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Federal Tax ADVISORY ■

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IRS Issues COVID-19 Forbearance Guidance for REMICs and Investment Trusts

The IRS on April 13, 2020 issued Revenue Procedure 2020-26, which provides safe harbors for payment forbearances (and "related modifications") arising from the COVID-19 emergency on mortgage loans held by real estate mortgage investment conduits (REMICs) and investment trusts and on mortgage loans contributed to REMICs.

These REMIC and investment trust safe harbors apply to mortgage loan payment forbearance procedures (and related modifications) under:

- The Coronavirus Aid, Relief, and Economic Security (CARES) Act, which generally provides temporary forbearance relief for borrowers with certain federally backed mortgage loans experiencing a financial hardship due directly or indirectly to the COVID-19 emergency.
- Similar programs, such as voluntary or state-mandated mortgage loan forbearance programs for borrowers experiencing direct or indirect hardship due to the COVID-19 emergency, with forbearances of up to six months requested or agreed to between March 27, 2020 and December 31, 2020. These similar programs can include forbearances for non-federally-backed commercial mortgage-backed securities (CMBS) and residential mortgage-backed securities (RMBS) mortgage loans that meet these conditions.

The provisions of the new Revenue Procedure do not define "related modifications" but provide two examples: (1) adding deferred payments to the principal amount to be paid after what would otherwise be the final payment on the loan; or (2) reamortizing an amortizing mortgage loan at the end of the forbearance period to preserve the original maturity date.

The REMIC and investment trust mortgage loan payment forbearance (and related modification) safe harbors are:

- **REMIC "Principally Secured" Test.** The loan-to-value ratio of a mortgage loan to be contributed to a REMIC does not need to be retested after its origination solely because of the occurrence of a qualifying payment forbearance (and related modifications).
- **REMIC "Foreclosure Property".** Qualifying payment forbearances (and related modifications) do not prevent real property acquired by the REMIC in foreclosure of a mortgage loan acquired by a REMIC to qualify as "foreclosure property" (e.g., the REMIC is not treated as acquiring the mortgage loan with "improper knowledge" that a default was imminent or anticipated).
- **Excess Fees and Payment Delays and Shortfalls.** Delays and shortfalls in payments associated with or caused by mortgage loan payment forbearances (and related modifications) held by REMICs are "contingencies" that can be disregarded under the relevant REMIC rules. Thus, excess special servicing fees from workout activities, delays or shortfalls from a servicer's inability to advance funds, and shortfalls from payments subject to forbearance and not accruing compound interest, in each case associated with qualifying payment forbearances (and any related modifications), are contingencies that can be disregarded and will not affect the ability of a REMIC's "regular interests" to qualify as such.
- **"Significant" Modifications and the "Power-to-Vary" Standard.** Qualifying payment forbearances (and related modifications) will not (1) be treated as jeopardizing a trust's tax status as an "investment trust" (i.e., will not be treated as creating an impermissible power to vary its investment assets); (2) be treated as jeopardizing a REMIC's tax status (as a deemed exchange of its mortgage loan assets or a deemed reissuance of its regular interests); or (3) cause a REMIC to be subject to the 100% prohibited transactions tax.

The Revenue Procedure helpfully includes safe harbors for certain COVID-19-related forbearance programs beyond those mandated by the CARES Act, including non-federally-backed CMBS or RMBS loans under state-mandated loan forbearance programs. For other voluntary forbearance programs not mandated by the CARES Act or state law, loan servicers are not legally obligated to enter into a payment forbearance and the servicing standard must be independently exercised to determine whether a particular payment forbearance is appropriate. However, once a loan servicer determines that a payment forbearance is appropriate, if a servicer enables a forbearance that meets the Revenue Procedure's conditions, the REMIC or investment trust holding the mortgage loan or the REMIC subsequently acquiring the mortgage loan will obtain the benefits of the Revenue Procedure's safe harbors.

For more information, please contact John Baron at 704.444.1434, Clay Littlefield at 704.444.1440, or Danny Reach at 704.444.1272.

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