new borrower should review the existing loan documents prior to beginning the assumption process, and to the extent that the proposed new borrower intends to request modifications to the underlying loan documents, such a request should be submitted as soon as possible, to ensure consideration is given during the approval process with each required approval party. Most document modifications are subject to the review and approval of the same parties responsible for reviewing and approving the proposed assumption. If the request to modify the loan documents is received after the conditional approval is granted, the assumption request will need to be resubmitted to the approval parties for consideration of the requested modifications, thus resulting in potential closing delays.

The proposed new borrower and the current borrower should obtain copies of the servicer's form assumption documents from the servicer or the servicer's counsel early in the assumption process.

²⁰

However, the release of the current borrower and any indemnitor or guarantor does not release the parties from any possible liability for actions or activities performed prior to the assumption closing.

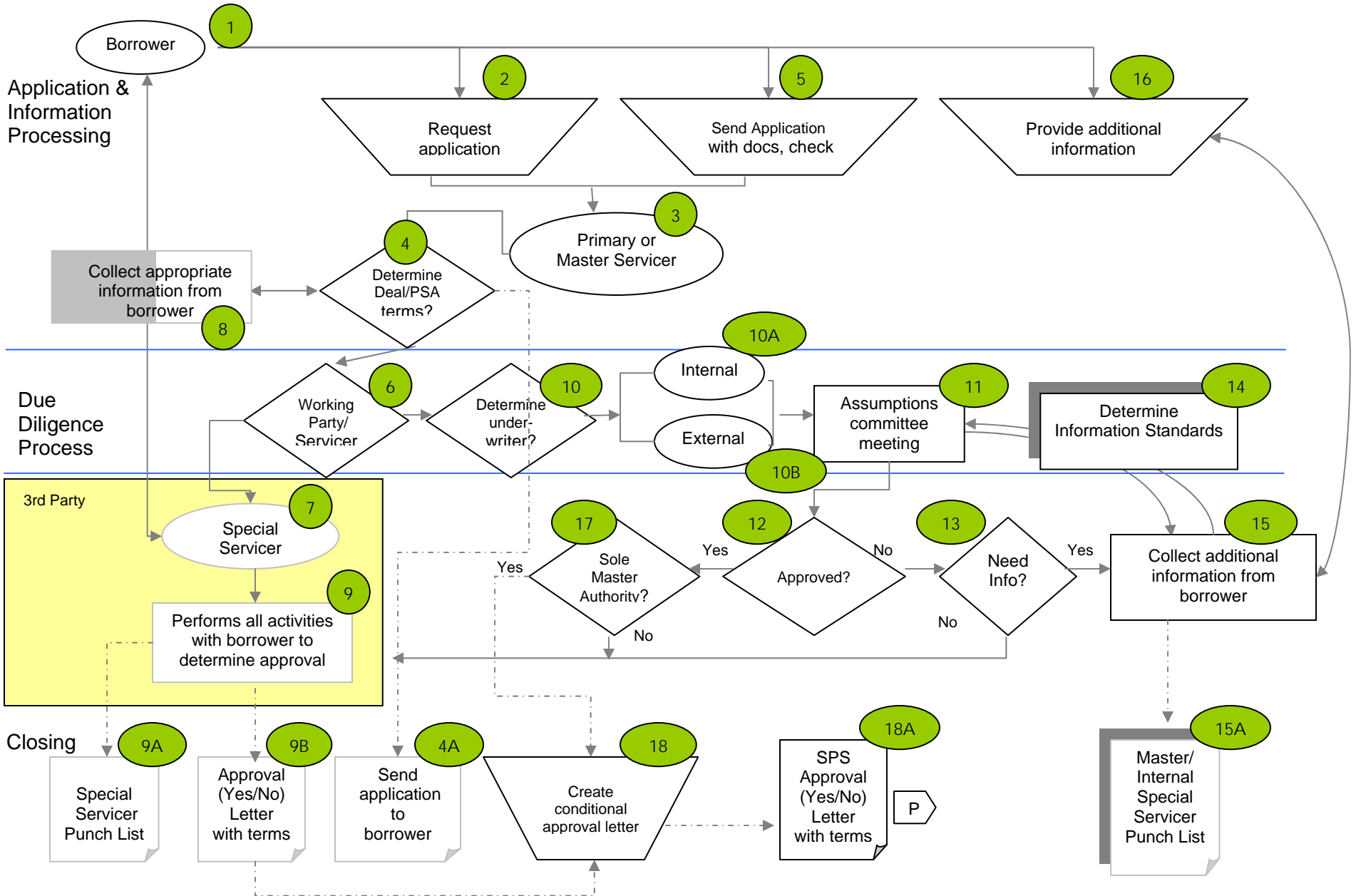
CONCLUSION

The task force hopes this paper has helped to demystify the CMBS assumption process by establishing realistic market expectations and providing a better understanding of the roles of the parties, documentation requirements, approval process and the challenges inherent on the assumption process.

Preparation and better communication between the seller, buyer and the servicer will help ensure a smoother flow of information and facilitate the quicker processing of your loan assumption.

Further questions about the specifics of a loan assumption should be directed to your CMBS servicing representative. Working together, we can continue to improve and refine the assumption process.

EXHIBIT A: ASSUMPTION WORK FLOW CHART



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