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The Long and Winding Road Away from LIBOR as the Chosen Floating Rate Index—SOFR Has Now Won the Day!

*By Ellen M. Goodwin**

This article discusses the transition from LIBOR, the long-term benchmark for floating rate commercial mortgage loans, to the Secured Overnight Financing Rate ("SOFR"), the reasons SOFR was chosen as the replacement benchmark and the involvement of the Alternative Reference Rates Committee (the "ARRC") in the process of choosing and recommending such benchmark, the impact on the real estate capital markets generally as a result of such transition to SOFR, and the impact on and changes to mortgage loan documentation as a result of such transition.

I. How did We Get Here?

A. The ARRC

In 2014, the Alternative Reference Rates Committee ("ARRC") was tasked by the Federal Reserve Board to identify an alternative benchmark to U.S. dollar LIBOR ("LIBOR") due to years of manipulation by many banks involved in the setting of LIBOR for the marketplace. In 2017, the ARRC selected the Secured Overnight Financing Rate ("SOFR") as LIBOR's replacement. SOFR is based on overnight transactions in the U.S. dollar Treasury repo market, the largest rates market at a given maturity in the world.[1] The following is a list of differences between LIBOR and SOFR, some of which influenced the ARRC's decision to recommend SOFR:

(a) LIBOR is an unsecured rate while SOFR is secured by treasuries;

(b) LIBOR has various tenors (all forward looking) and SOFR is an overnight rate (calculated in arrears);

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(c) at the time of the ARRC's recommendation, LIBOR's daily transaction volume was $500 million while SOFR's transaction volume was $1 trillion; and

(d) LIBOR contains a bank credit risk premium due to the risk of borrowing from a bank (LIBOR is based on interbank loans) while SOFR does not (it is almost risk-free because it is based on Treasury transactions).[2]

Due to the foregoing factors, SOFR was and continues to be a lower rate than LIBOR. In 2018, the ARRC was reconstituted to ensure an efficient and successful transaction from LIBOR to SOFR.[3] The ARRC, with the help of its industry-wide participants and working groups, developed, among other things, ARRC Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Syndicated Loans (April 25, 2019), ARRC Recommendations Regarding More Robust Fallback Language for New Originations of LIBOR Bilateral Business Loans (May 30, 2019), ARRC Recommendations Regarding More Robust Fallback Language for New Issuances of LIBOR Securitizations (May 31, 2019), ARRC Recommendations Regarding More Robust Fallback Language For New Originations of LIBOR Syndicated Loans (June 30, 2020), ARRC Recommendations Regarding More Robust Fallback Language For New Originations of LIBOR Bilateral Business Loans (August 27, 2020), and ARRC Supplemental Recommendations of Hardwire Fallback Language for LIBOR Syndicated and Bilateral Business Loans (March 25, 2021).

In the commercial real estate financing space, lenders (with hesitation) began incorporating the ARRC Recommended Fallback Provisions into their underlying floating-rate mortgage loan documents in the latter half of 2020, which would be used in connection with new mortgage loan originations with LIBOR as the floating rate index. The ARRC Recommended Fallback Provisions were designed to replace the now antiquated fallback provisions contained in LIBOR floating rate mortgage loan documents for over 40 years, which provided for a transition, to an alternative index chosen by certain Reference Banks in the London interbank market selected by the lender in the event LIBOR was unavailable, and if fewer than two (2) such Reference Banks were available for rate quotations, then the lender would select certain major New York banks lending to European Banks, and if fewer than two (2) such New York banks were available for rate quotations, the floating index would, in most cases, convert to the Prime Rate. Initially many servicers of commercial mortgage loans did not like the ARRC Recommended Fallback Provisions due to the discretion given to lenders to choose and then implement a "Benchmark Replacement" upon a "Benchmark Transition Event" and corresponding "Benchmark Replacement Date" in the ARRC Fallback Provisions. Some servicers had liability concerns as well as concerns about having the technology and capability in order to implement and service a Benchmark Replacement based upon a Compounded SOFR Average "in arrears," one of the choices in the ARRC Benchmark Replacement waterfall. Please see Exhibit A for the Benchmark Replacement waterfall initially recommended by ARRC for Bilateral Business Loans (May 30, 2019) and related definitions.

B. FannieMae/FreddieMac

FannieMae and FreddieMac were leaders in the LIBOR to SOFR transition and to the

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ARRC's delight, after September 1, 2020, no longer offered LIBOR-indexed loans and all new loan originations were SOFR-indexed loans. The SOFR index chosen by FannieMae and FreddieMac was the compounded average of SOFR over a rolling 30-day period, as published on the website of The Federal Reserve Bank of New York (the "Fed Rate").[4] FannieMae and FreddieMac were very instrumental in putting pressure on other commercial real estate capital markets lenders to not only implement the ARRC Fallback Provisions in their mortgage loan documentation, but to consider originating loans based on a SOFR index rather than a LIBOR index.

