Commercial Mortgage Advisors

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Credit Tenant Lease (CTL) Financing

Long term CTL financing is abundantly available throughout the US for a multitude of property types that have either Moody's (Baa3) or Standard & Poor's (BBB-) Investment Grade credit ratings or higher. Compared to all of the multi-tenant commercial real estate property types, CTL financing is by far the easiest to accomplish in the shortest period of time because of its single credit tenant structure.

This article will give you a brief description of what's involved with the financing of these type properties, such as Publix, Walgreen's, CVS, Home Depot, Blue Cross & Blue Shield and thousands of others that qualify because of their investment grade credit rating (IGCR). Click here for Investment Grade Credit Ratings.

The borrowing entity has to be set up as a Single Asset Entity, the principals of which do not have to be personally liable on the debt. CTL loans are Non-Recourse to the borrower, except for standard carve outs. Carve outs include such items as fraud, mismanagement, laying waste to the property, intentional contamination, etc, known in the industry as the "Bad Boy" clauses.

In residential loan underwriting, it's the borrower that has to meet the permanent lender's loan criteria, but in CTL financing, it's the tenant that has to meet the lender's credit criteria.

The CTL financing example used here will be an existing IGCR tenant occupied building, like the ones mentioned above to explain how the financing is structured. Since the loan approval is based upon the credit of the tenant, the CTL would preferably be triple net (NNN) to the landlord, so that the tenant is totally responsible for the payment of all the taxes, insurance and other expenses. For maximum financing, the Loan to Value (LTV) can be as high as 100%, which the MAI appraisal must concur with. The term and amortization (without any balloon payment) of the loan will be the same as the term of the lease in order to fully amortize the loan to zero at maturity. With an IGCR tenant, the lender will allow the annual Debt Coverage Ratio (DCR) to be as low as 1.01 to 1.00 for NNN leases; 1.05 for NN leases. Once the lender has approved the CTL, they will determine what the fixed interest rate will be for the term of the loan. Interest rates for these type loans are determined by the lender using a spread over the interpolated 10 year Treasury bond. For example, if the 10 year Treasury bond was in the 2.25% range, the long term interest rate would probably be around 4.5%. This rate over a 25 year loan term would have an annual constant of .0667%. Click here for the Constant Chart.

In addition to the maximum LTV requirement of 100%, the annual loan payment cannot have a DCR of less than 1.01 to 1.00. The loan amount is determined by CTL lender's loan formula as follows: The annual NNN operating income (NOI) from the lease, divided by the DCR of 1.01, divided by the annual loan constant; equals the loan amount. Using an NOI of $650,000, the DCR of 1.01, with an annual constant of .0667%, the loan amount would be $9,648,641. (NOI/DCR/Constant=Loan Amount) Click here for the CTL Financing Brief and for a broader explanation the CTL Financing Summary. Examples of the CTL's that have been funded by various CTL lenders are listed on All Property Types & Equipment.

Assuming a market capitalization rate of 6.5%, the MAI appraised value would most likely be around $10,000,000, which equals a 96% LTV. Any upward movement in the cap rate might require the loan amount to be adjusted, unless the interest rate could be lowered to achieve a lower constant; and vice versa. As they say "the devil is in the details".

CTL loans for proposed properties can also be funded in advance of construction by the permanent lender. The permanent loan is funded in full into an acceptable FDIC approved bank, with the bank issuing the permanent lender an irrevocable Letter of Credit using their funds as collateral. The developer draws against these funds until the project is complete, the certificate of occupancy is issued and the tenant is in occupancy paying rent. The Letter of Credit is canceled and the loan amortization begins.

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