

11-6-2023

AST DEFEASANCE & RATE CAP ADVISORS

Defeasance and Interest Rate Hedging Solutions



Defeasance vs Yield Maintenance

Defeasance

- Substitution of Collateral
- Costs are locked in at closing
- No minimum payment
- Consultant Required
- 24-month lockout period
- Can close anytime

Yield Maintenance

- Payoff
- Costs locked in 30-days prior
- 1% Floor on Prepayment
- Borrower can elect to pay off without a consultant
- Closing on 1st of the month or Payment Date

The main difference between defeasance and yield maintenance is that defeasance involves replacing the collateral of a loan with securities (generally fixed-rate government bonds) that will offer a lender an equivalent return, while yield maintenance involves the borrower paying a penalty to the lender to prepay the loan.

Defeasance FAQ – Money Making Defeasance

How have the increase in treasuries impacted my defeasance?

- **The increase in yields have caused defeasances to be ten times cheaper than they were just a year ago**

What is a Negative/No Cost Defeasance?

- High treasury yields are causing many loans to have no defeasance penalty at all. Many owners are *even* getting the chance to pay off their loans at a discount below their current principal balance.

Does that mean that the servicer will pay us money at the time of defeasance?

- No. You will never be handed back money from the servicer, but the costs of the defeasance will be beneath your outstanding principal balance.



October 19, 2022

Defeasance Fee Estimate Letter

Property Name:

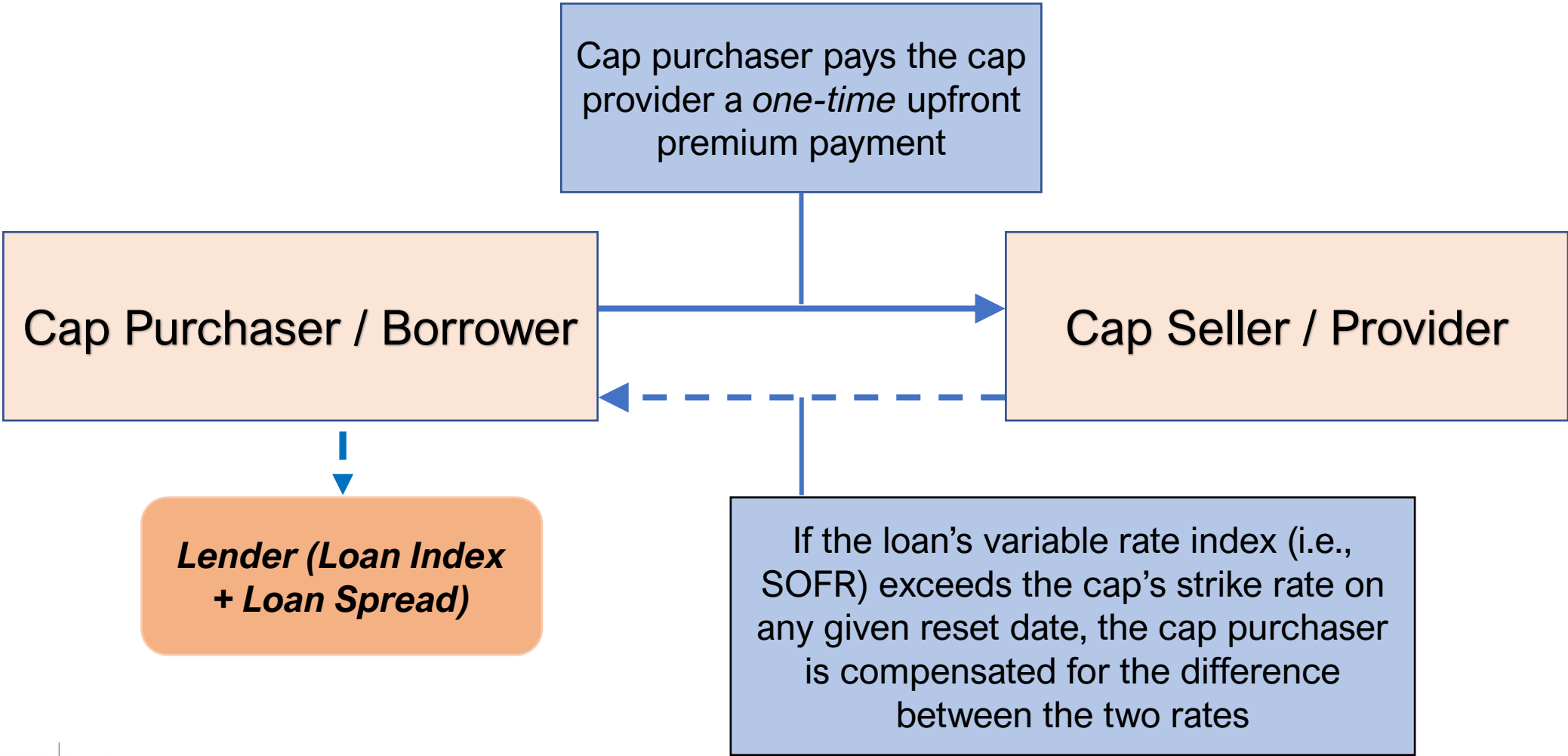
- Original Loan Amount: \$16,500,000
- Defeasance Date: 1/15/2023
- Loan Servicer: Wells Fargo Commercial Mortgage Services