C. The Benchmark Transition Event

Another significant milestone for the transition of LIBOR to SOFR was the announcement by the ICE Benchmark Administration ("IBA"), the administrator of LIBOR, on March 5, 2021, that since the IBA would no longer have the ability to calculate LIBOR settings on a representative basis beyond certain cessation dates it would have to cease publication of all 35 LIBOR settings immediately after such dates set forth in the IBA announcement. The cessation date for 1-, 3-, 6- and 12-month USD LIBOR settings was June 30, 2023.

The U.K. Financial Conduct Authority (the "FCA"), the regulator of LIBOR, issued a separate announcement confirming that the IBA had notified the FCA of its intent to cease providing all LIBOR settings. The ARRC also made an announcement on March 5, 2021, that the FCA announcement constituted a "Benchmark Transition Event" for USD LIBOR settings under the ARRC Recommended Fallback Language. Despite fears of CRE servicers, mortgage lenders, warehouse lenders and investors in securitizations, the occurrence of the Benchmark Transition Event did not require an immediate transition to a Benchmark Replacement pursuant to the ARRC Recommended Fallback Language which was then contained in many real estate capital markets loan documents, including CLO and CMBS securitization documents and several mortgage loan documents.

The announcement caused a lot of confusion in the real estate capital markets.

Actual transition to the Benchmark Replacement (likely a SOFR index) pursuant to the Benchmark Replacement waterfall in the ARRC Fallback Provisions is based on the "Benchmark Replacement Date" which is expected to be June 30, 2023 for 1 month, 3 month, 6 month and 12 month USD LIBOR as set forth in the IBA announcement referred above.

Pursuant to the ARRC Fallback Provisions, both a Benchmark Transition Event and a Benchmark Replacement Date must occur before there is an actual transition to a new Benchmark Replacement.[5]

D. Fixing of the Spread Adjustment by the ARRC

Additionally, the FCA announcement also triggered an "Index Cessation Event" under the LIBOR Fallbacks Supplement (Supplement Number 70 to the 2006 ISDA Definitions) and the ISDA 2020 IBOR Fallbacks Protocol. The ISDA fallback spread adjustments (to account for the difference in LIBOR and SOFR discussed above in I(A)) published by Bloomberg have been fixed as of the date of the FCA announcement for all LIBOR benchmark settings or tenors. The ARRC previously acknowledged

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that it would adopt the ISDA spread adjustments. The final spread adjustment for one month USD LIBOR is.11448, which essentially represents the historical median over a 5-year lookback period between USD LIBOR and SOFR. ISDA and the ARRC adopted the same methodology to calculate the applicable spread adjustment, which is added to the applicable Benchmark Replacement in the Benchmark Replacement waterfall pursuant to the ARRC Fallback Provisions. Please see Exhibit A. The spread adjustment of.11448 is now fixed until (and will be applicable) for any LIBOR transition to SOFR occurring on or prior to June 30, 2023.[6]

E. Bank Regulators - No More LIBOR After December 31, 2021

After the FCA announcement in March 2021, the U.S. bank regulators, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation put increased pressure on banks to move away from their reliance on LIBOR as an index in their banking transactions and encouraged regulated banking institutions to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practical but in no event later than December 31, 2021 other than in certain limited circumstances.[7]

F. Term SOFR

The issue before the CRE capital markets at the time of the FCA announcement and the U.S. banking regulators' announcement to stop using LIBOR at year-end was the fact that a Term SOFR index was not yet available and market participants had to rely on SOFR alternatives such as the Fed Rate (a compounded average of SOFR on a rolling 30-day period calculated in advance) or a compounded average of SOFR for the applicable interest period calculated "in arrears."

A forward-looking Term SOFR was what the CRE capital markets participants wanted because that index most closely replicated 30-, 60-, 90- and 180-day LIBOR and how it was implemented. As previously discussed, FannieMae and FreddieMac adopted the Fed Rate; however, ISDA blessed the SOFR Average calculated "in arrears" for converting ISDA LIBOR contracts. All of these factors contributed to market confusion felt by both bank and non-bank lenders participating in the commercial real estate finance market in early 2021.

Then on July 29, 2021, the ARRC announced that it was formally recommending the CME Group's forward-looking Secured Overnight Financing Rate term rates ("SOFR Term Rates"). The CME SOFR Term Rates were available in 1 month, 2 month, 3 month and 6 month terms. The CME Term Rates have been produced since April 2021. The forward-looking CME Term Rate was now the first step in the Benchmark Replacement waterfall in the ARRC Fallback Language and thus the recommended fallback rate by the ARRC for all legacy LIBOR products.[8]

The recommendation by the ARRC of the SOFR Term Rate was instrumental in pushing the CRE capital markets further away from LIBOR and towards SOFR as its new benchmark for mortgage loan transactions. Mortgage lenders, however, now needed to decide between Term SOFR and the Fed Rate.

