



COMMERCIAL DEFESANCE
DEFESANCE WITH EASE®

Ten Cost Saving Tips for New Conduit Loans

When negotiating new loan documents, consider the following valuable tips. They can save the borrower a lot of money on the defeasance transaction when it's time to sell or refinance. These tips are not meant to be all-inclusive and are not a substitute for the advice of qualified legal and accounting professionals. As the context requires, the term "Lender" herein refers to the original lender with whom the borrower negotiates the terms of the new loan and refers to the servicer who will process the defeasance years later.

1. **Definition of "Defeasance Collateral":** Expand the definition of "Defeasance Collateral" to include agency securities (e.g., FNMA, FMAC). They often provide a higher yield than standard U.S. Treasuries and reduce the cost of the defeasance collateral.

Sample language: "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, that provide for payments on or prior to, but as close as possible to, the scheduled monthly payments.

2. **Definition of "Scheduled Defeasance Payments":** Many defeasance provisions require that the defeasance collateral cover all successive payment dates, including the final maturity date. If there isn't one, request an open payment period during the last 3 – 6 months of the loan term and then request that the defeasance collateral only cover payments through the first date of the open payment period instead of through the maturity date.
3. **Prepayment:** Some loan documents negate the borrower's right to prepay the loan (during the open payment period) after the loan is defeased. If the request in # 2 above is denied, request that any language negating the right to prepay after defeasance be eliminated, so any prepayment value can be included in a residual sharing arrangement. Additionally, the open payment period should be stated in months rather than days (e.g., "payment during the 3 month period prior to the maturity date" rather than "prepayment on or after any payment date that is 90 days prior to the maturity date"). A precise application by the lender of the "day count" method can effectively shorten the open payment period by one month due to months consisting of 31 days.
4. **Designating the Successor Borrower:** 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 subject to the approval of the lender in its *reasonable* discretion. Giving up the ability to designate the successor borrower will affect the borrower's ability to negotiate for a share of any residual value.
5. **Delivering "Defeasance Collateral" vs. "Defeasance Deposit":** Some loan documents state that the lender will select a broker-dealer to buy the securities with *funds delivered* by the borrower. This language allows the lender to require the use of their in-house or subsidiary broker-dealer at above-market costs. Borrowers should request that they be required to *deliver securities* to the lender (the more standard practice) rather than delivering cash to the lender. This will allow the borrower to maintain greater control over the securities purchase and obtain the best market pricing for the defeasance collateral.
6. **Definition of "Lock-Out Period":** REMIC regulations prohibit defeasance during the first two years after securitization. However, some loan documents define this "lock-out period" as the longer of (a) the standard 2 year REMIC lock-out period, and (b) a specified number of years (usually 3 or 4 years). At a minimum, the lock-out period should be the "*lesser of*" (a) and (b), rather than the "longer of". Some borrowers have successfully negotiated to delete (b) (the specified number of years) all together.
7. **Cap on Lender Fees:** Every lender charges a fee for accommodating and processing a defeasance transaction. Recently, some lenders started charging significantly higher fees, so consider negotiating a range or cap on fees charged for processing a defeasance (e.g., lender fees charged to process a defeasance shall not exceed \$15,000).
8. **Reserves:** Lenders typically take 15-30 days to return reserves to the borrower after defeasance. Some lenders charge a fee to wire reserves and others send a check by regular mail weeks after the defeasance closes. Request that the lender return all reserves by wire, within five business days after the defeasance closes, at no additional charge to the borrower.
9. **Notice Period:** Typically, the borrower must notify the lender of its intent to defease 30 to 60 days before the borrower wants to close. Some lenders charge an additional "expediting" fee for closing a defeasance in less than 30 days. Consider negotiating a shorter notice period to avoid this extra fee but, at a minimum, make sure no more than 30 days' notice is required.
10. **"Business Day" Convention:** Request that monthly payments due on "non-business days" be made on the succeeding, rather than preceding, business day without penalty. This change will expand the universe of eligible securities to more efficiently meet the scheduled defeasance payments, which will reduce the cost of the defeasance collateral.