Defeasance Activity Falls Short of Expectations

By Orest Mandzy

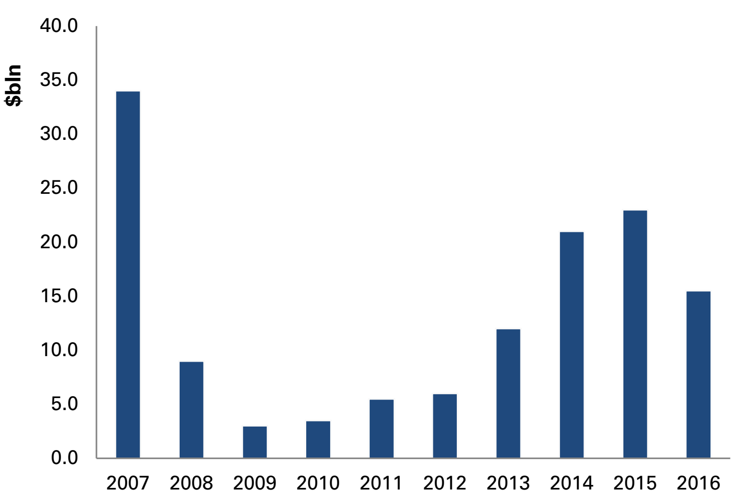
Defeasance activity among CMBS loans declined last year—a surprise given that interest rates remained at or near historic lows for most of the year and overall property values continued on their upward march.

According to Trepp, LLC a total of 1,058 securitized loans with a balance of $15.9 billion were defeased, or replaced by government securities last year. That compares with 1,309 loans with a balance of $22.5 billion that were defeased a year earlier.

Professionals in the defeasance business had been expecting activity to be comparable to that of 2015. But volatility in the CMBS market crushed those hopes.

Property owners, who had become accustomed to CMBS lenders providing loans of 70% of a property's value or more, suddenly found themselves in a relatively hostile lending environment, as bond market volatility prompted securitized lenders to pull back on the amount of proceeds they were offering. Out went loans with loan-to-value ratios of 70% or more and in came loans with LTVs of 65% or less—often much less—particularly for smaller and middle-market properties, the bread and butter of the CMBS business. That's had a heavy impact on defeasance.

Defeasance Volume Trends



Source: Trepp

Defeasance Activity in Major Markets

MSA	#Loan	Balance $mln	% of Loan
New York	85	3,160.50	20.57%
Washington D.C	24	804.04	5.23%
Boston	12	755.00	4.91%
Chicago	18	488.07	3.18%
Los Angeles	38	477.57	3.11%
San Francisco	13	119.66	0.78%
		5,804.85	**37.79%**

Source: Trepp

Volumes also were impacted by what defeasance professionals say was the "wait-and-see" attitude many borrowers adopted. They were hoping to burn off as much of what could be viewed as the "defeasance penalty" they would face as possible. The closer to a loan's open date that defeasance occurs, the fewer government securities need to be purchased.

Most commercial mortgages come with prepayment restrictions to ensure that lenders receive the cash flows they expect for the life of their loans. Borrowers choosing to pay off loans before they become open to prepayment would face penalties that often are onerous. They could, however, defease their loans. That is, replace their collateral with government securities that mimic the mortgages' cash flow.

But the process could be costly and time-consuming, in that it involves negotiations with servicers and rating agencies, among others, and the selection of appropriate substitute securities. As a result, a number of advisory firms have been formed to specialize in the process. Those include AST Defeasance of Los Angeles; Chatham Financial of Kennett Square, Pennsylvania;

Commercial Defeasance and Waterstone Capital Advisors, both of Charlotte, North Carolina; Trimont Real Estate Advisors of Atlanta; Bank of America, and Wells Fargo Bank.

Defeasance activity flourishes when interest rates are low and property values high. If a property's value climbs, as generally has been the case, given that the Moody's/RCA Commercial Property Price Index is now 22.3% greater than it was at its last peak in November 2007, its owner could refinance the property, through defeasance, in order to access the added equity. That increased value otherwise would remain trapped. But for a defeasance transaction to make financial sense, interest rates typically would have to remain low. Otherwise the benefits of a prepayment could be nullified.