G. Term SOFR v. The Fed Rate

Given the U.S. bank regulators' strong

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encouragement that no new LIBOR contracts be entered into after December 31, 2021, in the third quarter of 2021, both bank and non-bank lenders felt the pressure and began working on floating rate loan documents to replace the LIBOR index with a SOFR index; however, at this time there was still uncertainty as to whether to implement the Fed Rate or Term SOFR for their new CRE mortgage loan originations. In the CRE capital markets space, this decision concerning the use of SOFR was being made by lenders who were (A) originating (1) short-term transitional mortgage loans for their balance sheet, (2) short-term transitional mortgage loans (originated by debt funds) and placed into a CLO securitization, and (3) large mortgage loans (originated by banks) and placed into a single asset, single borrower ("SASB") CMBS securitization, and (B) bank warehouse lenders that were financing the non-bank lenders making the short-term transitional loans referenced in (A)(2) above.

In the 3rd quarter of 2021 when lenders were deciding between the Fed Rate and Term SOFR, FreddieMac and FannieMae continued to use the Fed Rate for their multifamily mortgage loans and one large national bank had chosen the Fed Rate to use across all lines of bank business at the bank, including the real estate capital markets, which made both bank and non-bank lenders hesitant to implement Term SOFR as part of their floating rate origination programs given that most new mortgage loan originations that were not using LIBOR at this time were indexed off of the Fed Rate. Additionally at this time, interest rate caps and swaps, which are required by most lenders of floating rate CRE mortgage loans as additional collateral security, indexed at the Fed Rate were available for borrowers at a reasonable cost (in-line with the cost of a cap or a swap based on LIBOR) due to the increased liquidity of transactions involving the Fed Rate,[9] but interest rate caps and swaps linked to Term SOFR were extremely expensive due to a lack of liquidity involving transactions based on Term SOFR. Finally, lenders faced an additional hurdle with Term SOFR.

In order to access the CME Term SOFR, a Use License must be obtained directly with CME Group. A license is required by any institution that uses CME Term SOFR Reference Rates as a data input or reference in valuation, pricing, transactional or benchmark activities.[10] Due to all of the reasons listed above, as of November 2021, the lion's share of non-LIBOR floating rate commercial mortgage loans were being originated using the Fed Rate as the index. This was true for both balance sheet loans being originated by banks and CMBS (SASB) mortgage loans being originated and placed into a securitization; however, debt funds originating transitional loans at this time were still using LIBOR as the index because they were not regulated entities and did not have as much pressure as the banks to begin using SOFR as the index on their loans. Due to the continued pressure put on the CRE capital markets by the ARRC and CREFC to use Term SOFR, in December 2021 and January 2022, there began a shift from the Fed Rate to Term SOFR and with that shift Term SOFR caps and swaps became less expensive due to the increased liquidity of Term SOFR transactions across many lines of business, including the real estate finance market.

Now in 2022, the lion's share or super-majority of floating rate mortgage loans in the

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CRE capital markets space are indexed off of Term SOFR.

However, there are exceptions: FreddieMac and FannieMae continue to use the Fed Rate as does a large national bank for most of its lines of business where the loans are held on its balance sheet, some syndicated mortgage lenders use Daily Simple SOFR (the daily SOFR rate) on their syndicated loan facilities and a very small minority of lenders may use the Bloomberg Short-Term Bank Yield ("BSBY") or the Ameribor index. Regulators have questioned the use of BSBY and Ameribor due to concerns over the low liquidity of the transactions that underline these indices and the potential of even less transaction volume during the time of market volatility.[11]

Most warehouse lenders have given their borrowers/sellers the option of Term SOFR or the Fed Rate, and most borrowers/sellers under their warehouse facilities are utilizing Term SOFR based on a market poll. Additionally, now in the 2nd quarter of 2022, most securitization documents utilized for CLO securitizations and CMBS (SASB) securitizations are also based on Term SOFR. Interestingly some major bond buyers in the CLO market required their bonds to be based on the Fed Rate, so in order to accommodate these investors some CLO securitizations in early 2022 were based on the Fed Rate as well, creating a mismatch on the underlying mortgage loans and the bonds payable to investors. That practice in the CLO securitization market has now ceased. It does appear that the CRE capital markets are now settling into Term SOFR as the new floating rate benchmark as of June 30, 2022, but at this time there has been less mortgage loan volume due to the market turmoil caused by the stock market volatility, increased interest rates due to recent rate hikes by the Federal Reserve, inflation and the war in Ukraine.

As of July 1, 2022, the real estate finance market is on pause as it is almost impossible to price a mortgage loan transaction; however, when the market recalibrates and stabilizes and mortgage loan volume increases, there should be further solidification of SOFR (and in most cases, Term SOFR) as the major benchmark for the floating-rate commercial real estate capital markets.

II. Issues to Consider In Loan Documents

A. Benchmark Replacement Waterfall

Most lenders now are collapsing their Benchmark Replacement waterfall in their loan agreements to include only the last prong in the waterfall set forth in the ARRC Fallback Provisions. Please see clause (3) of the definition of Benchmark Replacement on Exhibit A. The last prong in the waterfall is the discretionary bucket given to the lender when the lender determines the alternative rate giving due consideration to (1) any selection or recommendation of a replacement rate by any Relevant Governmental Body (the Federal Reserve Bank of NY) and (2) then prevailing market conventions. As observed with the current transition away from LIBOR due to the occurrence of a Benchmark Transition Event in March 2021, participants in the CRE finance market want to move together and are wary of adverse consequences if not moving with the market generally.

