February 7, 2008

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Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20044

Ladies and Gentlemen:

This letter is submitted by the undersigned members of the real estate and securitization industry in response to proposed regulations (the "Proposed Regulations") promulgated by the Internal Revenue Service (the "Service") affecting real estate mortgage investment conduits ("REMICs").[1] Members of the industry had previously submitted a letter (the "Industry Letter") requesting changes in the regulations,[2] in response to a request for comments appearing in Notice 2007-17, 2007-12 IRB 748 (March 19, 2007). The undersigned also request the opportunity to appear through a representative at a public hearing on the Proposed Regulations.

The undersigned applaud the Service's willingness to address the issues raised in the Industry Letter by proposing regulations that are intended to facilitate REMIC administration. 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 transactions without a compelling policy rationale or potential for abuse. In addition, the undersigned continue to believe that the other changes requested in the Industry Letter, while perhaps not absolutely necessary under the current regulatory regime, would provide bright-line, easily-administered tests that would greatly simplify this area of the law. Therefore, we respectfully request that the Service reconsider those requests together with suggested textual changes in the Proposed Regulations set forth below.

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[1] REG-127770-07, 72 Fed. Reg. 63523 (November 9, 2007).

[2] Letter dated April 30, 2007 from Jonathan Kempner, Mortgage Bankers Association, et al. to Internal Revenue Service.

1. The Proposed Regulations should not be exclusive in the case of releases of collateral.

The Proposed Regulations would amend Treas. Reg. §1.860G-2(a)(8), to provide:

> "If a REMIC releases its lien on real property that secures a qualified mortgage, that mortgage ceases to be a qualified mortgage on the date it is released unless –
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> (i) The REMIC releases its lien pursuant to a modification described in paragraph (b)(3)(v) of this section addressing changes to the collateral for, guarantees on, or other form of credit enhancement on a mortgage . . . ."

Semantically, this formulation excludes all releases of real property other than those covered by paragraph (b)(3)(v) (aside from defeasances, which are addressed in clause (ii) of paragraph (a)(8)). Although this result may have been unintentional, it should be made as clear as possible that releases allowed under existing law, including those that are not significant modifications under section 1001[3] and those that are occasioned by a default or reasonably foreseeable default, are not adversely affected by the addition of paragraph (b)(3)(v). We believe that neither the industry nor the Service has interpreted current paragraph (a)(8) to apply to releases or substitutions outside the defeasance context. For example, commercial mortgage loans frequently contain provisions that allow (i) a specified parcel of property to be released automatically if certain net income or leasing targets are reached, (ii) the release of a parcel that was not included in the original underwriting of the loan or was assigned no value or (iii) a release at the unilateral request of the borrower upon demonstrating satisfaction of specified objective criteria. In the latter case, the release is typically accompanied by a partial payment of principal (a "release price") specified in the loan, which is determined based on a proportionate part of the fair market value of the total property at origination of the loan. Not infrequently, the release price is a multiple (e.g., 110 percent or 125 percent) of that allocated value. If there is no principal paydown required, this would indicate that the release parcel was not included in the initial underwriting of the loan or had de minimis value, so it did not enter into the calculation of the required REMIC loan-to-value-ratio. All releases under the foregoing types of loan provisions are taken into account by tax counsel in evaluating the qualified mortgage status of the loan at the inception of the REMIC. These loan provisions reflect well-established practices in the REMIC industry and cannot be abrogated by new regulations without causing significant disruptions in loan administration or even breaches of loan agreements. We believe that the goal of ensuring that paragraph (a)(8) not inadvertently override new paragraph (b)(3)(v), while

[3] All section references are to the Internal Revenue Code of 1986, as amended, and references to "Treas. Reg." are to the regulations of the U.S. Department of the Treasury promulgated thereunder.

clarifying its intended scope, would be accomplished by making the following change to the lead-in to paragraph (a)(8):

> "If a REMIC releases its lien on real property that secures a qualified mortgage in conjunction with a pledge of collateral other than real property, that mortgage ceases to be a qualified mortgage on the date it is released unless -. . ."

Pursuant to this change, proposed clause (i) would be eliminated and the remainder of paragraph (a)(8) would read as it does currently. As further discussed in Section 3 of this letter, the preamble to the final regulations should include an explicit statement to the effect that releases of real property other than through defeasance that are permitted under existing law will continue to be allowed.

