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Northeast retail defeasance activity jumps 300% as the economy continues to improve

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As the economy continues to improve in the current low interest rate environment it is generating greater lending activity in the commercial real estate market. Subsequently, as lending improves it drives commercial real estate sales and refinance transactions. These trends, in turn, are also generating a larger number of defeasance transactions in CMBS loans as borrowers take advantage of the opportunity to refinance their loan or sell the property.

Defeasance is the process through which a borrower is released from the obligations associated with its debt through the purchase of a portfolio of high quality bonds, typically U.S. Treasuries. This portfolio serves as replacement collateral to secure the CMBS loan and generates the cash flows required to meet the future loan payments. By far the largest potential cost of defeasance is the price of the replacement collateral over the outstanding principal balance of the loan, often referred to as the "defeasance premium."

The defeasance process allows a borrower to get released from a CMBS loan when the borrower is either selling the property or refinancing the loan. The process is typically coordinated by a defeasance consultant that coordinates with the various parties such as the servicer, servicer's counsel, verification accountant, securities broker/dealer, securities custodian, rating agencies, title company, and the successor borrower. The process is complex and often times the parties have competing interests.

According to Bloomberg, approximately 845 CMBS loans totaling $10 billion were defeased in 2013, which is double the volume from the previous year. Of that, approximately 260 loans totaling $2.9 billion were retail property types. Drilling down further in the retail data, 67 loans representing 26% were located in the northeast states, where 66% were un-anchored retail and 34% were anchored. The data also reveals the average defeased retail loan in the northeast was $14.3 million, with a 5.9% rate, and 25 months remaining on the loan. The northeast states with the most defeasance activity were New York, New Jersey, and Maryland, respectively. The largest northeast retail loan to be defeased in 2013 was a $320 million loan on the Time Warner Retail property located at 10 Columbus Circle in NYC. The average northeast retail property defeasance in 2013 involved a $14 million loan with a 5.8% interest rate and approximately 2 years remaining to maturity.

On a recent defeasance transaction we handled, the owner of a retail portfolio refinanced their CMBS loan and absorbed a 15% defeasance premium with approximately 3 years remaining in order to take lock in at a low rate for another 10 year term.

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