

COVID-19: REVENUE PROCEDURE 2020-26 (APRIL 13, 2020) AND THE CARES ACT

TREATMENT OF MORTGAGE LOAN FORBEARANCES AND MODIFICATIONS FOR MORTGAGE LOANS IN REMICS AND FIXED INVESTMENT TRUSTS

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Throughout the United States, state and local governments have ordered various businesses to close in response to the coronavirus (“COVID-19”) pandemic. The resulting economic distress has affected borrowers, including businesses and individuals alike. The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) contains new and mandatory debt relief provisions requiring forbearances for some mortgage loans in light of the ongoing national coronavirus emergency declared on March 13, 2020.

Many mortgage loans are held in real estate mortgage investment conduits (“REMICs”) and “fixed investment trusts.” These entities generally have organizational documents that restrict or prohibit certain types of loan modifications to reflect constraints on loan modifications altering a REMIC’s collateral or regular interest terms imposed by various provisions of the Internal Revenue Code of 1986, as amended (the “Code”). Additionally, the Code prohibits a REMIC from foreclosing on a mortgage loan that was known to be troubled when the REMIC acquired it.

Revenue Procedure 2020-26, released on April 13, 2020 (the “Revenue Procedure”), describes safe harbors under which forbearances and related modifications to certain mortgage loans under the CARES Act provisions and other COVID-19-related programs will not jeopardize the federal income tax status of REMICs and “fixed investment trusts” that hold the loans.

KEY CARES ACT PROVISIONS GOVERNING FORBEARANCES ON SINGLE-FAMILY AND MULTIFAMILY FEDERALLY-BACKED LOANS

Section 4022 of the CARES Act: Foreclosure moratorium and consumer right to request forbearance.

This provision applies to first and second federally-backed mortgage loans on one- to four-family housing (e.g., mortgages insured by the VA, HUD, FHA, Fannie Mae, and Freddie Mac). A mortgagor of a federally-backed mortgage loan who is experiencing a financial hardship due, directly or indirectly, to the COVID-19 pandemic may request forbearance on their mortgage loan, regardless of delinquency status, by submitting a request to the mortgage loan’s servicer and affirming that the mortgagor is experiencing a financial hardship. The servicer must grant a forbearance of up to 180 days and that forbearance must be extended for up to an additional period of

180 days at the borrower's request. The servicer may not request or require additional information from the mortgagor. During the forbearance period, no fees, penalties, or additional interest beyond that which would be due if all payments had been made on time are allowed to accrue on the mortgagor's account. Additionally, except with respect to a vacant or abandoned property, a servicer of a federally-backed mortgage loan may not initiate a judicial or non-judicial foreclosure process, move for a foreclosure judgment or order of sale, or execute a foreclosure-related eviction or foreclosure sale during the 60-day period beginning on March 18, 2020. Of note in light of the Revenue Procedure, this CARES Act provision speaks only to "forbearances" and not to "forbearances and related modifications."

Section 4023 of the CARES Act: Forbearance of residential mortgage loan payments for multifamily properties with federally-backed loans.

A borrower of a federally-backed multifamily (i.e., a building with five or more housing units) mortgage loan that is experiencing a financial hardship due, directly or indirectly, to the COVID-19 pandemic, may request a forbearance on their mortgage loan. If the borrower was current as of February 1, 2020, the borrower may make an oral or written request for forbearance. The servicer must then document the financial hardship, provide forbearance for up to 30 days, and extend the forbearance for up to two additional 30-day periods upon request. During the forbearance period, the borrower may not evict tenants solely for nonpayment of rent or charge a tenant any late fees or penalties for late payment of rent. Of note in light of the Revenue Procedure, this CARES Act provision also speaks only to "forbearances" and not to "forbearances and related modifications."

