

Defeasance Team

at Chatham Financial



Excellence in Execution

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At Chatham Financial

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A Defeasance Overview

Defeasance is the process by which a borrower is released from the obligations associated with its debt through the purchase of a portfolio of high quality bonds. This portfolio serves as replacement collateral for the property or properties under the loan. The portfolio secures the debt and generates the cash flows required to meet the future obligations of the debt.

The concept of defeasance first originated in the municipal market. It was later adapted to the commercial real estate market, with the first defeasance provisions appearing in fixed rate, securitized loans in the mid 1990's. These provisions have increasingly become the only avenue for borrowers to sell or refinance their encumbered properties.

While the process is easily summarized, in practice it is very complex, involving a large number of parties with competing interests. The Defeasance Team at Chatham Financial has a successful track record of assisting its clients in defeasing their loans since 2000. Because we are not affiliated with any third party, we provide completely unbiased, transparent services to our clients.

When a Loan Can Be Defeased

Although the exact period of time a borrower has to defease their loan varies, REMIC (Real Estate Mortgage Investment Conduits) rules that govern CMBS (Commercial Mortgage-Backed Securities) preclude defeasance during the first two years

after the loan has been securitized. The Borrower, Borrower's Counsel, or the Defeasance Consultant must review the loan agreement to determine if additional timing or other defeasance limitations exist.

The Parties of a Defeasance Transaction

Due to the legally rigorous and complex defeasance process, multiple parties must become involved. In addition to the Borrower and their Counsel, it is common to see the following parties:

- Servicer
- Servicer's Counsel
- New Buyer's or Lender's Counsel
- Defeasance Consultant
- Successor Borrower
- Successor Borrower's Counsel
- Securities Intermediary or Custodian
- Certifying Accountant
- Rating Agencies
- Title and Escrow Agents

The Defeasance Consultant's role is to represent the borrower and facilitate the defeasance process. Our experienced defeasance consulting team works with its clients to maintain complete transparency. Our relationships with the various parties involved allow us to execute the process efficiently, which ensures a cost effective transaction.

The Defeasance Process

A typical defeasance transaction takes 30 to 45 days to complete. With the help of a Defeasance Consultant, the Borrower notifies their loan Servicer of their intent to defease, and pays the Servicer a good faith deposit. The Defeasance Consultant will typically engage all of the required parties, structure a securities portfolio as the defeasance collateral, and hold an auction to ensure the best pricing. The Consultant will coordinate the delivery of replacement collateral in favor of the loan Servicer, who services all remaining payments of principal and interest left on the loan.

The loan documents typically require that a Successor Borrower assume the obligation of the Borrower. Once the Successor Borrower takes the place of the Borrower, the Borrower is released from their financial obligation under the loan.

The Cost of Defeasance

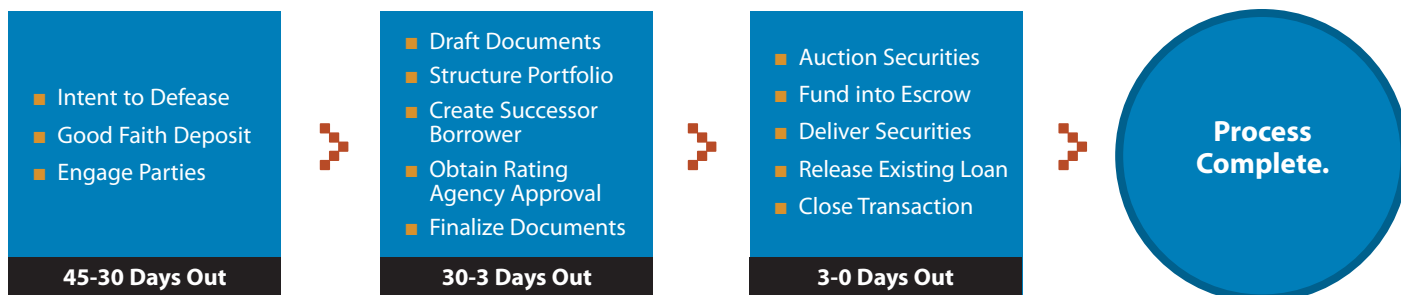
Many Borrowers focus on the transaction fees associated with a defeasance, yet are unaware that the largest expense they incur

is caused by an inefficiently structured securities portfolio. Borrowers may also be "leaving money on the table" by walking away from the residual value of the Successor Borrower. Our goal is to increase the transparency of the defeasance process by constructing and competitively bidding optimized securities portfolios, and by sharing the Successor Borrower value with our clients.