Thus, following the recommendation of the ARRC (which is convened by the Fed), SOFR (either, Term SOFR, a SOFR Average or Daily Simple SOFR as discussed above in I(G)) has

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been generally chosen by most lenders in the real estate capital markets as the Benchmark Replacement for LIBOR with respect to (A) new mortgage loan originations, (B) legacy LIBOR mortgage loans that contain the ARRC Fallback Provisions which will convert to SOFR in June 2023, and (C) legacy LIBOR mortgage loans which lenders are amending currently with the consent of their borrowers prior to June 2023 to provide for SOFR-based loans.

Based not only on the qualifications in the definition of Benchmark Replacement discussed above in clauses (1) and (2), but the nearly uniform transition from LIBOR to SOFR by the CRE capital markets (bumpy as it may have been initially), gives most borrowers, including large institutional sponsors, comfort with this last lender discretionary prong of the waterfall in connection with a future transition away from SOFR to a new Benchmark Replacement. This last prong in the waterfall gives borrowers no consent rights in the choice and implementation of a new Benchmark Replacement; however see below under Section II(F) where a borrower may be granted consultation rights in certain limited situations.

B. An Additional Benchmark Transition Event

As stated earlier, most CRE mortgage lenders currently index their floating rate loans off of Term SOFR, but in order to address the uncertainty surrounding the choice of Term SOFR versus the Fed Rate felt by lenders, especially debt fund lenders in the unsettled CRE CLO market due to some investors' demands for the Fed Rate at the securitization bond level, loan documents currently include a SOFR Transition Event in addition to the customary Benchmark Transition Event set forth in the ARRC Fallback Provisions.

The SOFR Transition Event (see below) is triggered if a lender subsequently commences originating loans on its balance sheet at the Fed Rate or its warehouse lender begins requiring the lender to pay interest based on the Fed Rate in connection with the financing of its mortgage loans, and upon any such event, provided the SOFR Transition Date (see below) has occurred, Lender is free to implement a transition from Term SOFR to the Fed Rate to avoid any rate mismatch with other market participants or with its warehouse lender.

"**SOFR Transition Event**" means Lender shall have determined (A) Term SOFR ceases to be reported or (B) variable rate loans being originated by **[INSERT LENDING ENTITY]**, its Affiliates or any Funding Party are generally referencing SOFR Average. For the avoidance of doubt, (i) a SOFR Transition Event shall not be deemed a Benchmark Transition Event and (ii) in the event a SOFR Transition Event and a Benchmark Transition Event occur simultaneously, the terms herein relating to a Benchmark Transition Event shall govern.

"**SOFR Transition Date**" means the date Lender determines in its sole discretion that the use of SOFR Average as the Benchmark Replacement will be operationally, administratively and technically feasible. Notwithstanding the foregoing, in no event shall the SOFR Transition Date occur prior to satisfaction of the SOFR Rate Index Replacement Conditions and Benchmark Conforming Changes.

Most borrowers have been comfortable with this additional Transition Event to address this current short-term issue due to market partici-

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pants' understanding that the CRE finance market is not quite settled yet on the correct SOFR index to maximize a lender's benefits on its loan execution.

Upon a SOFR Transition Event, however, pursuant to the loan agreement, a borrower is required to obtain a new cap or swap based on the new SOFR benchmark (the SOFR Average or the Fed Rate) which can be a cost issue and can be a point of negotiation between the lender and the borrower.

Typically the party with the most leverage in the loan transaction will win this point. Some large sponsors on balance sheet loans get some relief on the new IRPA (defined below) for a SOFR Transition Event if the lender determines that the existing IRPA provides sufficient protection to such lender, as determined in lender's discretion, even though the loan is now based on the SOFR Average or Fed Rate.

C. SOFR And Interest Rate Protection Agreements

Most lenders require an interest rate protection agreement (an "IRPA") in connection with any floating rate transaction, including any floating rate transaction indexed off of SOFR. Due to increased liquidity of Term SOFR in December 2021 and the first quarter of 2022, the cost of Term SOFR caps/swaps were essentially the same as caps/swaps being indexed off of the Fed Rate.

However, in the second quarter of 2022 due to volatility generally in the CRE capital markets discussed above, the cost of caps/swaps indexed off of SOFR for CRE borrowers has soared. Neither debt fund lenders making short-term transitional loans that will be placed into a CLO, nor banks making large loans that will be placed into a CMBS SASB securitization, nor a balance sheet lender providing short-term floating rate financing will waive an IRPA in connection with its loan transaction.

However, some balance sheet lenders making short-term loans and banks making a large loan that will go into a CMBS SASB securitization may make some concessions. A balance sheet bank lender originating a short-term floating rate loan may consider accommodating a borrower with a springing IRPA if it is a low leveraged transaction with strong sponsorship, provided such borrower and guarantor back their obligation to purchase the IRPA in the future with a recourse carve-out for losses.

