

# SARATOGA SPRINGS CAPITAL

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## Glossary:

**Securitization:** The act of securitizing is the financial process of pooling various types of contractual debt such as commercial mortgages (CMBS), residential mortgages, auto loans or credit card debt obligations (or other non-debt assets which generate receivables) and selling their related cash flows to third party investors as securities, which may be described as bonds, pass-through securities, or collateralized debt obligations (CDOs). The ownership of the assets is usually transferred to a legal trust or special purpose, bankruptcy remote corporation to protect the interests of the security holders. Investors are repaid from the principal and interest cash flows collected from the underlying debt and

## TO PREPAY OR NOT TO PREPAY? WHY BOSTON PROPERTIES PAID \$26.9 MILLION TO DEFEASE THE JOHN HANCOCK TOWER LOAN.

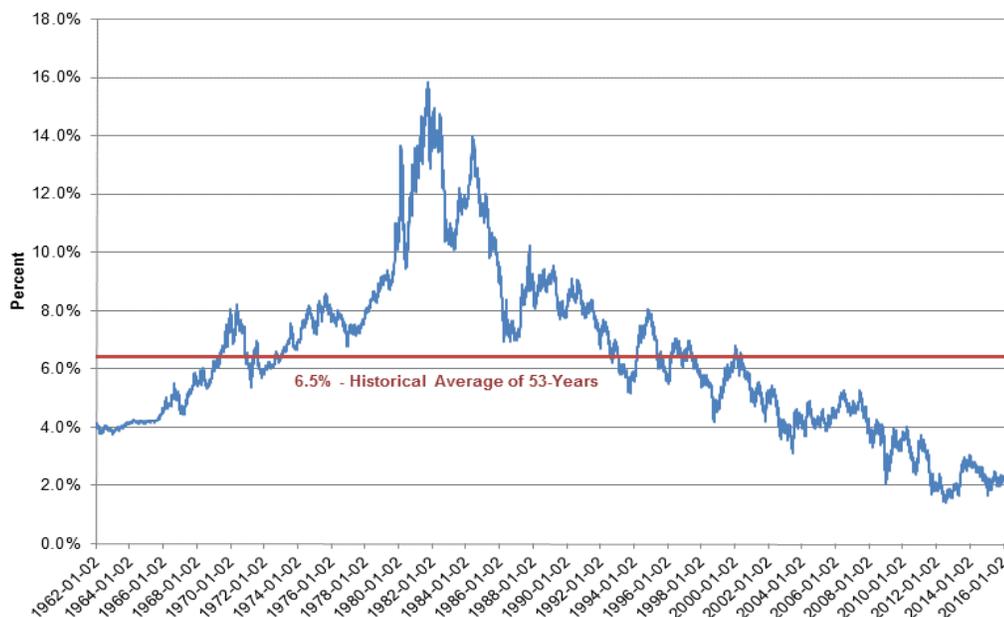
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Many commercial real estate (“CRE”) owners are reluctant to prepay their commercial real estate loan due to the assumed high cost of defeasing or prepaying their loan. Would you, the commercial real estate owner, pay approximately \$26.9 million in transaction fees plus the cost of securities to defease your commercial real estate loan today? That is the crux of the question, which Boston Properties, Inc. (“Boston Properties” or “BXP”), one of the largest owners, managers, and developers of Class A office properties in the United States, answered by deciding to defease their CRE loan today due to the current and future interest rate environment despite paying approximately \$26.9 million for their loan that would have been open to prepayment in October of 2016. If a firm the size and as sophisticated as Boston Properties knew it was best to prepay the loan, then why aren’t more commercial real estate owners similarly positioned in this market cycle defeasing or prepaying their performing loans?

## Despite the Recent Interest Rate Hike, Interest Rates Are Still at “Eye-Opening” Historical Lows

Interest rates are still near historical lows despite the recent increase in the Federal Funds Rate by 25 basis points implemented by the Federal Reserve on December 16, 2015 (see exhibit 1 below).

Exhibit 1: Historical 10-Year Treasury Rate (1/2/1962 - 1/4/2016)



Sources: Federal Reserve Economic Data

As displayed in Exhibit 1, the current interest rate environment remains near “eye-opening” historical lows and many believe this will not last forever. [Please click here to access Saratoga Springs Capital’s July 8, 2015 research publication that discusses interest rates further \[www.saratogaspringscapital.com/research--analytics\].](#)

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redistributed through the capital structure of the new financing.

