Defining Defeasance In Today's CRE Market

BY DAWN HOLLAND

Boston —If you've been investing in commercial real estate long enough, you probably have seen the term "defeasance" buried somewhere in your loan documents. For most owners, it's a footnote, until it isn't. When it becomes relevant, it's no longer just legal boilerplate; it's the gatekeeper between you and the transaction you're trying to close. And here's the thing - if you wait until you're already under contract to learn how it works, you've waited too long. In today's market, understanding defeasance early can save you time, money, and a lot of headaches.


Dawn Holland

Defeasance is a term that tends to catch owners off guard. At its simplest, it's a substitution of collateral. You don't literally pay off the loan early. Instead,

continued on page 40

Defining Defeasance

CONTINUED FROM PAGE 6

you replace the real estate securing the loan with a portfolio of government securities, typically U.S. Treasuries, that generate enough cash flow to make the scheduled loan payments through maturity.

While it's most common in CMBS loans, defeasance is not confined to Wall Street paper. Certain bank, agency, and life company loans, especially those that have been securitized, also carry defeasance clauses. And despite popular belief, it's not something reserved for public REITs or large institutional owners. We regularly see private developers, family offices, and single-asset owners face defeasance when they need to sell or refinance before loan maturity.

The reason it matters? If you have a fixed-rate, securitized loan, defeasance may be your only contractual path to releasing the property from the loan. But this is not a process to "discover" after you've signed a purchase and sale agreement or locked a term sheet with a new lender.

At this point, it's also worth clarifying that defeasance is not the same as Yield Maintenance. Yield Maintenance is a formulaic penalty calculation that provides a lump sum amount that the Borrower is required to give the Lender to pay off the loan. Yield Maintenance calculations are usually based on the net present value of future interest payments at a single predetermined discount rate. Yield Maintenance also carries a floor, or minimum prepayment, so the loan cannot be prepaid at 'par', without penalty or at a discount. For a Yield Maintenance payoff, Borrowers simply request a payoff statement and wire the funds at closing.

Defeasance, on the other hand, is a weeks-long transaction involving multiple parties, legal documentation, due diligence items (including legal opinions), and a two-day closing process. Defeasance leaves the loan outstanding but swaps the collateral and provides for an assumption by a third-party, allowing for a release of the property and original borrower.

Since the defeasance collateral structure discounts all future payments across the yield curve, there may be material differences in the cost of a Yield Maintenance Penalty vs. Defeasance as the yield curve shape changes. In recent years, this has benefited Borrowers with defeasance language, allowing several of our clients to defease at a "discount" - meaning the cost of the defeasance collateral was less than the outstanding balance on the loan.

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This would not be possible with a Yield Maintenance calculation as it requires a minimum prepayment penalty threshold.

Why Timing Matters

Defeasance takes planning. One of the biggest mistakes we see is owners assuming they can "figure out the defeasance" after they've gone under contract. By then, your timeline is locked, your deal structure is set, and your negotiating leverage is gone.

The cost, driven by prevailing Treasury yields, can swing dramatically with market conditions. The timeline can be unpredictable, especially with certain servicers or more complex cross-collateralized structures. And the process can take up to 30 days or longer, especially with complex structures or slower-moving servicers. The earlier you model your exposure and understand the mechanics, the more room you have to negotiate costs, adjust deal terms, or even restructure ahead of time to minimize the impact.

The Current Market

Compared to the last major down cycle, defeasance activity today is more selective but also more strategic. In the 2008–2010 downturn, much of the activity was driven by distress, borrowers forced into early exits because the property or borrower was underperforming.

Today, we're seeing more owners use defeasance as part of a broader portfolio strategy. For example, selling a strong asset in a cross-collateralized pool to improve the debt profile of the remaining properties, or freeing up capital from one market to redeploy into another with better yield potential.

That said, the challenges are real. With interest rate volatility, the cost of replacing loan collateral can swing quickly. And in some cases, lower property values compared to original underwriting, com-

continued on page 41

Defining Defeasance

CONTINUED FROM PAGE 40

bined with higher lending rates, mean some borrowers are bringing cash to the table to make a transaction happen.

Getting It Done Right

• Start Early: Run the numbers well in advance of any sale or refinance to understand costs involved. Also, discuss the process with a defeasance advisor to understand the timing and mechanics.

• Use Experienced Advisors: The right team will coordinate with the servicer, legal counsel, and securities dealer to keep the process moving.

• Know Your Loan Docs: Subtle differences in defeasance clauses can have big cost implications, especially in partial releases or cross-collateralized loans.

• Model Market Scenarios: Treasury yield movements can work for or against you—scenario modeling helps you lock in when the numbers make sense.

How It's Changed Over the Years

When we started in this business, twenty-five years ago, defeasance was manual and slow—full of back-and-forth phone calls, overnighted documents, and spreadsheets that took hours to update. Now, with real-time Treasury data and advanced modeling platforms, we can structure a defeasance in minutes and make decisions with better timing.

The other major change is strategic awareness. Ten years ago, many borrowers didn't even know defeasance existed until a servicer explained it to them. Today, more sophisticated owners are baking it into their capital planning years in advance.

Looking ahead, we believe the next phase is about data and AI. We're already building tools that connect directly to portfolio data, understand loan structures, model costs instantly, and run "what-if" scenarios for interest rates and transaction timelines. That transforms defeasance from a last-minute hurdle into a proactive lever for portfolio strategy.

In this market, the best-positioned owners aren't just the ones who know what defeasance is—they're the ones who have it mapped, modeled, and ready to execute when opportunity knocks.

The bottom line: Defeasance isn't just a line item in your loan agreement—it's a mechanism that can unlock flexibility in your portfolio if you know how to use it. The owners who model it early, understand the moving parts, and watch the market closely are the ones who turn it from a cost into a strategic advantage. In today's market, where timing and execution are everything, preparation can be the difference between getting your deal done or watching it fall apart. ■

Retalitory Taxes

CONTINUED FROM PAGE 7

And the state's tax chief also declined an invitation by Bailey and Pioneer legal fund staff to sit down in person. Nor does Snyder appear to have any interest in using the documentation provided to launch his own review of the matter.

Bailey wasn't buying it, and responded with a stinging letter last week, effectively accusing Snyder of using a bureau-

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cratic dodge - professed confusion over the purpose of the retired federal judge's letter - to avoid taking action.

"My hope is that the (state revenue) commissioner will undertake an investigation of this and direct the assessor's office in Boston to cease and desist," Bailey said. "My optimism for that result is pretty quickly disappearing."

Currently, it appears that dozens of Boston office buildings and towers have been overcharged. That number could reasonably be expected to increase to hundreds of properties, as other owners and real estate firms begin to more closely examine their tax bills.

Some of the more prominent corporate addresses that have been hit with the extra charges by Boston assessors include One Federal, 125 High and 60 State, according to a report in The Boston Globe.

On Thursday, mayoral challenger Josh Kraft seized on the issue to accuse Boston Mayor Michelle Wu of "using her office to punish property owners for exercising their rights under the law."

Kraft warned that if the cases go to court and the city loses, "it will be a massive blow to Boston's finances."

In a statement issued by her campaign, Wu failed to address any of the issues raised by Kraft, instead taking a personal shot at the longtime local nonprofit executive and son of the billionaire Patriots owner.

"Maybe he's been slow to understand the issue because he has never had to worry about how to afford rent or housing costs," reads the statement. ■