

Navigating the Choppy Waters of the CMBS Loan Assumption Process: 10 Ways to Bring Calm to the Storm

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The commercial mortgage backed security loan assumption process initially may appear to be time consuming and cumbersome, but with the proper understanding, guidance, and expectations, it is one that can be managed so that all parties can benefit without unreasonable delay. This article addresses 10 ways to make the process more manageable for all parties involved.

At first glance, the assumption of a commercial mortgage backed security (“CMBS”) loan may appear to be a difficult task. Given the parties involved—master servicers, special servicers, rating agencies and their counsel, for starters—and the documentation required—assumption agreements, guaranties and opinion letters, among others—it is understandable why some purchasers and sellers may approach the loan assumption process with trepidation.¹

However, if both the seller of the property and the loan-assuming purchaser understand the process and timing going in, an ostensibly daunting task may become substantially easier. This article addresses 10 ways to make

the process more manageable for all parties involved.

10 Key Considerations

1) Understand the Time Frames and Parties Involved

Assuming a somewhat traditional CMBS loan assumption scenario (i.e., one in which a master servicer, special servicer and rating agencies are involved), it is important that all parties understand the process and likely timing from start to finish. This is important in order to manage expectations of all parties and to enable the seller and purchaser to build in sufficient time frames in their purchase contract for completing the transaction.

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In short, the process will be initiated by the submission of an application to a master servicer. The initial submission likely will include financials for the incoming sponsor, a copy of the purchase and sale agreement, certain organizational documents and information regarding the new sponsor's intentions with respect to property operations, property management, its choice of clearing bank, and possibly capital improvements and leasing plans. The master servicer will then send this information to an underwriter for review.

After underwriting is complete (the underwriting process may include direct discussions between the underwriter and new sponsor), the master servicer will send a recommendation to the special servicer. The special servicer will typically have 10 or 15 business days to approve or deny consent to the assumption or request additional information² in order to evaluate the submission, and the special servicer will generally have to obtain the consent of the most junior bondholder (which also will have a specific time period, less than the 10 or 15 business days, in which to respond) prior to the special servicer granting its consent.

Assuming the special servicer approves the request, which approval may be subject to satisfaction of certain conditions, requests for no downgrade letters will then be sent by the master servicer to the rating agencies. Although the master and special servicer are each held to a "servicing standard" in granting or withholding consent, the junior bondholder is not held to such a standard. All of this will take place while master servicer's counsel gathers required diligence and negotiates and prepares documents for closing, such as an assumption agreement, replacement guaran-

tees and various opinion letters. The entire process likely will take approximately 10-12 weeks.

Again, the process described herein is for a somewhat traditional CMBS loan assumption scenario. Under some pooling and servicing agreements or trust and servicing agreements, the assumption process may vary significantly.

For instance, an assumption of a loan below a certain dollar threshold may not require a no downgrade letter from the rating agencies. Additionally, the special servicer's role may vary greatly depending upon the terms of the servicing agreement. Its role may be one of the following: (i) total control of the assumption process, (ii) the right to consent to the assumption transaction which is processed by the master servicer or (iii) the right to confirm master servicer's determination that certain assumption conditions in the loan documents have been satisfied. For purposes of this article, we have generally assumed the first scenario referenced in the foregoing sentence. In any event, it is important to ask master servicer's counsel, at the outset, about the process specified in the applicable agreement.

Addressing the remaining issues below in the manner suggested may prevent the process from being delayed or even putting the entire sale of the property and corresponding loan assumption in jeopardy.

2) Consider All Loan Document Provisions, Including Those in Ancillary Loan Documents, and Potential Loan Modifications Early in the Process

It is important that a party assuming a CMBS loan review and understand, early in

the process, each of the provisions in the loan documents.

For starters, the requirements and deliverables for an assumption set forth in the loan documents must be carefully reviewed.

Additionally, provisions such as those regarding property management and permitted transfers must be carefully analyzed as well. If changes to these or any other provisions are required or desired by the assuming borrower, such proposed changes must be discussed as early as possible with the master servicer.