## Commercial Mortgage Backed Security:

Commonly referred to as CMBS, which are securities collateralized by a pool of mortgages on commercial real estate properties in which all principal and interest from the mortgages flow to certificate holders in a defined sequence or manner.

**Defeasance:** A process to substitute real property collateral when looking to sell or refinance an existing property, which was acquired through a real-estate loan that is call protected but allows defeasance at a certain point in time. The defeasance process is an act of making an investment whole by substituting real property collateral with a specified type of other collateral, typically government securities, that will generate sufficient cash flows on a schedule to closely mirror the principal and interest payments on the loan through maturity and including the maturity balance.

**Basis Point (Bps):** A basis point is one hundredth of one percent, which is used mainly to express differences in interest rates.

Why did Boston Properties pay approximately \$26.9 million in transaction fees to defease a loan that would have been open to prepayment within the next year? As mentioned above, the markets are projecting interest rates to rise and not return to the current historical lows for a very long time. Therefore, BXP decided to incur the \$26.9 million in transaction costs in order to save a far greater amount with a lower fixed interest rate for the next 10-years.

## Boston Properties Could Potentially Save \$14.1 Million by Defeasing their Loan 10-Months Early

In 2006, Broadway Partners obtained a 10-year interest only loan for the John Hancock Tower from Greenwich Capital and Lehman Brothers, which was assumed by Normandy Real Estate Partners and Five Mile Capital Partners in 2009 and subsequently acquired and assumed by Boston Properties in 2010.

By defeasing their loan before the October 2016 open prepayment date, Boston Properties could potentially save approximately \$14.1 million, which comprises \$32.0 million by reducing their next 10-years of interest payments if you consider a modest 50 basis points rise in interest rates by the open prepayment period, \$9.0 million in opportunity costs by foregoing 10-months of higher interest payments until the open prepayment date, minus \$26.9 million in transaction costs to defease their loan. The \$41.0 million saved by reducing their overall interest payments significantly offsets the \$26.9 million transaction costs (see Exhibit 2 below).

### Exhibit 2: Projected Savings Through Defeasance

Defeasance of John Hancock Tower			
Loan Terms & Information	Original Terms (Dec. 2006)	10-YR Interest Only (Dec. 2015)	10-YR Interest Only (Oct. 2016)
Interest Rate (annual)	5.68%	4.00%	4.50%
Term (months)	120	120	120
Amortization (months)	0	0	0
Interest Only Period (months)	120	120	120
Interest Payment (annualized)	36,380,400	25,620,000	28,822,500
10-Years of Interest Payments	363,804,000	256,200,000	288,225,000
Before Tax Cash Flow (annualized)	4,543,574	15,303,974	12,101,474
10-Years of Before Tax Cash Flows	45,435,740	153,039,740	121,014,740

Projected Savings by Defeasing John Hancock Tower	
10-Months of Interest Payments @ 2006 Terms	30,317,000
10-Months of Interest Payments @ 2015 Terms	21,350,000
Opportunity Cost (Waiting 10-Months)	8,967,000
10-Years @ 2016 Interest	288,225,000
10-Years @ 2015 Interest	256,200,000
10-Years Early Refinance Savings	32,025,000
Cost of Defeasance	26,900,000
Total Savings by Prepaying Early*	14,092,000

\* Total Savings = Opportunity Cost (Waiting 10-Months) + 10-Years Early Refinance Savings - Cost of Defeasance

Source: Saratoga Springs Capital, Trustee – Financials as of June 2015 (annualized)

As per Exhibit 2, Boston Properties saved approximately \$14.1 million just by defeasing their loan 10-months before the open prepayment date and locking in a potential lower interest rate today. In addition, this does not include the additional tax savings by expensing the transaction costs during the 2015 fiscal year, which would reduce both the taxable

income and liability for BXP, as well as taking advantage of a lower cap rate environment that probably will produce greater non-recourse proceeds.