2. Modifications other than releases or substitutions of collateral should not require retesting collateral value.

Under existing regulations, the qualified status of a mortgage loan is determined at the inception of the REMIC based on the value of the real property either at the origination date of the loan or as of the startup day of the REMIC (or, if the loan has been significantly modified (within the meaning of section 1001) between those dates, the date of the modification).[4] The use of the modification date in this context is still intended to identify the LTV ratio of a "new" mortgage loan going into a REMIC as of a date not later than the startup day of the REMIC. A REMIC does not lose its qualified status because of changes in the market value of real property after the REMIC's startup day, and neither guarantees nor credit enhancements taken into account in determining market value. Moreover, the LTV ratio is not affected by the recourse or nonrecourse nature of the loan. To impose a collateral value test in connection with changes in guarantees, credit enhancement or recourse nature, or the addition of collateral, suggests that the Service views these events as the equivalent of contributing a "new" mortgage loan to the REMIC on its startup day. To the contrary, the fact that these loan modifications may be recognition events under section 1001 does not mean that a "new" loan is being originated, and the Proposed Regulations should not raise a new impediment to ease of loan administration that they are seeking to promote. For these reasons, we believe that §§1.860G-2(b)(3)(v) and (b)(3)(vi) of the Proposed Regulations should not impose the "principally secured" test in the case of additions of collateral or changes to guarantees or other form of credit enhancement or changes in the recourse or nonrecourse nature of the underlying mortgage loans.

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[4] Treas. Reg. §§1.860G-2(a)(1)(i), -2(b)(i)(ii). The regulations also contain an alternative test based on the use of substantially all of the loan proceeds to acquire, improve or protect the real property. Treas. Reg. §1.860G-2(a)(1)(ii).

3. If other changes described in this letter are made, reference to a "substantial" amount of collateral is unnecessary.

As drafted, §1.860G-2(b)(3)(v) of the Proposed Regulations applies to modifications of a "substantial" amount of the collateral for, a guarantee on, or other form of credit enhancement for a qualified mortgage. Although it is true that "substantial" changes are the ones of concern, since insubstantial changes would not give rise to a deemed exchange under the section 1001 regulations, part of the industry's goal in seeking these clarifications of the regulations is to facilitate REMIC administration by reducing a servicer's need to consult with counsel before making a requested modification. What is a "substantial" amount of collateral is not defined in existing regulations, and servicers up until now have relied on the judgment of counsel to make this determination. Retaining this term in the Proposed Regulations continues the need to make this judgment to determine whether or not the regulation would apply in a given context. At the same time, however, it would be very helpful for the preamble to the final regulations to clarify that paragraph (b)(3)(v) is an alternative exception, and that changes to collateral, guarantees or other credit enhancement that are currently excepted, including alterations that are not "modifications," modifications that are not "significant" and modifications occasioned by a default or reasonably foreseeable default are not affected by the new regulations. Servicers will then be able to make changes to collateral based on these alternate exceptions without having to consult counsel. We therefore recommend that the phrase "a substantial amount of" be eliminated from proposed paragraph (b)(3)(v).

4. An appraisal should not be the exclusive means of meeting the "principally secured" test.

Section 1.860G-2(b)(3)(v) of the Proposed Regulations would require that the release, substitution or addition of collateral or of a guarantee or other form credit enhancement satisfy the requirement that the obligation in question be "principally secured" by real property following the modification. Similarly, §1.860G-2(b)(3)(vi) of the Proposed Regulations would require that the "principally secured" test be met upon a change from recourse (or substantially all recourse) to nonrecourse (or substantially all nonrecourse). Under §1.860G-2(b)(7) of the Proposed Regulations, the "principally secured" test is met if the fair market value of the real property is equal to at least 80% of the adjusted issue price of the modified obligation as of the date of the modification, and the fair market value must be determined by an appraisal performed by an independent appraiser. Section 2 of this letter discusses the inappropriateness of applying the "principally secured" test to an addition of collateral or a modification of a guarantee or other form of credit enhancement, or to a change in the recourse nature of an underlying mortgage loan. If this suggestion is accepted, the "principally secured" test would only apply to releases or substitutions. However, requiring that this test be met by a formal appraisal is both inconsistent with the requirements upon a REMIC's formation (where there is no appraisal requirement) and, in many cases, difficult to implement or even unnecessary. Requiring an appraisal for a loan secured by multiple properties can be extremely onerous and could prevent a release or substitution from occurring at all. Loans secured by four, eight or a dozen or more properties are common, and we are also aware of commercial mortgage loans secured by hundreds of separate properties. Even in the case of a single property, a full appraisal by an independent appraiser can be an expensive proposition (e.g., $7,000-$10,000 for a smaller property and $50,000-$100,000 for a larger property), and this cost should not have to be borne by investors in the REMIC. Moreover, imposing it on the borrower may well be a violation of the loan terms or may discourage the borrower from undertaking the modification itself. Instead, final regulations should leave the determination to the REMIC's servicer to establish that the "principally secured" test continues to be met based on all information available to it to make that determination, without prescribing a specific methodology. This is no different than establishment of "qualified mortgage" status at the inception of the REMIC pursuant to Treas. Reg. §1.860G-2(a)(1)(i), where no particular method is prescribed to determine value. We therefore have two recommendations: (i) final regulations should not require that fair market value be established exclusively by a current appraisal. Such an approach should either be a safe harbor or should be one of several approaches for establishing value, including brokers' price opinions, "desk" appraisals or appraisals obtained in connection with the origination of the loan and, if appropriate, updated for the passage of time; and (ii) in the case of a substitution, the test should be deemed to be met if the fair market value of the substitute real property equals or exceeds the fair market value of the substituted property, as established by an appraisal or one of such other methods.

