

REMIC Rules Revisited: Got Compliant Property Releases?

June 11, 2011 by [Devin M. Swaney](#)

Greetings. What ever happened to those REMIC rules regarding property releases that we [blogged](#) and wrote about in [2009](#) (pdf) and [2010](#) (pdf)? The REMIC rules were revised in September 2009 to add flexibility to facilitate certain types of servicing transactions. However, under the new rules, if a property release occurs, the loan had to be retested to determine whether it continued to be principally secured by real estate (e.g., secured by no more than 125% loan-to-real property value ratio).

Quite a price for a bit more flexibility! This caused enormous consternation as it was promulgated during a massive cyclical downturn in real estate values which resulted in many properties not being able to pass the new “principally secured” test if a release occurred. And many loans contemplated such a release. In a bold recognition of reality, something not entirely common in regulatory circles, the IRS issued [Revenue Procedure 2010-30](#) (pdf) establishing a safe harbor for certain “grandfathered transactions” and “qualified paydown” transactions. Under the Rev Proc, a loan would not lose its status as a REMIC “qualified mortgage” even if the “new” loan-to-real estate value ratio was in excess of 125% (i.e., if the loan was less than 80% secured by real property) so long as the loan was “grandfathered,” meaning that it was closed on or before December 6, 2010 (and not amended after that date).

The Rev Proc also provided exemption for a “qualified paydown.” This is a release where the loan’s balance is reduced by a “qualified amount.” A qualified amount, for these purposes, includes an amount equal to (i) the net proceeds of an arm’s length sale of the release parcel to an unrelated person, (ii) the fair market value of the release parcel at the time of the release or (iii) an amount such that the loan-to-value ratio of the loan (as determined by the lender according to an acceptable REMIC valuation) does not increase as a result of the release.

So what does all that mean for a securitizer or mortgage loan seller conveying loans into a deal these days? Essentially, if loans are grandfathered, it’s business as usual. But what about loans originated or modified after December 6, 2010 with release mechanics? Obviously, as the market reflates, more loans going into new securitizations were closed after that magic date. Then we have two options. First, make sure that the loan documents are drafted at origination to be in compliance with the Rev Proc or find and modify any existing loan documents to make them compliant before putting them into a deal. As mortgage loan originator/seller or its counsel, ya just got to focus. Is there a release provision that may blow up the REMIC? What to do if you’ve found a loan originated or modified after December 6, 2010 with non-compliant provisions? Fix it or throw it out.

The servicer’s job has been made easier on this conundrum by [CMBS 2.0](#) practice. CMBS 2.0 documents now generally contain a rep confirming that no releases are allowed in the loan documents other than in compliance with applicable REMIC provisions. This gives an out to a servicer who might otherwise be caught between the proverbial rock and hard place of a contractual obligation to permit a release and its obligation to prevent any REMIC violation. If

the servicer discovers a non-compliant release mechanic, the loan can then be put back to the mortgage loan originator/seller for breach of rep. A solution for the servicer. Cold comfort for the originator/seller.

As you contemplate this nifty additional trap for the unwary, remember this release restriction applies to outparcels even if underwritten at no material value, and it applies to partial releases resulting from casualty or condemnation (whether voluntary or involuntary) and releases under a cross-collateralized structure or a multi-property portfolio structure.

Within the tsunami of regulatory change that our industry is confronting, these REMIC changes were a one-day wonder and have since gotten little attention outside servicer land. But this is important, particularly for the originator/seller. At the end of the day, you're going to give a clean rep that the loan documents comply. A non-compliant release restriction is easy to miss. The price of screwing up is high. Save at least one worry bead for Rev Proc 2010-30.