Although an assuming borrower will generally not have the ability to renegotiate the terms of the CMBS loan documents, if there are legitimate business reasons for changes to specific terms, such as modifications to the permitted transfer provisions or changes to the financial reporting sections due to a different equity ownership structure of the new borrower/sponsor, the servicers likely will consider such requests. Such proposed requests must be presented to the master servicer to evaluate as part of its underwriting and to include in its recommendation to the special servicer, and therefore, must come early in the process to avoid potentially significant delays.

When reviewing the loan document provisions prior to commencing the loan assumption process, particular attention should be paid to the provisions regarding a replacement guarantor. Does the replacement guarantor meet the standards in loan documents (if any financial thresholds are specified in detail as opposed to “acceptable to Lender”)? Will the replacement guarantor be able to meet all of the financial covenants and reporting requirements in a timely manner going forward? Is it

a different or similar entity structure to the current guarantor?

3) Know all about Rating Agencies, Rule 17g-5 and Opinion Letters

Not only is it important to know if rating agency no downgrade letters are required for an assumption transaction (in terms of additional level of review and timing expectations), but it is equally important to know if the loan is categorized as a “17g-5” loan.³

Most pooling and servicing agreements drafted after 2009 will have 17g-5 provisions which prohibit the master and special servicers from communicating directly with the rating agencies, except under certain very limited circumstances and subject to certain strict requirements. Instead, the servicers must post documents and communications to a website run by a “17g-5 information provider.” It is important to understand that the required 17g-5 procedures may cause delays during the assumption process, particularly if rating agencies have questions or additional document requests.

The loan documents will also set forth requirements with respect to delivery of opinion letters on behalf of the new borrower and replacement guarantors. Certain opinion letters will require review by the rating agencies. For larger CMBS loans (generally \$20MM or more), new non-consolidation opinions likely will be required and will have to be reviewed by the rating agencies.

Additionally, to the extent a non-consolidation opinion is required, it will generally be included with a master servicer’s initial submission to the rating agencies, so it is important to draft, negotiate and agree upon a

form of non-consolidation opinion prior to a package being ready to be sent by the master servicer to the rating agencies.

Similarly, Delaware state law and authority to file opinions for the assuming borrower may also be required. This may require the retention of separate Delaware counsel and the negotiation of such opinions and should be started early.

4) Assumption Agreement—Be Prepared for What Will Be Required

From a CMBS loan servicing standpoint, the key document in an assumption transaction typically will be an assumption agreement. It is important for both sellers and purchasers to understand that the master servicer will expect certain representations, reaffirmations, and confirmations from each of the parties.

For example, an outgoing seller will be expected to represent that there are no defaults with respect to the loan and loan documents and to confirm that the representations it made at closing are true, correct and complete as of the day of the assumption.

Carve-out guarantors often will be released from matters arising after the closing of the assumption, but will have to reaffirm his/her/its obligations for all matters prior to such date. Furthermore, the new borrower must recognize that it is assuming all obligations of the original borrower under the loan documents from the date of the original loan closing and not just obligations arising after the closing of the assumption, although the new recourse carve-out guarantors will generally only be responsible for acts or omissions that occur on and after the closing of the purchase and sale transaction.

5) Cash Management—Start Early

Simply stated, cash management is a crucial lead-time issue for a CMBS loan assumption. If cash management is in place, an incoming sponsor should decide early on which bank will serve as the clearing bank. The process of obtaining and negotiating a clearing account agreement should not be left until the last minute. As part of the new sponsor's review of the existing loan documents, a determination must be made if the existing cash management agreement will continue to work for the new sponsor as drafted. For example, if approval has been obtained for a new OpCo-PropCo structure in connection with the assumption of a loan secured by a hotel property, minor changes to the cash management agreement may be required.

Large banks frequently serve as master servicer, and while their assumptions team can quarterback the assumption process, separate cash management groups from within the bank may have to be brought in to address changes or to have new accounts opened.

6) Title and Survey—Understand the Servicer's Requirements

The new survey (or updated survey) being prepared must be certified to the current holder of the loan (i.e., the real estate mortgage investment conduit (REMIC) trust). It is important that an incoming sponsor obtain the precise certification required by the master servicer early on in the process.