Of course, values haven't climbed uniformly across all property sectors. As of last October, prices for properties in major markets were up 38.7% from their previous peaks, while those in non-major markets were up only 8.4%.

So it's no surprise that loans against properties in the six markets that the CPPI classifies as major accounted for 37.8% of all defeasance activity. New York City alone accounted for 20.6% of the year's defeasance volume. That was to be expected given the lofty prices certain properties in New York command. Among the biggest loans to be defeased last year was the $625 million mortgage against 9 West 57th St., a 1.7 million-square-foot office building in midtown Manhattan.

The loan was securitized four years ago through COMM, 2012- 9W57. At the time, the property was appraised at a value of $2.5 billion, based on its $67.7 million of net cash flow. The $625 million loan that Deutsche Bank then had provided paid an interest-only coupon of 3.787% for its five-year term.

That loan was taken out through defeasance last year—it wasn't set to mature until February and became open to prepayment last November—with a $1.2 billion financing package that JPMorgan Chase Bank provided. The loan pegged a $3.4 billion appraised value on the property—a 36% increase over the past four years—largely because of recently signed leases that would increase cash flow to $107.1 million. That would be a 60% hike since 2012. The pays an interest-only coupon of 2.86% for its full 10-year term.

With interest rates climbing steadily since the presidential election, and the expectation that property values might already have hit their peaks, defeasance volumes may be challenged to keep pace with last year. ■

See the next page for a list of the top defeased loans in 2016.