<u>Transaction Costs:</u>	
Estimated Securities Costs	\$ 15,687,344
Principal Balance @ Defeasance	\$ 16,500,000
Defeasance Premium (securities cost – PB @ def.)	\$ (812,656)
<u>Third Party Estimate Fees:</u>	
Defeasance Consulting Fee	\$ TBD
Estimated Successor Borrower/Legal	\$ 5,000
Estimated Securities Structuring Fee	\$ TBD*
Estimated Accounting Opinion	\$ 5,500
Estimated Servicer Processing Fee	\$ 10,000
Estimated Servicer Legal Fee	\$ TBD*
Estimated Custodian Fee	\$ 11,350
Total Fees	\$ 66,850
Total Estimated Defeasance Cost (Outstanding Principal + Premium + Fees)	\$ 15,754,194
Total Estimated Premium	\$ (745,806)

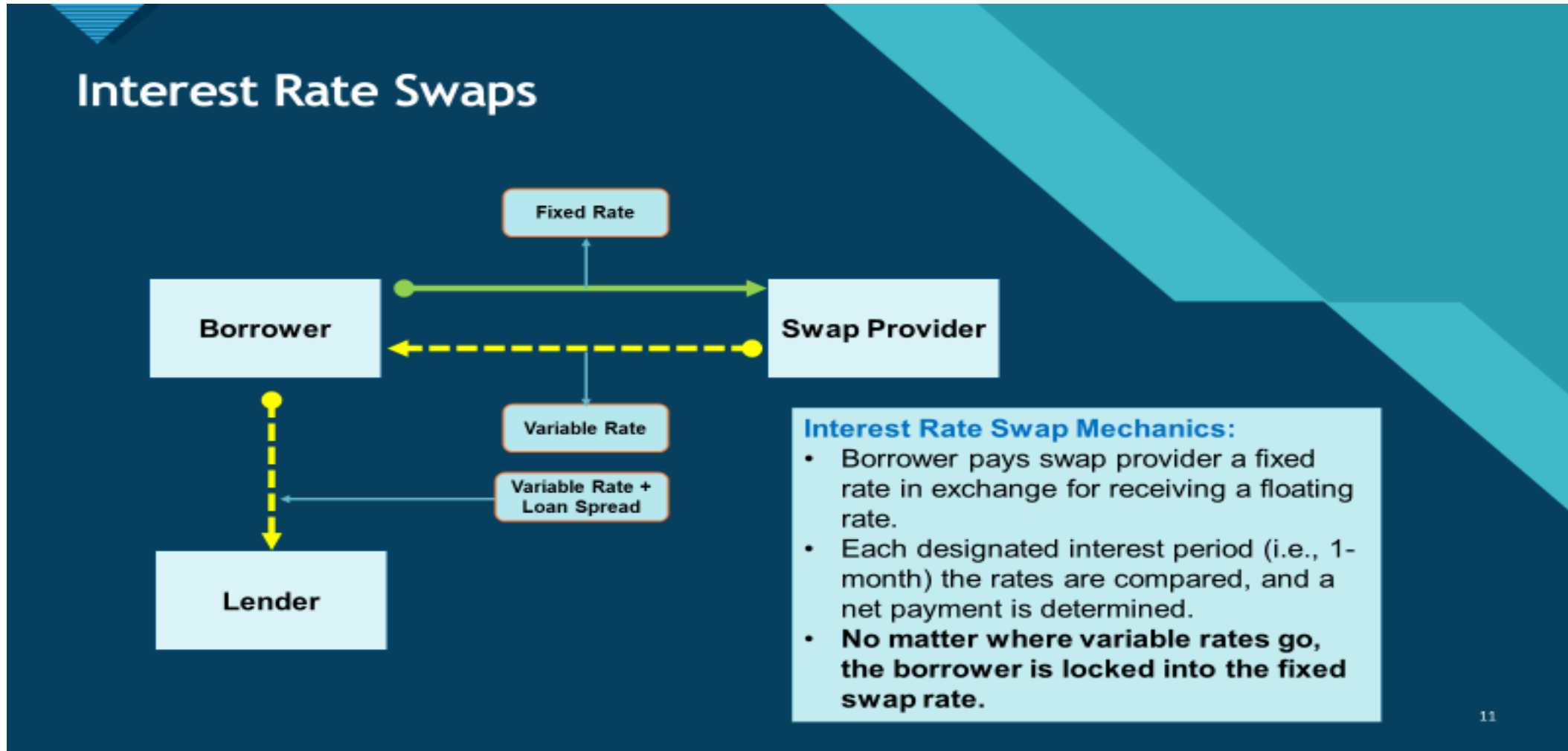
Treasury Yield Curve at Pricing

6 Months	1 Year	2 Year	3 Year	5 Year	10 Year
4.35%	4.53%	4.46%	4.45%	4.23%	4.01%

Interest Rate Caps: Product Overview Diagram



Interest Rate Swaps: Product Overview Diagram



Market Intel & “Hot Topics”

