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Structuring a Credit Tenant Lease Financing: Balancing Interests of Developers, Lenders, Tenants, and Investors

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Structuring Credit Tenant Loan Financing: Alternative to Traditional Real Estate Debt Financing

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CTL Structure Overview

- National Association of Insurance Commissioners (NAIC)
 - An association whose members are the state insurance commissioners with a purpose to promote uniformity in state regulatory schemes
 - *Purposes and Procedures Manual of the NAIC Securities Valuation Office* (the “**Guidelines**”)
 - **Schedule A:** Real estate owned
 - **Schedule B:** Long-term mortgages
 - **Schedule D:** Bonds, preferred stock and common stock
 - NAIC Schedule D treatment: By following the Guidelines insurance companies are able to invest in real estate without incurring traditional real estate risks, while receiving favorable risk-based capital (RBC) treatment (i.e. the reserves required for an investment)
 - Definition of CTL from the Guidelines: “Mortgage loans that are made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien”

CTL Structure Overview

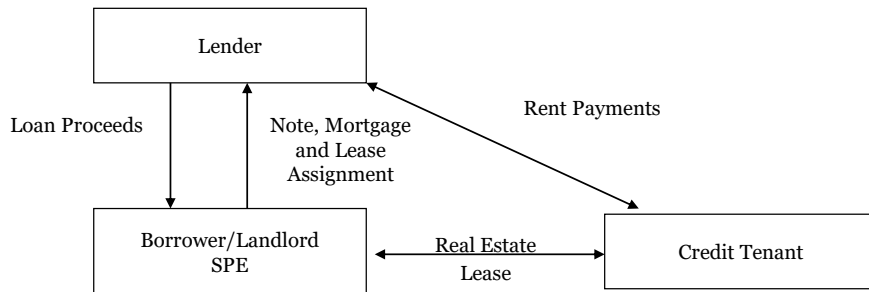
- Tenants, Properties and Lease types
 - Tenants usually are investment grade (i.e., BBB- or better)
 - Public or private universities, hospitals, retailers, Federal, State, municipal, domestic or foreign
 - Any Real Estate
 - Retail, office, distribution center, computer center, call center, hotel, laboratory, hospital, warehouse, factory, special use,
 - Air rights
 - Building facade and systems
 - Leasehold interest
 - Condominiums

CTL Structure Overview

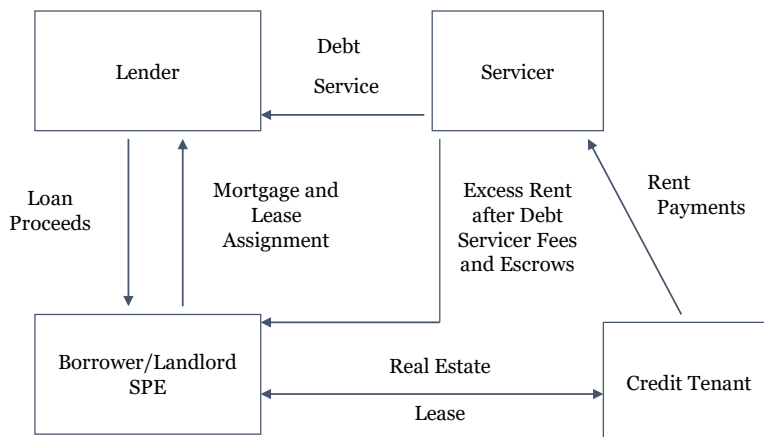
- Tenants, Properties and Lease types
 - **Bond Lease:** Tenant must: (i) pay rent come “hell or high water”, (ii) assume all obligations under the Lease (no landlord obligations even if landlord will be fully reimbursed) and (iii) not terminate the Lease without payment of the CTL debt in full (including upon the occurrence of a casualty or condemnation of the property)
 - **Triple Net Lease:** Tenant must pay rent “net” of predictable, ongoing expenses: property taxes, maintenance and insurance (and utilities)
 - Landlord may have certain obligations for non-predictable expenses such as repair latent defects in construction, environmental cleanup, repair roof and structure, enforce declaration of covenants, etc.
 - **Double Net Lease:** Landlord responsible for some recurring expenses. Typically one of the following expenses: property taxes, capital repair and replacement and insurance
 - **Gross Lease:** Landlord responsible for all expenses relating to the property although usually at least partially reimbursed by tenant (associated with a state or federal facility leases)