The customary interest rate protection trigger is when the applicable SOFR index equals or exceeds 2.5%. Similarly a CMBS lender lending to a strong sponsor on a high-quality asset with low leverage shall require an IRPA at closing but may give some relief on the strike price as discussed below. Typically lenders placing transitional loans into a CLO will require an IRPA at closing and offer no flexibility given the loan leverage and transitional nature of the collateral.

Another way to potentially reduce the cost of the IRPA (especially if a borrower is not planning to keep the loan for the full term) is to buy a one-year term IRPA at closing with the obligation to purchase a replacement IRPA prior to its expiration. One-year IRPA's are cheaper than 3 year IRPA's for the same notional amount and strike rate, but the cost of 3 one year term IRPA's is more expensive than 1 three year term IRPA. Borrowers must weigh the costs and benefits of this decision. Most lenders will agree to this cost-saving

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measure provided borrower and guarantor back the obligation to purchase a replacement IRPA with a recourse carve-out for losses.

The cost of an IRPA may also be reduced if the lender agrees to a higher strike price. Typically now, even with the rising interest rates, lenders set the requirement at 3.0% or 3.5%, in extremely rare situations, 4.0% to a strong sponsor, and on a CMBS SASB transaction, strike prices may exceed 4% if it is a high quality asset with strong institutional sponsorship. A CMBS lender on a SASB deal may even go further in very limited situations and allow the institutional sponsor to purchase a cap with a strike price above the required strike price (with a specific ceiling) if the sponsor posts a letter of credit, a guaranty, or a reserve in the amount of the interest that would accrue on the outstanding principal balance of the loan during the loan term assuming the interest rate was equal to the difference between the alternative higher strike price chosen by borrower and the required strike price under the loan documents.

Finally, a borrower may request a lender to reduce the downgrade trigger for ratings of the cap/swap counterparty where the borrower in the loan agreement (and the counterparty in the cap/swap confirmation) is required to obtain a replacement counterparty. Many lenders require a counterparty to have an "A" rating from S&P and an "A2" rating from Moody's (an "A/A2 Rating") and if the counterparty is downgraded below the A/A2 Rating then the existing counterparty must be replaced on the IRPA.

However, if the downgrade trigger where the counterparty must be replaced under the IRPA is reduced to an "A-" rating from S&P and an "A3" rating from Moody's, the cost of a cap/swap will be reduced. An A-/A3 downgrade requirement will be acceptable in the CLO market and to most balance sheet lenders, but on a SASB CMBS deal the ratings requirement for a downgrade must remain at the A/A2 Rating. Additionally, if possible, borrowers should obtain a swap and not a cap for their mortgage loan because swaps are much cheaper. The security for the on-going "netting-out" payments and the swap breakage costs on the swap is a pari-passu mortgage on the mortgage property in favor of the swap counterparty so the swap counterparty for the loan must also be lender or this structure will not work (because a lender who is not the swap counterparty will not permit an additional mortgage on its collateral).

In addition to the additional mortgage encumbrance issue, swaps are also unacceptable in CMBS transactions for SPE concerns relating to borrower's obligation to pay the swap breakage costs on the termination of the swap. Typically swaps are only issued in connection with balance sheet loans by bank lenders who can also issue swaps.

Finally, borrowers should also note that, pursuant to the fallback language in most floating rate loans, upon a Benchmark Transition Event and Benchmark Replacement Date, when the Benchmark Replacement is implemented, borrower is required to obtain a new IRPA acceptable to lender that is indexed to the new Benchmark Replacement (not SOFR, the current benchmark). This is a cost the borrower must cover in the floating rate CRE finance market and most lenders will not waive the requirement as lender wants to avoid a mismatch on the loan and the IRPA. Generally there is no flexibility here for lenders (balance

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sheet, CMBS, CLO or debt fund lenders), other than as set forth above, and borrower will have to purchase a new cap or swap.

D. Adjusted Term SOFR

One item for lenders and borrowers to pay attention to is the use of the term "Adjusted Term SOFR," which originated in the LSTA form of SOFR Loan Agreement and many other lenders have also included the concept in their loan agreements. The term "Adjusted Term SOFR" is the sum of (a) Term SOFR and (b) 0.11448%, the spread adjustment fixed by ISDA and the ARRC on the Benchmark Transition Event (the "Fixed Spread Adjustment"), which occurred on March 5, 2021, to account for the difference between SOFR and LIBOR as discussed above.