## **Hesitating or Delaying “Probably Will” Cost Borrowers More Money in the Future**

For commercial real estate owners, the time is probably right to defease or prepay their loans in order to maximize profits over the long term. Borrowers should not worry as on average transaction costs would not be anywhere near what Boston Properties had to pay given their original loan amount was \$640.5 million. On average, transaction costs typically range from \$20,000 to \$60,000, and borrowers can expect to only pay a small fraction of the loan amount to purchase government bonds at a premium. Those transaction costs should be a very small percentage of the increased loan proceeds that a CRE owner will obtain given the growth in property's values and inflation since the prior loan origination date.

## **Selecting a Broker/Advisor Who Can Guide the CRE Owner Through This Process Is Key**

Commercial real estate owners will save and profit significantly as long as they are careful with whom they select to help guide them through this process. Saratoga Springs Capital has seen variances as great as 60% between different lenders and brokers/advisors on how they underwrite. Selecting a broker/advisor such as Saratoga Springs Capital that has sat in the lenders' seat and knows in-depth how the market works is key to securing the best loan terms and maximum proceeds.

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## APPENDIX A: Sample of Loans in Upstate New York and Vermont that are Candidates for Defeasance/Prepayment

Upstate New York Properties					
Property Name	City	State	Property Name	City	State
88 Willett Street	Albany	NY	Rite Aid - Kingston, NY	Kingston	NY
1516 Western Avenue	Albany	NY	Idlewood MHP	Kirkville	NY
Marriott - Albany, New York	Albany	NY	32 Saranac Avenue	Lake Placid	NY
Kohl's Shopping Center	Albany	NY	Outpost - Lake Placid, NY	Lake Placid	NY
U-Haul Center Albany	Albany	NY	20 Century Hill Drive	Latham	NY
Albany Apartments	Albany	NY	The Woodlands Apartments	Latham	NY
Crossgates Mall	Albany	NY	Residence Inn - Albany Airport	Latham	NY
Pine Meadows Park MHC	Amsterdam	NY	Leray Heights Apartments	Le Ray	NY
4883 State Highway 30	Amsterdam	NY	Whitney Point Estates	Lisle	NY
Westover Hills MHC	Ashland	NY	Eckerd - Liverpool - Route 57	Liverpool	NY
Bel-Air Estates MHC	Ashland	NY	Eckerd - Old Liverpool	Liverpool	NY
2523 Route 9N	Au Sable Forks	NY	Raymour & Flanigan	Liverpool	NY
Lowe's - Auburn, NY	Auburn	NY	Route 30	Long Lake	NY
Standard Woods Apartments	Auburn	NY	Thornhill Terrace Apartments	Lowville	NY
Fingerlakes Crossing Shopping Center	Aurelius	NY	4116 Center Street	Lyons Falls	NY
Peter Harris Plaza - Bethlehem	Bethlehem	NY	Lowe's Macedon	Macedon	NY
Hudson Slingerlands Crossing I	Bethlehem	NY	Eckerd - Malone	Malone	NY
Corning	Big Flats	NY	126 West Main Street	Malone	NY
