

Question of the Month: If I wait until maturity to refinance, I won't pay a "premium," right? Wrong!!!



John Hosmer, Defease with Ease

SAMPLE LOAN	
Original Loan Amount - \$15,000,000	Origination Date - 6/15/2008
Term - 10 Years	Interest Rate - 6.25%
Amortization - 30 Years	Defease Discount Rate - 0.28%
Future Payments Due - (1/1/13 - 7/1/14)	Defease Now Closing Date - 12/1/12
DEFEASE NOW	WAIT UNTIL MATURITY
Loan Balance 12/2012 - \$13,261,000	Loan Balance 12/2012 - \$13,261,000
Prepaid Interest - \$ 1,247,000	Future Interest Due - \$ 1,366,000
Transaction Costs - \$ 30,000	Transaction Costs - \$ 0
TOTAL COST TO DEFEASE NOW	TOTAL COST TO WAIT
\$1,297,000	\$1,308,000

Photo 1 is representative of loans defeased in the last 2 years and illustrates the point.

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Whether you (a) refinance your CMBS loan and defease now, or (b) wait until maturity to refinance, you will pay all principal and interest due over the life of your loan. If you defease now, interest is paid as a lump sum discounted at treasury rates (because you're buying a portfolio comprised of government treasuries structured to mature just prior to each remaining mortgage payment). If you wait until your maturity date to refinance, you are still making your monthly loan payments at the full, undiscounted, future amounts due.

The amount of future interest that you prepay at a discount in connection with a defeasance transaction is sometimes referred to as the "defeasance premium" and is similar to yield maintenance costs. However, the "defeasance premium" is not a separate penalty that you pay in order to defease. It is just the present value of all the interest that you will pay over the remaining life of the loan if you don't defease and instead wait to refinance at maturity.

Photo 1 is representative of loans defeased in the last 2 years and illustrates the point. The Defease Now option results in a cost to defease of 9.44%.

That sounds like a big "penalty" to defease, but remember... it's just future interest prepaid now at a discount.

In fact, a comparable Wait Until Maturity calculation results in an even higher cost to wait of 9.86%!

If you have less than five years to maturity and the ability to refinance now, consider the following factors:

- * Refinancing now and paying defeasance costs can be cheaper than waiting until maturity.
- * Defeasance costs are often tax deductible in the year of a defeasance.
- * Commercial real estate loan volume and terms are the best they've been in several years.
- * New loan interest rates will not stay low forever.
- * With economic and political uncertainty, both domestically and globally, any recovery in real estate may present a fragile window of opportunity to lock in 10-year money at low rates.

Contact us for a free defeasance analysis and cost estimate. We'll help you analyze the economics and understand the process, so you're ready to Defease With Ease, as soon as you have a commitment letter in hand.

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