Structuring the Defeasance Collateral

Structuring the portfolio of bonds from the defeasance collateral is a complex task; strict guidelines govern how much cash may be included month-end cash balances have limits throughout the life of the loan; and a large universe of bonds is available from which to construct the portfolio. We use proprietary optimization techniques to structure portfolios of bonds so they meet the Servicer's requirements at the lowest possible cost to our clients.

The Defeasance Team at Chatham Financial is not a broker/dealer. We do not profit by trading any of the securities involved in the construction of a defeasance portfolio, nor do we receive any money from the dealer.





The Defeasance Team's Consulting Services

Why Defeasance Team? Because we invest as much time and effort as our clients desire into education about the defeasance process, while taking the administrative burden and heavy lifting off their plates. We will:

- Review defeasance language *before* a client enters into new conduit loans
- Review the defeasance language in existing loans to determine the most favorable defeasance approach allowed
- Develop hedging strategies to protect the portfolio against fluctuating interest rates

- Structure an optimized, cost effective securities portfolio to serve as the defeasance collateral – including customized agency bonds if permitted
- Competitively bid securities portfolios to ensure optimal pricing
- Release client from securities shortfall liability by acting as Successor Borrower
- Share residual value of the Successor Borrower, including value gained from prepayment of a defeased loan

Recovering the Residual Value

Mismatches in timing typically exist between cash receipts from the defeasance collateral (coupon payments or bond maturities) and cash payments (loan obligations), resulting in interest accruing at money market rates over the life of the defeased loan. However, rules governing the structuring of the defeasance collateral stipulate that the earned interest cannot be applied toward scheduled loan payments.

This accrued interest represents the residual value of a defeasance transaction. Whenever we act as the Successor Borrower, we share that value with the Original Borrower either on a present value basis at defeasance closing or upon final payment of the defeased loan.

Managing Future Defeasance Costs

The best time to reduce your defeasance costs is when you are negotiating the term sheet for your new loan. Defeasance Team can review the defeasance language in the loan documents free of charge so you have peace of mind if you choose to defease in the future. We will identify the loan language pitfalls and suggest more favorable language for inclusion in your loan.

Choosing a Defeasance Consultant

As a leading advisor in the real estate industry, our experienced defeasance consulting team will work with you to maintain complete transparency. We have a consistent pricing approach whereby all of our clients can be assured that they are receiving the same quality service. We also bring new insights to

defeasance, helping our clients to avoid unpleasant surprises at closing by hedging defeasance costs and structuring agreements that could recover significant residual value.

Hedging a Defeasance

Defeasance Team is interested in not only making the defeasance process as painless as possible, but in saving our clients as much money as possible. Therefore, we advise our clients on various strategies to protect the portfolio against fluctuating interest rates. With proper analysis and knowledgeable execution of a hedging strategy, our clients are able to mitigate defeasance costs while being able to focus on their sale or new financing.

Defeasance vs. Yield Maintenance

A Borrower with a securitized loan looking to release their property may have one of two options at their disposal: defeasance or early loan payoff (yield maintenance). Yield maintenance is a prepayment penalty that allows the lender to attain the same yield as if the borrower had made all scheduled payments through maturity. Although yield maintenance typically requires a 1-3% penalty, it may be a cheaper option for the Borrower if current market rates are higher than the coupon payment on the original debt.

We can review the provisions in your loan documents free of charge to determine whether defeasance or yield maintenance is allowed, and which is the most favorable option for you.



The Defeasance Team at Chatham Financial is an industry leader, completing over 750 defeasances with a total balance of over \$22 billion on behalf of our clients, including the largest commercial real estate loan ever defeased (\$1.2 billion).

Chatham Financial is the first name that comes to mind...

... whenever I have a client that needs to defease a loan. Their involvement and friendly approach enable my clients to focus on the real estate transaction as opposed to worrying about the defeasance process."

Jeffrey H. Kapner ■ Partner , Kaye Scholer LLP

"Chatham's superior customer service turned a complicated defeasance into an understandable, manageable process. Their assistance was invaluable."

Laura Knapp ■ The JBG Companies

"Chatham gave me the confidence that our defeasance was done correctly and efficiently. Their explanations, diligence, and communication made the process go smoothly and allowed me to focus on other important parts of our transaction. I wouldn't go through a defeasance without them."

Adam Keller ■ Vice President, Wolff Urban Development, LLC

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