The Fixed Spread Adjustment is intended to be added to Term SOFR pursuant to the ARRC Fallback Provisions when converting a legacy LIBOR loan to a SOFR loan (whether it be Term SOFR, a SOFR Average or Daily Simple SOFR). If a new loan origination is based on SOFR, it is not necessary to add the Fixed Spread Adjustment to Term SOFR (or the SOFR Average or Daily Simple SOFR, as applicable), as the spread on the loan that has been set by the lender's business/credit team shall reflect the risk of the loan and shall compensate the lender appropriately for such risk. Any additional spread necessary to compensate lender for making a SOFR loan (rather on a LIBOR loan) in the current market at the time of origination will be reflected in the spread and thus the Fixed Spread Adjustment does not need to be added to Term SOFR (or Daily Simple SOFR or a SOFR Average, as applicable) as the relationship between SOFR and LIBOR is no longer relevant to the loan transaction.

However, notwithstanding the foregoing, one may find the term "Adjusted Term SOFR" used by a lender in the loan documents for a new loan origination. If that is the case, a borrower should make sure that the Fixed Spread Adjustment is deducted from the spread on the loan if the concept of "Adjusted Term SOFR" is not incorporated in the term sheet, but is going to be used in the loan documents.

Some lenders insist on keeping the concept in the loan documents so it is an issue to not overlook.

Additionally, it may also cause confusion on the loan servicing side. There have been instances where a servicing group on behalf of a lender has not collected the full interest payment for an interest accrual period as servicers are customarily not adding two spreads to an interest rate index. The term "Adjusted Term SOFR" causes confusion to both borrowers and lenders on new mortgage loan originations and this author believes the concept should be revisited.

E. Benchmark Unavoidability Period

See below for an example of language incorporated into the Benchmark Fallback Provisions presently contained in most loan agreements (balance sheet, CMBS and CLO) to cover a period when a Benchmark Replacement is temporarily not available.

<u>Temporary Benchmark Unavailability</u>. Unless and until a Benchmark Replacement is implemented with respect to the then-current Benchmark in accordance with the terms of this Section 2.5(c)(III), if for any reason Lender determines (which determination shall be conclusive and binding absent manifest error) that, other than as a result of a Benchmark

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Transition Event **[or an Early Opt-in Election]**, (a) United States dollar deposits are not being offered to banks in the applicable market or at the applicable rate of the then-current Benchmark for the applicable amount and Interest Accrual Period; or (b) reasonable and adequate means do not exist for ascertaining the Benchmark for an applicable Interest Accrual Period; or (c) the Benchmark does not adequately and fairly reflect the cost to Lender of making or maintaining the Loan during an applicable Interest Accrual Period, then Lender shall promptly give notice thereof to Borrower. Upon Borrower's receipt of such notice, Borrower may elect to prepay, in whole, but not in part (and without obligation to pay any Prepayment Premium), the then outstanding principal amount of the Loan, together with all accrued and unpaid interest and all other amounts otherwise due and payable under the Loan Documents in accordance with the terms of Section 2.7(a) hereof. If Borrower shall fail to prepay the Debt in accordance with the previous sentence, the Interest Rate for the Loan shall convert to the Prime Rate plus the Spread as of the next Monthly Payment Date.

Benchmark Transition. Notwithstanding anything to the contrary set forth herein or in any of the other Loan Documents, with respect to the then-current Benchmark, if for any reason Lender determines (which determination shall be conclusive and binding absent manifest error) that a Benchmark Transition Event and a Benchmark Replacement Date have occurred (but the Benchmark Replacement has not yet been implemented), then the Interest Rate for the Loan shall convert to the Prime Rate plus the Spread on the next Monthly Payment Date and continue until a Benchmark Replacement is implemented with respect to the then-current Benchmark in accordance with the terms of this Section 2.5(c)(III).

This provision and variations thereof are included to cover a scenario where a Benchmark Replacement is not implemented due to issues or timing with respect to a consent that may be required to be obtained either by:

(1) An Administrative Agent from a co-lender in connection with a syndicated mortgage loan;

(2) A servicer from a collateral manager in connection with a mortgage loan in a CLO; or

(3) A servicer from a controlling or directing holder of a mortgage loan in a CMBS securitization.

Additionally the provision above also addresses the scenario where the benchmark to be implemented does not represent a lender's cost of funds or such benchmark is not otherwise ascertainable for the applicable interest accrual period.

Please note that the scenario (where the benchmark to be implemented does not represent the lender's cost funds) may also be alternatively addressed in the "Additional Cost Section" found in most floating rate loan agreements, and the borrower shall agree to indemnify lender for losses incurred as a result of converting to, implementing and/or maintaining a Benchmark Replacement.

Upon the occurrence of the events set forth in the definitions above, in some instances the borrower is given the right to prepay the loan and if the borrower does not prepay, then the loan converts to the Prime Rate plus the Spread (as defined in the applicable loan agreement). In other instances, the loan

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automatically converts to the Prime Rate plus the Spread (as defined in the applicable loan agreement) with no right to prepay. Since the Prime Rate is significantly higher than SOFR, many borrowers push to have the loan convert to the Federal Funds Rate (which is more in line with SOFR) rather than the Prime Rate. Some lenders may be amenable to this request provided there are additional basis points added to the Federal Funds Rate (e.g., anywhere from .05 to .5%). The right to prepay may not be granted in a securitization execution (either CLO or CMBS) due to adverse effect on investors (there will only be a rate conversion), but the right to prepay may be granted in some balance sheet loan documents as noted above.

