BACKGROUND

The London Interbank Offered Rate (LIBOR) is a reference rate used, in part, to establish an interest rate for a floating-rate instrument. The interest rate for the instrument may be set as a specified tenor of LIBOR plus a fixed spread.

LIBOR is based on a combination of actual transactions and judgment by certain banks. The credibility of LIBOR was eroded when it came to light that some of the participating banks manipulated LIBOR by contributing inaccurate estimates of their borrowing costs. Various efforts to reform LIBOR have failed to fully address the inherent weakness of a reference rate based in part on judgment and estimates rather than verifiable data on a sufficient volume of transactions.

Because LIBOR is in broad use in floating rate commercial mortgage lending, the cessation of the production of daily LIBOR updates will have an impact on the commercial real estate finance industry.

PREPARNING FOR LIBOR TRANSITION

The Mortgage Bankers Association is focused on providing resources to assist our member firms in the transition away from LIBOR to a successor index. Our goal is to work across the range of stakeholders to facilitate the implementation of a successor index, as well as to help educate our members and draw attention to transition issues that are important to our membership, the borrowers with whom they partner, and the communities in which they operate.

To that end, MBA has developed a Primer on Evolving Issues for LIBOR Transition and Commercial Mortgage Market Challenges. The Primer includes an initial checklist of issues that commercial real estate finance firms will need to address as they consider the LIBOR transition. Proactively focusing on these issues within the contexts of individual organizations and the overall real estate finance market is vital. It also identifies a number of evolving issues that may require industry action in the near future.
The end of LIBOR began in the summer of 2017 with the Financial Conduct Authorities (FCA) announcement of its decision to wind down the reference rate.

To address concerns of contracts that do not provide a LIBOR fallback, in March 2022, President Biden signed the US Adjustable Interest Rate (LIBOR) Act into law. The Act creates a clear and uniform federal solution for transitioning legacy contracts that either lack or contain insufficient contractual provisions addressing the permanent cessation of LIBOR and provides safe harbor provisions protecting the selection and use of the Board-selected benchmark replacement as a replacement for LIBOR.

In December 2022, the Federal Reserve issued a final rule implementing the US Adjustable Interest Rate (LIBOR) Act by identifying benchmark rates based on SOFR (Secured Overnight Financing Rate) that will replace LIBOR in certain financial contracts after June 30, 2023.

**RECOMMENDATION**

As the transition rapidly approaches, it is important that lenders and other market participants promptly take action if they have not already done so to prepare for the transition away from the LIBOR index.

*March 2023*