Additionally, as soon as a title commitment is received, it should be sent along to the master servicer's counsel. The master servicer's counsel will focus on instruments which were recorded after the date of the original

loan closing, plus any other changes to title since the original loan closing. In short, the master servicer must end up with title coverage similar to that which was obtained in connection with the original loan closing, including all endorsements and affirmative coverage. This can be accomplished either by an entirely new policy or, in some cases, by title endorsement. In either case, a memorandum of assumption agreement will be recorded and this instrument will have to be insured.

Since a new borrower will be of record, new UCC-1's will have to be filed using a description similar to that used at loan origination. Of course, Uniform Commercial Code ("UCC") searches will have to be conducted to confirm that no filings have been made since the original loan closing.

7) Organizational Documents and other Checklist Items—Stay On Top from the Beginning

Master servicer's counsel will provide a legal checklist early in the process. New sponsor's organizational documents should be provided early on and as they become available, including a detailed organizational chart with ownership percentages and jurisdictions of formation/incorporation for entities.⁴ Outgoing sponsors should be prepared to provide resolutions authorizing the sale of the property and the execution of the assumption agreement, together with good standing certificates.

Other crucial lead-time checklist items may include searches, proof of insurance and, as noted above, title and survey. With respect to insurance, the incoming sponsor should engage its insurance broker early in the assumption process, and confirm that its broker

understands the master servicer's closing requirements with respect to insurance.

If the parties continuously address the legal checklist items as the assumption application makes its way through the master servicer, special servicer and rating agencies, a closing could take place as soon as one or two days after the servicers have granted approval and the rating agencies have issued their no downgrade letter(s).

8) Purchase and Sale Agreement and Deadlines—Keep Master Servicer Apprised

As previously noted, the parties will be required to provide the master servicer with their purchase and sale agreement in connection with the initial application. At such time, the master servicer and its counsel should be made aware of any crucial deadlines, such as the proposed closing date (and whether it is time of the essence), and should be kept apprised of any changes during the assumption process.

For example, if an amendment to the purchase and sale agreement is executed during the assumption process, the amendment should be provided to the master servicer upon execution. This is particularly important if any key terms or crucial deadlines have changed. It is also important that the master servicer have the most current information if questions arise from the special servicer and/or rating agencies regarding the terms of the sale and purchase transaction.

9) Remember Tenant Issues May Be Master Servicer Issues Too

A discussion should be had with the master

servicer at the start of the assumption process about its requirements with respect to estoppel certificates. In many cases, a master servicer will take the purchaser's lead in terms of the number of estoppel certificates required. The reliance language in the estoppel certificates should be discussed with the servicer as well. And as estoppel certificates become available, they should be provided to the master servicer's counsel.

10) Other Considerations—Think Ahead

If a mezzanine loan is being assumed simultaneously with a mortgage loan, it is important to confirm that all parties are working together to make sure both assumption matters can close simultaneously and mutual consents are exchanged between the mortgage lender and the mezzanine lender to the extent required under the applicable intercreditor agreement.

Any other unusual aspect to the transaction should be discussed with the master servicer upfront. For example, if the borrower ownership structure is changing, perhaps from a single member limited liability company to a tenant in common structure, this must be ad-

dressed head-on at the outset of the transaction. Similarly, if an existing guaranty is to remain in place due to an arrangement between seller and purchaser, this must be discussed with the master servicer at the start of the assumption application process.

Conclusion

The CMBS loan assumption process initially may appear to be time consuming and cumbersome, but with the proper understanding, guidance and expectations, it is one that can be managed so that all parties can benefit without unreasonable delay.

NOTES:

¹A CMBS borrower wishing to sell its property may have only two options under its loan documents, either an assumption of the CMBS loan or defeasance.

²A request for additional information may restart the 10 or 15 business day clock.

³See, generally, Securities and Exchange Commission Rule 17g-5 which was amended in a significant fashion in 2009 to address conflicts of interests of Nationally Recognized Statistical Rating Organizations and to improve transparency with respect to the ratings process.

⁴If the master servicer has agreed to run all searches (Office of Foreign Assets Control, UCC, bankruptcy, lien, litigation, etc.), a detailed organizational chart will enable the master servicer to conduct and complete such searches in a timely fashion.