F. Borrower Consent/Consultation Rights Upon Implementation of a New Benchmark Replacement

Many borrowers upon review of the Benchmark Fallback Provisions in a loan agreement ask for a borrower consent right or a borrower consultation right in connection with the choice of a Benchmark Replacement upon a Benchmark Transition Event. Lenders rarely grant such a right as the definition of Benchmark Replacement typically requires the lender to consider evolving or then prevailing market conditions and/or the industry accepted rate of interest chosen as the replacement for the then current benchmark in the applicable market relevant to the applicable mortgage loan.

Additionally, when lenders are implementing Benchmark Conforming Changes in connection with such Benchmark Replacement, most forms only permit lenders to require technical, administrative or operational changes to reflect the implementation of the Benchmark Replacement and to allow the administration thereof by a lender consistent with market practice for the applicable market relevant to such mortgage loan (such as the syndicated loan market, the market for securitized loans, or the real estate capital markets generally). The obligation for lender to implement the Benchmark Replacement and the Benchmark Conforming Changes consistent with market practice usually gets a borrower comfortable. Some balance sheet lenders will further accommodate a borrower by agreeing to implement a Benchmark Replacement and Benchmark Conforming Changes consistent with loans of similar size, type and quality and with similarly situated borrowers on such lender's balance sheet. Borrowers are then additionally assured that their loan will be treated the same as all other similar loans on such lender's balance sheet.

Finally, in some CMBS SASB loan transactions, some large institutional borrowers (depending on how much leverage such borrower has on the applicable loan transaction) are granted consultation rights with respect to the implementation of a Benchmark Replacement and Benchmark Conforming Changes, but the CMBS market has not yet given the borrower a consent right due to the pushback that a lender would receive from servicers, bond buyers, controlling holders and rating agencies and such a right would be viewed as credit negative by the noted securitization participants and would adversely affect a lender's execution on the applicable securitization.

III. Conclusion

It has been quite a journey sorting out the issues and concerns brought about by the

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transition away from LIBOR, the floating rate index used across so many financial markets for over 40 years. In the CRE capital markets, a new benchmark affects pricing, structure, loan documentation, derivatives delivered as collateral, servicing and administration of commercial mortgage loans.

There is a lot for the CRE finance market to absorb with the choice of SOFR as the Benchmark Replacement for LIBOR. With increased SOFR transactions across all financial markets, the real estate capital markets players, including debt funds, banks, servicers, special servicers, trustees, rating agencies, investors, and institutional and non-institution borrowers, are on their way to settling into and accepting SOFR as the Benchmark Replacement, but there will continue to be minor bumps on the way until the SOFR floating rate benchmark is fully integrated and fused into the CRE capital markets.

Exhibit A - Definitions

"Benchmark Replacement" means, for any Interest Period, the first alternative set forth in the order below that can be determined by the Lender as of the Benchmark Replacement Date:

(1) the sum of: (a) Term SOFR or, if the Lender determines that Term SOFR for the applicable Corresponding Tenor cannot be determined, Next Available Term SOFR, and (b) the Benchmark Replacement Adjustment;

(2) the sum of: (a) Compounded SOFR and (b) the Benchmark Replacement Adjustment;

(3) the sum of: (a) the alternate rate of interest that has been selected by the Lender as the replacement for the then-current Benchmark for the applicable Corresponding Tenor [giving due consideration to (i) any selection or recommendation of a replacement rate or the mechanism for determining such a rate by the Relevant Governmental Body at such time or (ii) any evolving or then-prevailing market convention for determining a rate of interest as a replacement for the then-current Benchmark for U.S. dollar-denominated syndicated or bilateral credit facilities at such time] and (b) the Benchmark Replacement Adjustment;

provided that, in the case of clauses (1) and (2) above, such rate, or the underlying rates component thereof, is or are displayed on a screen or other information service that publishes such rate or rates from time to time as selected by the Lender in its reasonable discretion. If the Benchmark Replacement as determined pursuant to clause (1), (2) or (3) above would be less than zero, the Benchmark Replacement will be deemed to be zero for the purposes of this Agreement.

"Benchmark Replacement Adjustment" means, for any Interest Period:

(1) for purposes of clauses (1) and (2) of the definition of "Benchmark Replacement," the first alternative set forth in the order below that can be determined by the Lender as of the Benchmark Replacement Date:

(a) the spread adjustment, or method for calculating or determining such spread adjustment, (which may be a positive or negative value or zero) that has been selected or recommended by the Rele-

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vant Governmental Body for the applicable Unadjusted Benchmark Replacement;

(b) the spread adjustment (which may be a positive or negative value or zero) that would apply to the fallback rate for a derivative transaction referencing the ISDA Definitions to be effective upon an index cessation event with respect to USD LIBOR for the Corresponding Tenor; and