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Top Defeased Loans - 2016

Mo. of Defeasance	Bloomberg Name	Vintage	Property Name	Location	Property Type	Balance $mln	DSCR	LTV	NOI $mln	Maturity Date
January	GCCFC 2007-GG9	2007	John Hancock Tower & Garage	Boston	MU	640.50	1.52	50.00	55.34	Jan. 6, 2017
October	COMM 2012-9W57	2012	9 West 57th Street	New York City	OF	625.00	3.76	24.80	90.12	Feb. 6, 2017
November	GSMS 2013-NYC5	2013	Manhattan Collection	New York City	LO	361.70	2.48	47.00	37.80	Jan. 6, 2018
October	GCCFC 2007-GG9	2007	667 Madison Avenue	New York City	OF	250.00	1.49	53.19	21.32	Feb. 6, 2017
August	MSC 2007-HQ11	2007	One Seaport Plaza	New York City	OF	225.00	1.55	46.88	18.26	Jan. 9, 2017
November	COMM 2007-C9	2007	Waterview	Rosslyn, Va.	OF	210.00	1.90	48.26	23.25	June 1, 2017
January	JPMCC 2007-LD11	2007	5 Penn Plaza	New York City	OF	203.00	1.61	67.67	18.58	May 1, 2017
August	COMM 2007-C9	2007	Ritz Carlton Key Biscayne	Key Biscayne, Fla.	LO	160.00	2.96	63.30	29.34	June 1, 2017
December	COMM 2007-C9	2007	85 Tenth Avenue	New York City	OF	150.00	1.27	60.70	19.52	June 1, 2017
June	CD 2007-CD4	2007	The Atlantic Building	Washington, D.C.	OF	149.70	1.68	71.29	14.11	April 1, 2017
November	WBCMT 2007-C34	2007	Ashford Hospitality Pool 5	Various	LO	148.82	1.78	79.93	20.14	April 11, 2017
February	CSMC 2006-C5	2006	HGSI Headquarters	Rockville, Md.	OF	138.75	2.21	59.10	23.30	Sept. 1, 2016
December	COMM 2013-LC6	2013	540 West Madison Street	Chicago	OF	135.00	1.61	63.50	15.01	Jan. 6, 2018
November	WFCM 2010-C1	2010	Dividend Capital Portfolio	Various	MU	124.21	2.87	46.58	28.97	July 1, 2020
June	GSMS 2007-GG10	2007	55 Railroad Avenue	Greenwich, Conn.	OF	124.00	0.85	80.00	7.35	June 6, 2017
November	WBCMT 2007-C31	2007	Ashford Hospitality Pool 2	Various	LO	119.04	2.03	80.19	18.37	April 11, 2017
February	MSC 2006-IQ12	2006	Oxford Centre	Pittsburgh	OF	118.00	1.68	79.70	11.40	Dec. 1, 2016
March	GSMS 2011-GC5	2011	Copper Beech Portfolio	Various	MF	111.90	1.48	68.29	12.01	June 6, 2016
November	MSC 2008-T29	2008	Kimco Portfolio	Various	RT	109.27	1.27	66.70	14.19	Dec. 1, 2017
November	WBCMT 2007-C31	2007	Ashford Hospitality Pool 1	Various	LO	108.81	2.28	79.45	18.85	April 11, 2017
June	WBCMT 2007-C32	2007	Ashford Hospitality Pool 4	Various	LO	98.42	1.95	74.27	14.54	April 11, 2017
August	UBS 2012-C1	2012	Apache Mall	Rochester, Minn.	RT	93.16	1.74	66.58	10.35	Aug. 6, 2017
July	CSMC 2007-C1	2007	HGA Portfolio	Various	MF	92.48	1.93	79.90	12.24	Nov. 11, 2016
October	MSC 2007-IQ16	2007	USFS Industrial Portfolio Roll-Up	Various	IN	89.75	1.67	75.00	50.96	Aug. 1, 2017
November	COMM 2007-C9	2007	USFS Industrial Portfolio	Various	MU	89.75	8.90	75.00	50.96	Aug. 1, 2017
April	GSMS 2007-GG10	2007	915 Wilshire Boulevard	Los Angeles	OF	85.00	1.24	72.65	6.35	March 6, 2017
December	WFRBS 2011-C2	2011	Rentar Plaza	Middle Village, N.Y.	MU	76.83	2.23	52.10	13.48	Jan. 1, 2021
June	WFRBS 2013-UBS1	2013	Sullivan Center	Chicago	MU	75.00	5.10	49.60	15.31	Nov. 6, 2018
October	MSC 2007-T27	2007	Plaza at Landmark	Alexandria, Va.	RT	69.00	1.71	61.90	6.57	May 1, 2017
July	BSCMS 2007-T26	2007	Academy Sports HQ	Katy, Texas	IN	68.25	2.22	66.00	8.61	Feb. 1, 2017
September	GSMS 2013-GC16	2013	Matrix MHC Portfolio	Various	MH	67.96	1.63	69.40	16.19	Aug. 6, 2018
June	WBCMT 2007-33	2007	84 Lumber Industrial Pool	Various	IN	67.92	1.87	68.54	18.86	May 5, 2017
October	WBCMT 2007-32	2007	60 Madison Avenue	New York City	OF	66.50	1.21	79.17	4.69	May 11, 2017
August	WFRBS 2013-C17	2013	Matrix MHC Portfolio	Various	MH	64.10	1.63	69.40	16.19	Aug. 6, 2018
September	CGCMT 2007-C6	2007	Culver Center	Culver City, Calif.	RT	64.00	1.65	80.00	5.97	May 6, 2017
February	BSCMS 2006-PW13	2006	Fairmont Plaza Office	San Jose, Calif.	OF	60.12	1.53	73.60	6.97	June 1, 2016

Source: Trepp

About Trepp

Trepp, LLC, founded in 1979, is the leading provider of information, analytics and technology to the CMBS, commercial real estate and banking markets. Trepp provides primary and secondary market participants with the web-based tools and insight they need to increase their operational efficiencies, information transparency and investment performance. From its offices in New York, San Francisco and London, Trepp serves its clients with products and services to support trading, research, risk management, surveillance and portfolio management. Trepp is wholly-owned by DMGI, the information publishing division of the Daily Mail and General Trust (DMGT).