Guthrie Medical Center	Big Flats	NY	Walgreens-Malone	Malone	NY
247 Main Street	Binghamton	NY	Eckerd Drugs - Manlius, NY	Manlius	NY
Kirkwood MHC	Binghamton	NY	Eckerd - Mattydale	Mattydale	NY
3 Winterton Road	Bloomington	NY	Applewood MHP	Medina	NY
Whispering Pines	Bloomington	NY	Village One Apartments	Menands	NY
Walgreens - Brighton, NY	Brighton	NY	Vil Vue Heights MHC	Moravia	NY
1901 Lac Deville Boulevard	Brighton	NY	Walgreens - New Hartford, NY	New Hartford	NY
2101 Lac Deville Boulevard	Brighton	NY	Walgreens - Utica	New Hartford	NY
9 North Main Street	Broadalbin	NY	Hudson New Paltz Medical Center	New Paltz	NY
Walgreens - Camilus, NY	Camilus	NY	New Paltz Plaza	New Paltz	NY
Warwick Place Apartments	Carthage	NY	Eckerd - NY Mills	New York Mills	NY
Catskill Commons	Catskill	NY	4995 Route 28 North	Newcomb	NY
603 River Road	Chenango Bridge	NY	Niskayuna Square	Niskayuna	NY
Cicero Market Place	Cicero	NY	244 Main Street	North Creek	NY
Airport Business Park	Cicero	NY	Mansions at Technology Park	North Greenbush	NY
Gander Mountain - Cicero	Cicero	NY	Partridge Hill Apartments	North Greenbush	NY
U-Haul Storage Business Avenue	Clay	NY	Countryside Townhomes	Ogden	NY
755 Pierce Road	Clifton Park	NY	Gateway Centre	Ogdensburg	NY
1772 Self Storage	Clifton Park	NY	Hampton Inn - Oneonta	Oneonta	NY
Tractor Supply - Clifton Park	Clifton Park	NY	Owego Fairgrounds	Owego	NY
Clifton Park Self Storage	Clifton Park	NY	Victory Village MHC	Painted Post	NY
755 Pierce Road	Clifton Park	NY	Hampton Inn - Painted Post	Painted Post	NY
1581 Route 9	Clifton Park	NY	Rochester Portfolio - Petco	Pittsford	NY
755 Pierce Road	Clifton Park	NY	789 Linden Avenue	Pittsford	NY
257 Ushers Road	Clifton Park	NY	Forest Park MHC	Plattekill	NY
USFS Industrial Distribution Portfolio	Clifton Park	NY	Champlain Centre	Plattsburgh	NY
Ashton Place	Clifton Springs	NY	Plattsburgh Plaza	Plattsburgh	NY
CVS - Clinton, NY	Clinton	NY	Eckerd - Plattsburgh	Plattsburgh	NY
Latham Lowe's	Colonie	NY	173 Market Street	Potsdam	NY
Walgreens-Colonie, NY	Colonie	NY	Great Escape Lodge	Queensbury	NY
Holiday Inn Express Cooperstown	Cooperstown	NY	CVS Plaza - Queensbury, NY	Queensbury	NY
Evergreen Plaza	Corinth	NY	Aviation Mall	Queensbury	NY
Radisson Hotel Corning	Corning	NY	Homestead Village	Queensbury	NY
SUNY Cortland, Cortland, NY	Cortland	NY	Oak Hill Apartments	Rensselaer	NY
Hampton Inn - Cortland	Cortland	NY	Medical Arts Building	Rochester	NY
Eckerd - Cortlandville	Cortlandville	NY	Triangle Building	Rochester	NY
Walgreens - Cortlandville, NY	Cortlandville	NY	BJ's Warehouse - Rochester	Rochester	NY
750 Utica Street	De Ruyter	NY	Glenbrook Manor	Rochester	NY
Peter Harris Plaza - Dewitt	Dewitt	NY	Kings Court	Rochester	NY
Peter Harris Plaza - Greenbush	East Greenbush	NY	Lake Vista	Rochester	NY
Residence Inn East Greenbush	East Greenbush	NY	Best Western Rochester Marketplace Inn	Rochester	NY