5. **<u>Changes from nonrecourse to recourse should be included.</u>**

Section 1.860G-2(b)(3)(vi) of the Proposed Regulations permits a change in the nature of an obligation from recourse (or substantially all recourse) to nonrecourse (or substantially all nonrecourse). In Section 2 of this letter, we discussed the inappropriateness of making this change subject to the "principally secured" test. We further believe that the omission of a change from nonrecourse (or substantially all nonrecourse) to recourse (or substantially all recourse) should be corrected. There are many situations where a recourse feature may be triggered, such as when a commercial property does not meet net operating income or leasing targets, or if such features decline below prescribed levels. If treated as a change from nonrecourse to recourse, such a change may not be treated as an "automatic" change under Treas. Reg. §1.1001-3(c)(2)(i), yet the change from nonrecourse to recourse will be treated as a "significant" modification under Treas. Reg. §1.1001-3(e)(5)(ii)(A). Since these changes nearly always involve the imposition of liability on the parent entity or owner of the borrower and not an actual change in recourse to the borrower's assets, servicers and their counsel treat these changes as changes in guarantees or other credit enhancement and not as changes in recourse. It would be much clearer to have these changes covered in a more straightforward way in paragraph (b)(3)(vi) of final regulations. We believe that the omission of changes from nonrecourse to recourse from the text of the Proposed Regulations was unintentional, because the preamble to the Proposed Regulations appears to contemplate such a change. However, if the omission of changes from nonrecourse to recourse in paragraph (b)(3)(vi) was intentional, we submit that there is no policy consideration justifying its omission, since this type of change has no relation to loan origination activity.

6. **Other industry requests should be included.**

In the Industry Letter, we identified certain other potential loan modifications that we believe are suitable for additional guidance. These include (i) modifying a defeasance provision or prepayment lockout date, (ii) the substitution of an obligor or the addition or deletion of a co-obligor, (iii) the imposition or waiver of a prepayment penalty or other fee and (iv) changing a principal payment schedule as a result of a partial principal payment, without extending the maturity date. We still believe that guidance on these changes is appropriate, whether or not they would be treated as deemed exchanges under section 1001. Recognizing that the purpose of the Proposed Regulations is to facilitate REMIC administration, this guidance will permit servicers to make these types of changes without the undue delay or cost of consulting with counsel that currently exists. We believe that there is no need to ration regulations based on whether they are absolutely necessary, rather than helpful. Indeed, the existing exceptions in Treas. Reg. §1.860G-2(b)(3) are not necessarily section 1001 events, but this does not diminish their helpfulness. In the case of changes in defeasance provisions, in particular, we do not believe that any policy exists to limit defeasance provisions beyond the lack of an intent to defease as of the REMIC's startup day evident in the two-year requirement of Treas. Reg. §1.860G-2(a)(8)(iv). The addition or change of a defeasance provision after the REMIC's startup day is entirely consistent with that intent.

7. The Proposed Regulations should also cover grantor trusts.

As described in the Industry Letter, commercial mortgage loans, particularly very large "stand-alone" loans, are not infrequently securitized utilizing a grantor trust structure. Even more often, a grantor trust is utilized along with one or more REMICs under the same trust document either to strip certain payments off the mortgage loans or to hold assets that cannot be included in the REMICs, such as an interest rate swap agreement. Covering REMICs but not grantor trusts in the Proposed Regulations could lead to anomalous situations where otherwise similar securitizations must be serviced differently, or where a change cannot be made because it would adversely affect the grantor trust portion of the transaction. We believe that allowing all the same modifications for grantor trusts as are allowed for REMICs under the Proposed Regulations, even if the recommendations contained in this letter are accepted, does not involve new loan origination or reinvestment of loan proceeds, and therefore cannot constitute "varying the investment of the certificate holders," within the meaning of Treas. Reg. §301.7701-4(c)(1). Appropriate limitations can be placed on the grantor trusts covered to ensure that they are either formed to hold mortgage loans (or payments thereon) that would qualify as "qualified mortgages" if transferred to a REMIC on its startup day or to hold assets that are incident to a REMIC securitization.

Conclusion

The undersigned would again like to commend the Service for its responsiveness to industry concerns in facilitating mortgage loan securitization and the transparency of the procedures it has instituted to obtain industry input. We would be happy to provide additional information in any way that would be helpful to finalizing the Proposed Regulations. If you require further information, please contact Charles M. Adelman of Cadwalader, Wickersham & Taft LLP (phone: (212) 504-6477; email: charles.adelman@cwt.com).

Respectfully submitted,

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