- ▶ Interest rate caps continue to be the preferred hedging product. There is a high level of uncertainty and recently, fear in the market regarding the forward path for interest rates.
- ▶ Cap extensions are a *major* concern for borrowers. Questions focus on extension timing, term and structure.
- ▶ Borrowers are exploring a range of alternatives: higher strike rates, shorter term, “legging” into replacement cap trades and non-cap hedge alternatives, such as swaps.
- ▶ We recommend borrowers negotiate with their lenders on the terms of their cap extension. *RCA can help with those discussions.*
- ▶ Borrowers are feeling the cash-flow sting from replacement cap escrow deposits and are exploring ways to reduce or eliminate costly escrow deposits. *RCA can help you analyze your alternatives.*
- ▶ We have seen increased Interest Rate Swap inquiry – cap premiums remain expensive, and the inverted yield curve offers an ideal time to consider a pay-fixed swap.
- ▶ Swaps are more difficult to place than caps due to the “credit exposure” created by the swap. *RCA can help educate you on rate swaps and explore if a swap is the right hedge for your situation.*
- ▶ Borrowers are inquiring about interest rate ‘Floors’ to “offset” embedded loan floors. *Contact us to learn more.*

Rate Cap Extensions: Review Your Alternatives!

- ▶ Your existing \$20M, 2.00% Strike, 1-Month CME Term SOFR Cap is due for extension.
- ▶ After discussions with your lender, you have the option to extend for 6-Months or 1-Year.
- ▶ The following table details the difference between 6-Month and 1-Year extension pricing.

Cap Description	Term	Premium	Addl. Int Expense	Total Cost 1-Year
\$20M 4.00%	1-Year	~\$283k	~\$399k (12 Mos.)	~\$682k
\$20M 2.00%	6-Months	~\$369k	\$0 (6 Mos.)	~\$369k + ??

- ▶ If we assume that cap premiums remain static (and that is a bold assumption), the 1-Year extension is the most cost-effective alternative.
- ▶ As we know, the forward curve rarely if ever manifests as forecast. **By purchasing the 6-Month extension you are gambling that cap premiums will decrease.**
- ▶ The 1-year alternative mitigates rate risk for the entire extension term *at a known cost.*

1-Year, 4.00% Cap with Addl. Int Expense	6-Month 2.00% Cap x 2 (Assumes 6-Month cap premium unchanged)	1Y Benefit
~\$682k	~\$738k	~\$56k

About Rate Cap Advisors

- ▶ Rate Cap Advisors is part of an expansive network of partner firms specializing in commercial real estate finance solutions since 2006
- ▶ The firms' principals have a combined 95 years of commercial real estate finance experience in such fields as defeasance and yield maintenance penalties, interest rate hedging and CMBS surveillance and investment
- ▶ From our expertise in defeasance and yield maintenance calculations to our innovations in interest rate hedging strategies, we take pride in our pursuit of excellence regardless of the service or product



The RCA Advantage

- ▶ ***RCA offers a full range of hedge advisory services encompassing most interest rate derivative products***
- ▶ We speak to a wide network of interest rate cap providers to get you the best possible market pricing and terms
- ▶ Our market access provides RCA constant intel and allows us to find the optimal cap counterparty
- ▶ We are constantly evaluating ways to provide the most efficient hedge at the lowest cost
- ▶ We educate cap purchasers thoroughly and are available throughout the entire cap procurement process
- ▶ We can facilitate lender required or elective hedge objectives
- ▶ We have saved our clients tens of millions of dollars over the past decade



Current Market Pricing – IR Swaps & IR Caps

1M Term SOFR / \$25.0mm / Various Tenors

2 Year Swap*	3 Year Swap	5 Year Swap
4.867%	4.582%	4.462%

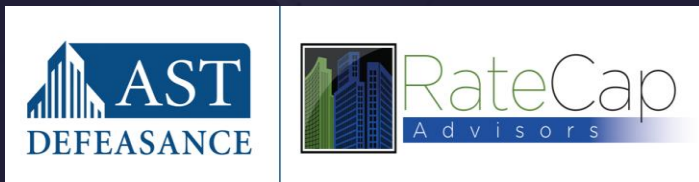
Strike Rate**	1 Year Cap	2 Year Cap	3 Year Cap	5 Year Cap
5.00%	~\$141k	~\$254k	~\$368k	~\$697k
5.50%	~\$72k	~\$148k	~\$219k	~\$481k
6.00%	~\$35k	~\$74k	~\$128k	~\$333k

*IR Swap pricing assumes borrower pays fixed monthly vs. 1-Month Term SOFR

**IR Cap pricing assumes strike rates shown cap 1-Month Term SOFR

All indications as of 11/2/2023, 12PM; All levels presented are subject to change.

Contact Us



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