



New Conduit Loan Tips and Potential Savings

Thank you for your request for suggestions in the areas of defeasance language that you should consider negotiating into your new loan documents. We are not attorneys or accountants, but we can offer some general observations based upon our experience with defeasance. Our observations are not meant to be all inclusive nor should they be considered a substitute for the advice of legal and accounting professionals. Following are general tips that we hope will be helpful in negotiating the defeasance provisions in a new loan.

- 1. Definition of Government Securities that serve as Defeasance Collateral** – Some borrowers have had success expanding the definition of “Defeasance Collateral” to include agency securities which usually provide a higher yield than the standard U.S. Treasuries and reduce the cost of the portfolio. Following is sample language for consideration:

-The 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, all successive payment dates* through and including a payment date occurring during the period in which the loan may be prepaid without penalty or fee; as selected by borrower.

*The definition of “Payment Date”, per the loan documents, should address that payment dates that fall on non-business days should be allowed to be paid on the *succeeding* business day.
- 2. Prepayment** – Some borrowers have successfully negotiated language (described above) that allows the defeasance collateral to cover monthly payments through the first payment date of the open prepayment period at the end of the loan term rather than through the full maturity date. If this request is rejected, consider eliminating any language that negates the ability to prepay after a defeasance occurs. This may preserve the ability to include that value in a residual sharing agreement upon defeasance of the loan.
- 3. Designating a broker/dealer** – Some loan documents state that the borrower shall deposit funds sufficient to buy the defeasance collateral and that the lender will use the funds to buy the securities. Loan servicers can seize upon this language as an opportunity to force the use of their in-house or subsidiary broker-dealer at fees and commissions above what is otherwise available in the market. Borrowers should negotiate to deliver securities to the lender not cash. That allows the borrower to maintain control over the securities purchase to obtain the best price.
- 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 with the related costs paid by the borrower. Loan servicers can seize upon that language to require that the successor borrower be an entity designated by the servicer. Some borrowers have had success negotiating the ability to designate the successor borrower subject to the approval of the lender in its reasonable discretion.
- 5. Definition of Lock-Out period** – There is a two year period after the loan is securitized during which REMIC regulations prohibit a defeasance. However, some loan documents will define the period during which a defeasance is prohibited as the longer of the standard 2 year REMIC period and a set number of years from closing (usually 3 or 4). At a minimum, the language should be the “lesser of” the two referenced periods and not the “greater of”, but some borrowers have successfully negotiated the ability to defease at any time other than during the REMIC lock-out period.
- 6. Reserves** – Servicers typically take 15-30 days to return reserves to the borrower after a defeasance. Some servicers will charge a fee to wire reserves and others will send a check by regular mail that can take weeks. Consider requiring the lender to return all reserves by wire, within five business days after the defeasance has closed, at no charge.
- 7. Notice Period** – A typical notice period for a defeasance is 30 to 60 days. It’s not uncommon for the servicer to charge an extra fee for closing in less than 30 days. Consider negotiating a shorter notice period to avoid this extra fee. In no event should the notice required exceed 30 days.
- 8. Cap on Servicer Fees** – Every servicer charges a fee for accommodating and processing a defeasance transaction. This fee is often based on loan size. Sometimes, however, it can be based on a percentage of the outstanding loan balance. Consider negotiating a set fee or a cap on fees charged by the servicer (i.e. not to exceed \$10,000).

Potential Savings

The analysis below illustrates how negotiating these terms and conditions into the defeasance provisions of a conduit loan can either save money or add value when it comes time to defease the loan.

Sample Loan Terms:

Original Loan Amount: \$10,000,000	Maturity Date: June 2014
Interest Rate: 6%	Defeasance Date: June 2008
Start Date : June 2004	Balance at Defeasance: \$9,394,271.65
Early Prepay Window: 6 months	

1. Definition of Government Securities that serve as Defeasance Collateral – Treasuries only vs. Agencies

Treasuries Only	Agencies	Savings
\$10,935,000	\$10,835,000	\$100,000

2. Ability to Defeasance to the Early Prepayment Date (using Agencies)

Defeasance to Maturity Date	Defeasance to Early Prepay Date	Savings
\$10,835,000	\$10,750,000	\$85,000

3. Ability to Designate the Securities Broker

Mark-up Using Retail Broker	Nominal Admin Fee Using Our Sources	Savings
\$15,000+	\$2,500-\$5,000	\$10,000+

4. Ability to Designate the Successor Borrower

Residual w/ Servicer Designation	Residual w/ Borrower Designation	Added Value
\$0	\$20,000*	\$20,000

* Average value to borrower of most residual sharing agreements

5. Shorter Lockout Period

"Later of" 4 yrs or 2 yr from Startup	"Earlier of" 4 yrs or 2 yrs from Startup	Opportunity Loss Avoidance
4 yr lock out	2 yr lockout	\$\$\$???

6. Unused Reserves and Escrows Refunded in a Timely Manner (\$400,000 for this Example at 4% AAA Money Market rate)

Reserves Refunded in 30 days	Reserves Refunded in 5 days	Savings
\$1,200+ to Servicer	\$200+ to Servicer	\$1,000

7. Shorter Notice Period – 25 vs 30-60 Day Notice Requirement

25 Days Notice Given w/30+ Days Required	25 Days Notice Given w/25 Days required	Savings
\$5,000 extra fee on avg.	\$0 extra fee	\$5,000

8. Cap on Servicer Processing Fee

1% of Outstanding Loan Balance	Fee Not to Exceed \$10,000	Savings
\$93,942	\$10,000	\$83,942

Total Potential Savings on this Loan: approx. \$305,000+

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