

**SPE'S – WHO, WHAT, WHY, WHERE, WHEN AND HOW?**

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**Introduction**

The ever increasing use in real estate lending transactions of both limited liability companies (“LLC’s”) and capital markets, through Commercial Mortgage Backed Securities (“CMBS”), has combined to require a working knowledge of yet another acronym, Special Purpose Entities, or “SPE’s. The purpose of this presentation is to attempt to reduce some of the mystery behind these entities and answer the following simple questions (although the answers may not always be as simple), with respect to SPE’s:

- I. WHO requires SPE’s as part of the lending transaction?
- II. WHAT are SPE’s and what provisions does the lender require to be in the organizational documents for this entity?
- III. WHY are SPE’s required (other than “Because the Rating Agencies require it”)?
- IV. WHERE should you form the SPE?
- V. WHEN should you form the SPE? and
- VI. HOW do you form an SPE that satisfies the lender’s requirements so that the lender will close your client’s loan?

This presentation is developed largely from the perspective of the lender’s counsel who is acting as primary real estate counsel for a lender who closes original mortgage loans that will be securitized. It will hopefully also provide useful information to developer’s counsel who must jump through the various hoops to form these entities.

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- I. Background-- The Commercial Mortgage Backed Securities (“CMBS”) Market and Securitized Conduit Loans
  - A. History of CMBS
  - B. Commercial Loans bundled into pools
  - C. Rating Agencies role
  - D. Homogenization/Standardization of Securitized Loans
  - E. SPE Provisions designed to create uniformity among the loans to reduce economic risks
- II. Rationale behind SPE Requirements
- III. Does this Rationale Work for Other Types of Lenders?
  - A. Portfolio Lenders
  - B. Difference in Requirements
- IV. SPE Limitations
  - A. Provisions Intended to Prohibit the SPE From Incurring Liabilities
  - B. Separateness Covenants
  - C. Provisions Intended to Protect the SPE from Dissolution Risk
  - D. Prohibitions Against Amendments to Organizational Documents
- V. Other Special SPE Limitations
  - A. “Bankruptcy Remote” Equity Owner (a “Two Tiered SPE”)
  - B. Independent Director
  - C. Non-Consolidation Opinion
  - D. Bankruptcy Issues
- VI. How to Form an SPE that the Lender (and Rating Agencies) Will Accept
  - A. It’s a Matter of Degrees
  - B. Follow the Lender’s Lead

- C. Where do Independent Directors Come From?
- D. How do I give a Non-Consolidation Opinion? Answer – VERY CAREFULLY!

VII. When to form an SPE

- A. Formation at the time that the loan is closing.
- B. Formation well prior to closing.
- C. Keep it Simple
- D. Tax Considerations

VIII. Is this my Document or the Lender's?

- A. It's more than Just the SPE Provisions
- B. Address How the Entity will Operate
- C. What Else Should the Lender's Counsel Look for in Organizational Documents?
  - 1. Duration
  - 2. Indemnification Obligations
  - 3. Preferred Equity