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Upstate New York Properties					
Property Name	City	State	Property Name	City	State
Piano Works Building	East Rochester	NY	Cornerstone Center	Rochester	NY
Time Warner Building- Syracuse	East Syracuse	NY	Haddon Hall Apartments	Rochester	NY
Shop Rite Ellenville	Ellenville	NY	U-Haul Storage Ridgeway Avenue	Rochester	NY
Eckerd - Elmira North Main	Elmira	NY	85 Metro	Rochester	NY
Endicott Self Storage	Endicott	NY	Time Warner	Rochester	NY
Jefferson Manor Townhomes	Fairport	NY	Brighton Gardens	Rochester	NY
25 Water Street	Fort Covington	NY	350 South Avenue Building	Rochester	NY
Big Blue Self Storage	Frankfort	NY	Rochester Portfolio - Rite Aid/Lyell	Rochester	NY
Price Chopper - Fulton	Fulton	NY	Rochester Portfolio - Rite Aid/Advance Auto	Rochester	NY
English Village Apartments	Gansevoort	NY	Rochester Portfolio - Rite Aid/Portland	Rochester	NY
Eckerd - Gates Plaza	Gates	NY	Pittsford Plaza	Rochester	NY
Crystal Commons	Gates	NY	Eckerd's	Rome	NY
Crystal Commons Office	Gates	NY	Brookview Court Apartments	Rotterdam	NY
Meadows Student Housing	Geneseo	NY	55 Broadway	Saranac Lake	NY
Morgan Estates	Geneseo	NY	Residence Inn Saratoga	Saratoga Springs	NY
Woodhill Apartments	Glenmont	NY	Wise Building	Saratoga Springs	NY
Glens Falls Hospital Building	Glens Falls	NY	BJ's Wholesale Club - Saratoga	Saratoga Springs	NY
Hannaford Plaza	Glenville	NY	Carman Road Medical Arts Building	Schenectady	NY
CVS Glenville - NY	Glenville	NY	Carman Plaza	Schenectady	NY
122 Balzano Drive	Gloversville	NY	North Road Townhomes	Scottsville	NY
141 Sal Landrio Drive	Gloversville	NY	Salina Meadows I&III	Syracuse	NY
109 Balzano Drive	Gloversville	NY	Eckerd - Syracuse Valley	Syracuse	NY
125 Balzano Drive	Gloversville	NY	Central New York Medical Center	Syracuse	NY
Gloversville Shopping Center	Gloversville	NY	Foundry	Syracuse	NY
Lakeshore Apartments	Greece	NY	Western Lights Shopping Center	Syracuse	NY
Peter Harris Plaza - Greece	Greece	NY	Park Point Syracuse University	Syracuse	NY
Park Ridge Medical Office	Greece	NY	Bridgewater Place	Syracuse	NY
Bast Properties	Halfmoon	NY	Lowes (Ground) Ticonderoga	Ticonderoga	NY
6 Executive Park Drive	Halfmoon	NY	1818 5th Avenue	Troy	NY
3092 Main Street	Hartwick	NY	CVS - Lansingburgh	Troy	NY
324 Prospect Street	Herkimer	NY	Hilton Garden Troy	Troy	NY
Ruby Mobile Home Park Portfolio	Highland/Kingston/Modena	NY	Kinney Drug Store	Trumansburg	NY
Hilton Garden Inn - Elmira	Horseheads	NY	314 Hosley Avenue	Tupper Lake	NY
Route 28 and 30	Indian Lake	NY	ShopRite Plaza	Ulster	NY
Eddygate Park Apartments	Ithaca	NY	70 Main Street	Unadilla	NY
Center Ithaca	Ithaca	NY	3407 Walters	Van Buren	NY
Gateway Plaza	Ithaca	NY	Fairfield Inn & Suites Verona	Verona	NY
Lakeland Apartments	Ithaca	NY	Town Square Mall	Vestal	NY
CVS- Ithaca	Ithaca	NY	Eastview Mall and Commons	Victor	NY
Cayuga Apartments	Ithaca	NY	Seaway Plaza	Watertown	NY
Walgreens - Johnson City	Johnson City	NY	Waverlywood Village	Webster	NY
Oakdale Mall	Johnson City	NY	Heritage Park Apartments	Webster	NY
150 Enterprise Road	Johnstown	NY	Heritage Park Townhomes	Webster	NY
123 Union Avenue	Johnstown	NY	Webster Plaza	Webster	NY
231 Enterprise Road	Johnstown	NY	Sedgewick Pines	West Carthage	NY
6 Clermont Street	Johnstown	NY	Bradley Meadows Shopping Center	Woodstock	NY
Hudson Benedictine Cancer Center	Kingston	NY	69 Main Street	Worcester	NY
			Bradley Meadows Shopping Center	Woodstock	NY
			69 Main Street	Worcester	NY

Vermont Properties					
Property Name	City	State	Property Name	City	State
Hampton Inn - Bennington	Bennington	VT	5068 Shelburne Road	Shelburne	VT
CVS - Bennington	Bennington	VT	1117 Shelburne Road	South Burlington	VT
Walgreens - Brattleboro	Brattleboro	VT	Doubletree Burlington	South Burlington	VT
Flynn Avenue Self Storage	Burlington	VT	Brattleboro & Bellows Falls	Various	VT
354 Mountain View Drive	Colchester	VT	Shaw's Supermarket	Waterbury	VT
356 Mountain View Drive	Colchester	VT	1108 VT Route 149	West Pawlet	VT
Archives One - Essex Junction	Essex Junction	VT	68 Helena Drive	Williston	VT
Shaw's Supermarket	Manchester	VT	Courtyard Burlington Taft Corners	Williston	VT
Rutland Plaza	Rutland	VT	431 Woodstock Road	Woodstock	VT
Tractor Supply - Rutland	Rutland	VT			