

Financial Services

Providing Strategic Legal Guidance to the Global Financial Services Industry

AUGUST 21, 2020

For more information,
contact:

Jonathan Arkins
+1 212 556 2300
jarkins@kslaw.com

Ryan McNaughton
+1 212 556 2244
rmcnaughton@kslaw.com

Jeff Misher
+1 212 556 2271
jmisher@kslaw.com

Michael Urschel
+1 212 556 2285
murschel@kslaw.com

Mendel Yudin
+1 212 556 2273
myudin@kslaw.com

Martin Eid
+1 212 556 2101
meid@kslaw.com

Katy Berger
+1 212 827 4301
kberger@kslaw.com

King & Spalding

New York
1185 Avenue of the Americas
New York, New York 10036-
4003
Tel: +1 212 556 2100

Commercial Mortgage Loan Repurchase Agreements: COVID- 19 Related Issues, Temporary Agreements and What May Come Next

The abrupt halt in commercial activity caused by the 2019 Novel Coronavirus (“COVID-19”) has had a significant impact on the global economy, and in particular, the commercial real estate market. As a result, the commercial real estate mortgage loans (“Loans”) that fund the commercial real estate market have seen a flurry of amendment, modification, holiday and waiver activity to address the stress placed on commercial real estate borrowers (“Borrowers”) by COVID-19. This, in turn, has had an impact on the financing facilities that fund Loans, including commercial mortgage loan repurchase facilities (“Repos”).

Repos are financing facilities through which banks and financial institutions provide liquidity to the commercial real estate market. Commercial mortgage loan originators make Loans to Borrowers and then sell those Loans, often through a special purpose subsidiary or “SPV” (the “Seller”), to banks and financial institutions (the “Buyer”) for a purchase price calculated as a percentage of the outstanding balance of the applicable Loan to obtain financing. The Seller agrees to repurchase the Loans from the Buyer on a later date.

Repos are an attractive financing arrangement for both Buyers and Sellers because Repos are structured to benefit from several bankruptcy code safe harbor protections including from the automatic stay in the event of a Seller bankruptcy, which allows the Buyer to liquidate, terminate and accelerate the loans in accordance with the Repo documents without having to go through the bankruptcy process and without having to seek approval of the bankruptcy court. The availability of these protections decreases the risk to Buyers and, as a consequence of the reduced risk, enables the Buyer to offer lower interest rates to the Seller than it may obtain through other types of financing facilities.



Margin mechanics and repurchase events are other features of Repos that operate to reduce risk to Buyers by stabilizing and right sizing the Buyer's exposure to the Loans. While the triggers for requiring margin payments are the subject of contractual negotiation between Buyer and Seller, typically margins are triggered if the market value of a Loan decreases (which may be determined by the Buyer in accordance with the Repo documentation – whether in Buyer's sole discretion, or based on factors including appraisals and Loan default triggers). Upon occurrence of a margin trigger, the Buyer may issue a margin call to the Seller requiring that the Seller pay down the purchase price of the Loan to restore the Buyer's advance rate with respect to the Loan's revised market value. Sellers often negotiate for protections against margin calls, including minimum margin thresholds or providing that a margin call can only be issued following the occurrence of a set of specific credit events (e.g., a default by the Borrower).

In addition to margin mechanics (which typically facilitate a pay down in respect of a specific Loan of an amount less than the full amount outstanding under the Repo in respect of that Loan), Repo documentation also includes triggers which, if implicated, mandate the complete repurchase (i.e., paydown) of the amount advanced under the Repo in connection with a Loan. These events – referred to as "repurchase events" – vary from Repo to Repo, but often include the occurrence of an event of default with respect to the Borrower under the Loan.

The disruption in the commercial real estate market caused by COVID-19 has severely impacted the cash flows of certain properties, which has led to defaults or anticipated defaults for some Loans. This has prompted requests for waivers, modifications and interest payment holidays from Borrowers. In turn, Sellers have made corresponding requests from Buyers that Buyers cede control over certain amendments to the Loan documentation that would otherwise require Buyer consent, and allow the Seller to manage the Loan in a way that may prevent that Loan from going into default. Those amendments often help to avoid a large margin payment or a repurchase event under the Repo.

In some instances, Buyers and Sellers have entered into agreements ("Temporary Agreements") with respect to Repos that (A) allow the Seller to, among other things, (i) enter into modifications to the underlying loan documents, (ii) defer interest payments for Borrowers and (iii) use certain reserves to cover payment obligations, and (B) allowed for margin and repurchase event holidays under the Repo. Such Temporary Agreements often require, in connection with their execution, certain payments by the Seller to the Buyer to reduce Buyer's exposure to the Loans. As the name implies, these Temporary Agreements are just that – temporary – and the accommodations extended to Sellers under them are documented to expire after a certain period of time.

As the Temporary Agreements expire, depending on how long COVID-19 continues to impact the commercial real estate market, the underlying issues that prompted the necessity to execute Temporary Agreements may still exist and Buyers and Sellers will need to figure out what the next steps will be. There are several possible options that Buyers and Seller may consider, including:

- Extending the Temporary Agreements based on a number of factors including the relationship between the Buyer and the sponsor of the Seller, the quality and value of the property backing the Loan, the financial strength and willingness of the sponsor of the Borrower to bring the Loan into compliance and the foreseeability and timing of an end to the issues with respect to the Loan (e.g., mall and hotel re-openings).
- Modifying the Repo to allow for different terms for distressed and defaulted loans in exchange for lower advance rates and/or higher spread and fees due to the increased risk to the Buyer (for example, adding a second facility for "distressed" Loans within the four corners of the existing Repo transaction for Loans that remain under stress, distinct and separate from the standard and less-stressed "performing" Loans that the original Repo was written to finance).
- If the Seller and Buyer cannot agree on terms to keep the Loan on the Repo facility, the Seller may be forced to repurchase the Loan and enter into negotiations with the Borrower for a loan workout or foreclose on the mortgage.



Alternatively, the Seller may seek to refinance the Loan with other Buyers who are willing to finance more distressed Loans or on other types of financing structures.

It's been said that, while the social and economic impact of COVID-19 and the various government responses and preventative measures in March and April of 2020 resulted in what was aptly described as "uncertain times", perhaps as we enter the dying days of summer 2020, it's now quite certain that times remain uncertain. This remains clearly evident in the commercial real estate market, where we expect that Buyers and Sellers will continue to come up with creative solutions to the financing of Loans on Repo as the markets evolve and stabilize. As practitioners who have practiced in this space for longer than some of us would like to admit, we have been pleasantly surprised with the flexibility shown across the board – on both the Seller side and Buyer side – to deal with the events of the past 6 months and with the maturity shown by market participants tackling problems not of the parties' making. We hold out hope that the reasonableness and "bigger picture" thinking we have witnessed continues.

ABOUT KING & SPALDING

Celebrating more than 130 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100, with 1,200 lawyers in 22 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters in over 160 countries on six continents and is consistently recognized for the results it obtains, uncompromising commitment to quality, and dedication to understanding the business and culture of its clients.

This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice. In some jurisdictions, this may be considered "Attorney Advertising." View our [Privacy Notice](#).

ABU DHABI	CHARLOTTE	GENEVA	MOSCOW	RIYADH	TOKYO
ATLANTA	CHICAGO	HOUSTON	NEW YORK	SAN FRANCISCO	WASHINGTON, D.C.
AUSTIN	DUBAI	LONDON	NORTHERN VIRGINIA	SILICON VALLEY	
BRUSSELS	FRANKFURT	LOS ANGELES	PARIS	SINGAPORE	
