Tips for CMBS Loan Origination

Waterstone Defeasance recommends borrowers pay close attention to the defeasance section of conduit loan terms they negotiate with lenders in order to reduce the cost of the defeasance securities portfolio, and maximize any potential prepayment residual value.

Successor Borrower Designation Rights: Some loan documents state that the Successor Borrower will be an entity designated and approved by the lender in its sole discretion. Request that the borrower have the right to designate the successor borrower. Not retaining this right may prevent the borrower from sharing in any prepayment residual value generated by the successor borrower.

Definition of Defeasance Collateral: By using the below definition of "U.S. Obligations", the borrower should retain the right to buy both treasury and agency securities (FNMA, FMAC), which may lead to a cheaper securities price:

> *"Defeasance Collateral shall consist of direct non-callable obligations of the United States of America or other obligations which are "government securities" within the meaning of Section 2(a)(16) of the Investment Company Act of 1940"*

Open Period: Borrowers should request an 'open payment period' prior to the maturity date (typically 3 to 6 months) where the loan can be paid at par without any penalty. Request this period be stated in months, not days, which will maximize any residual. Borrowers should further request the ability to buy defeasance securities only to "the first date of the open period" rather than through the maturity date.

Preserving Prepayment Rights by Successor Borrower: Should the lender not approve the request to defease to the open period, then the borrower should preserve the right for the Successor Borrower to prepay the loan to generate potential residual value if the loan is defeased in the future. This will enable the borrower to participate in a potential sharing agreement with the Successor Borrower. However, many loan documents prohibit the loan from being prepaid after the loan has been defeased, by inserting the following language:

> *"Upon the release of the Property…, Borrower shall have no further right to prepay the Note…"*

The borrower should request the above language be removed if included.

Controlling the Securities Purchase: Some loan documents give the lender the right to buy the defeasance securities, rather than the borrower. This gives the lender the right to require borrowers buy the defeasance securities through their internal broker-dealer, rather than seeking bids from multiple broker-dealers. The borrower should request language that gives them the right to deliver the securities, rather than to deliver the deposit to the lender, which ensures the borrower can obtain multiple bids.

Limit Servicer Processing Fees: The borrower may want to consider adding language that caps the servicer's processing fee. We have seen several documents that have this language, and it usually places a limit (e.g. $5,000) on the servicer's defeasance processing fee. Servicers typically use a sliding scale depending on loan size. Loans over $20 million can have fees well in excess of $25,000.

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