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IRS Issues Commercial Real Estate Loan Modifications Guidance

On September 16, 2009, the Internal Revenue Service issued highly anticipated guidance that will allow some commercial mortgage loans held by Real Estate Mortgage Investment Conduits (REMICS) and investment trusts to be modified prior to default without triggering adverse tax consequences to the holder. This guidance may be of great assistance to borrowers who have conduit financing (securitized loans).

Many borrowers under securitized commercial mortgage loans continue to feel the effects of the credit crunch and depressed property values as they evaluate options to refinance their real estate debt. Prior to the issuance of Revenue Procedure 2009-45, borrowers were unable to even begin loan modification discussions with their loan servicers until they had already defaulted, or there was a reasonably foreseeable default looming, because earlier loan modification could trigger significant adverse tax consequences for the holder.

The recent IRS guidance clarifies that loan servicers can implement modifications, such as interest rate changes, principal forgiveness and maturity extensions, at anytime without tax consequences if "based on all the facts and circumstances, the holder or servicer reasonably believes that there is a significant risk of default" upon maturity. The guidance opens the door for commercial borrowers to begin discussions with their loan servicer early on in order to achieve the most effective result. Since an enormous amount of conduit financing will be coming due in the next two to three years, this guidance will hopefully allow borrowers and lenders the opportunity to avoid loans going into default due to the inability to refinance.

If you have borrowed using conduit financing, we suggest that you review the maturity date of your loans and plan ahead so that you can work with your lender to try to secure any needed modifications. Reinhart's Real Estate attorneys have significant experience with conduit lending and can assist you in working to obtain the most favorable results in connection with any loan modifications.

Revenue Procedure 2009-45 is available at: <http://www.irs.gov/pub/irs-drop/rp-09-45.pdf>

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