STATE AND VOLUNTARY FORBEARANCE PROGRAMS

We understand that some states are requiring lenders and servicers of residential mortgage loans that are neither "federally-backed mortgage loans" nor "federally-backed multifamily mortgage loans" (as both terms are used in the CARES Act) to participate in forbearance programs ("State Forbearance Programs") for borrowers experiencing economic difficulty relating to the coronavirus pandemic. These State Forbearance Programs may encourage (or in the case of the District of Columbia, require) servicers of commercial mortgages to participate in such programs; we note that these provisions are nascent and may be changed over the coming weeks and months. Generally, State Forbearance Programs provide forbearances for the next three to six months on non-federally-backed mortgage loans to borrowers that are experiencing a financial hardship due, directly or indirectly, to the COVID-19 pandemic. Such programs may permit or require mortgage loan modifications in addition to the forbearance itself. For example, as mentioned in Section 2 of the Revenue Procedure, loan payments deferred under a forbearance may be added to the principal amount of the loan to be paid by the borrower after what would otherwise be the final payment on the loan. The Revenue Procedure notes that some State Forbearance Programs contemplate that, at the end of the forbearance period, an amortizing loan will be re-amortized to preserve the loan's original maturity date.

The Revenue Procedure noted that mortgage servicers are also contemplating voluntary forbearance programs (such programs, along with State Forbearance Programs, are referred to as "Other Forbearance Programs"). The Revenue Procedure does not limit its guidance relating to Other Forbearance Programs to mortgages securing residential or multifamily properties. Finally, there are no date restrictions listed for forbearances and related modifications performed pursuant to Other Forbearance Programs, although such restrictions may be specific to individual programs.

REVENUE PROCEDURE 2020-26 – SAFE HARBORS FOR FORBEARANCE-RELATED LOAN MODIFICATIONS

The Code generally prohibit mortgage loans held in a REMIC from being “significantly” modified (including many of the modifications envisioned by the CARES Act and the Other Forbearance Provisions) and prohibits the terms of REMIC regular interests from being modified after the REMIC's start-up date. Additionally, the Code generally prohibits a “fixed investment trust” from having the power to vary the investment of its investors.

The Revenue Procedure describes safe harbors under which modifications to certain mortgage loans that are described in Section 2 of the Revenue Procedure (i.e., forbearances and modifications under CARES Act provisions and Other Forbearance Programs) will not be treated (i) as replacing the unmodified mortgage loan obligation with a newly issued mortgage loan obligation, (ii) as giving rise to prohibited transactions, or (iii) as manifesting a power to vary for purposes of determining the Federal income tax status of REMICs and “fixed investment trusts” that hold the loans. Under the safe harbors, these forbearances and modifications should be allowable under the governing documents of REMICs and “fixed investment trusts” and not create adverse tax consequences.

REVENUE PROCEDURE 2020-26 – ACQUISITION OF LOANS WITH FORBEARANCES BY A REMIC

The Revenue Procedure also contains a safe harbor under which a REMIC is not treated as having improper knowledge of an anticipated default on the grounds that it acquired a mortgage loan with respect to which the borrower had participated in a CARES Act forbearance or Other Forbearance Program. This safe harbor would allow future REMICs to acquire mortgage loans that previously received a CARES Act or Other Forbearance Program forbearance of modification. Otherwise, a REMIC could be deemed to have “improper knowledge” that a default on the mortgage loan would occur and would then be prohibited from foreclosing on such property in the future.

CLOSING

The Revenue Procedure is fairly generous in allowing forbearances and related modifications to be made to many types of mortgage loans with borrowers experiencing financial distress due to the COVID-19 pandemic. It should be noted that many relief provisions for existing REMICs and fixed investment trusts are time-limited per the Revenue Procedure's cross-reference to CARES Act Provisions and State Forbearance Programs. In addition, other investment vehicles for mortgage loans, particularly those located offshore, are not covered by this guidance. Finally, troubled mortgage loans may need further modifications once any periods covered by the CARES Act or Other Forbearance Programs have passed; such additional modifications are outside of the scope of the Revenue Procedure.

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