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## Helpful REIT guidance

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IRS guidance issued last year provides some assistance for real estate investment trusts holding real property that has declined in value. The concern for many REITs was that certain loans secured by mortgages on REIT real property that had declined in value would not be treated as qualified real estate assets.

In Revenue Procedure 2014-51, the IRS announced that it would not challenge the treatment of a modified mortgage loan as a REIT real estate asset if (i) the modification arises from a default, or (ii) based on the facts, the REIT or the servicer of the loan prior to its modification has a reasonable belief that (A) there is a significant risk of default of the loan upon its maturity or at an earlier date, and (B) the modified loan presents a substantially reduced default risk in comparison to the pre-modified loan.

A "reasonable belief" needs to be based on a diligent contemporaneous determination of the default risk that should reflect the credible written factual representations of the issuer of the loan. If the REIT or the loan service knows or has reason to know that a representation is false, then the REIT or servicer may not rely upon it. Factors to be considered in determining the risk of default include (i) the projected time frame for the default (that is, how far away it is), and (ii) the historic payment performance of the payor.

If the above requirements are met, then the IRS will not challenge the status of the loan as a real estate asset so long as the REIT's stated value for it is equal to the lesser of (i) the value of the loan, or (ii) the greater of: (A) the current value of the real property securing the loan, and (B) the loan value of the real property securing the loan. Hopefully, few of our readers need to become acquainted with these rules; but, it is comfort to know the guidance is there.

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