(2) for purposes of clause (3) of the definition of "Benchmark Replacement," the spread adjustment, or method for calculating or determining such spread adjustment, (which may be a positive or negative value or zero) that has been selected by the Lender for the applicable Corresponding Tenor [giving due consideration to (i) any selection or recommendation of a spread adjustment, or method for calculating or determining such spread adjustment, for the replacement of the then-current Benchmark with the applicable Unadjusted Benchmark Replacement by the Relevant Governmental Body at such time or (ii) any evolving or then-prevailing market convention for determining a spread adjustment, or method for calculating or determining such spread adjustment, for the replacement of the then-current Benchmark with the applicable Unadjusted Benchmark Replacement for U.S. dollar-denominated syndicated or bilateral credit facilities at such time];

provided that, in the case of clause (1) above, such adjustment is displayed on a screen or other information service that publishes such Benchmark Replacement Adjustment from time to time as selected by the Lender in its reasonable discretion.

"Compounded SOFR" means the compounded average of SOFRs for the applicable Corresponding Tenor, with the rate, or methodology for this rate, and conventions for this rate (which may include compounding in arrears with a lookback and/or suspension period as a mechanism to determine the interest amount payable prior to the end of each Interest Period) being established by the Lender in accordance with:

(1) the rate, or methodology for this rate, and conventions for this rate selected or recommended by the Relevant Governmental Body for determining compounded SOFR; provided that:

(2) if, and to the extent that, the Lender determines that Compounded SOFR cannot be determined in accordance with clause (1) above, then the rate, or methodology for this rate, and conventions for this rate that the Lender determines are substantially consistent with at least [five] currently outstanding U.S. dollar-denominated syndicated or bilateral credit facilities at such time (as a result of amendment or as originally executed) that are publicly available for review;

provided, further, that if the Lender decides that any such rate, methodology or convention determined in accordance with clause (1) or clause (2) is not administratively feasible for the Lender, then Compounded SOFR will be deemed unable to be determined for purposes of the definition of "Benchmark Replacement."

"Term SOFR" means the forward-looking term rate for the applicable Corresponding Tenor based on SOFR that has been selected or recommended by the Relevant Governmental Body.

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NOTES:

[1]Alt. Rates Reference Comm., *ARRC Supplemental Recommendations of Hardwired Fallback Language for LIBOR Syndicated and Bilateral Business Loans*, 2 (Mar. 25, 2021), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/arrc-supplemental-hardwired-recommendation.

[2]Presentation, Com. Real Estate Fin. Council, CREFC LIBOR Implementation Call Series (June 3, 2020) (on file with author).

[3]Alt. Rates Reference Comm., *ARRC Supplemental Recommendations of Hardwired Fallback Language for LIBOR Syndicated and Bilateral Business Loans*, 3 (Mar. 25, 2021), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/arrc-supplemental-hardwired-recommendation.

[4]Email from Freddie Mac Multifamily, SOFR Loan Documents Published and New LIBOR Dates Announced (Aug. 3, 2020, 2:15 EST) (on file with author).

[5]Alt. Rates Reference Comm., *ARRC FAQ's Regarding the Occurrence of a Benchmark Transition Event*, 1–3 (Mar. 8, 2021), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC_Benchmark_Transition_Event_FAQs.pdf.

[6]Alt. Rates Reference Comm., *ARRC FAQ's Regarding the Occurrence of a Benchmark Transition Event*, 1–3 (Mar. 8, 2021), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC_Benchmark_Transition_Event_FAQs.pdf; Presentation, Com. Real Estate Fin. Council, CREFC LIBOR Implementation Call Series (Mar. 10, 2021) (on file with author).

[7]Presentation, Com. Real Estate Fin. Council, CREFC LIBOR Implementation Call Series (Mar. 10, 2021) (on file with author); Alt. Rates Reference Comm., *ARRC FAQ's Regarding the Occurrence of a Benchmark Transition Event*, 1–3 (Mar. 8, 2021), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC_Benchmark_Transition_Event_FAQs.pdf.

[8]Presentation, Com. Real Estate Fin. Council, CREFC LIBOR Update: Developments in Term SOFR (Jul. 2021) (on file with author); Alt. Reference Rates Comm., *Frequently Asked Questions on Best Practice Recommendations Related to Scope of Use of the Term Rate* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC-Scope-of-Use-FAQ.pdf (last visited June 29, 2022); E-Mail from Alt. Reference Rates Comm, ARRC Formally Recommends Term SOFR (July 29, 2021, 10:09 EST)(on file with author).

[9]Cap/Swap providers were able to deliver a cap or swap which ties to the Fed Rate (a compounded SOFR average over a rolling 30 day period calculated in advance) notwithstanding the fact that ISDA documentation and definitions (Supplement Number 70 to the 2006 ISDA Definitions) for compounded SOFR averages uses an "in arrears" calculation.

[10]CME Group, CME Term SOFR Reference Rates (October 12, 2021)(on file with author).

[11]CBRE & Chatham Fin., *Update: LIBOR Transition*, 1 (Nov. 2021); https://www.cbre.us/-/media/files/2021/cbre_chatham-update-libor-to-sofr-transition-nov2021.pdf.

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