Structures

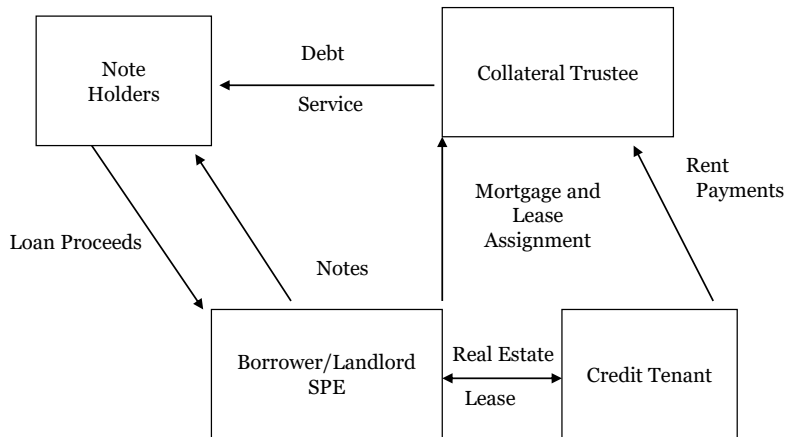
Credit Tenant Loan Basic Structure (For Bond or Triple-Net Lease, Single Property, Single Lender Transactions)



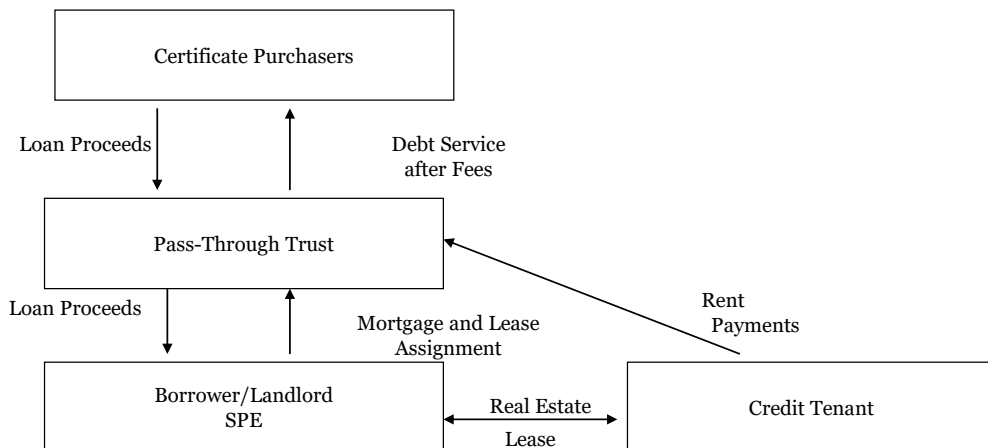
Credit Tenant Loan Loan Servicer Structure (For Double-Net Lease Transactions)



Credit Tenant Loan Collateral Trustee Structure



Credit Tenant Loan Pass-Through Trust Structure



Advantages and Considerations

- Advantages (to a borrower or a tenant)
 - CTL financing is treated as a bond of the tenant for investment purposes and is thereby priced off of tenant's unsecured debt rating rather than solely on real estate value
 - Underwriting analysis focuses on tenant's ability to pay rent as primary concern rather than "go-dark" value of real estate (financing available for properties in secondary and tertiary markets with proper lease and tenant)
 - Higher net proceeds with up to 100% loan-to-value and 1.0X debt service coverage for bondable/triple-net leases
 - Typically, no financial covenants and no cross-default from tenant
 - Exception: tenant-initiated transaction (usually a build-to-suit or sale-leaseback)
 - CTL lenders often are more flexible than CMBS or bank lenders (subject to the NAIC guidelines)
 - CTL lenders and servicers are more accessible than CMBS servicers
 - Construction to permanent financing available with one lender
 - Long term permanent fixed rate financing (up to 30 years for certain credits)
 - Leasehold financing available (require similar ground lease mortgagee protections to CMBS)

Advantages and Considerations

- Considerations for a borrower or a tenant
 - Limited to investment grade tenants
 - Broader "Non-Recourse" indemnity provisions
 - e.g., Indemnitor responsible for failure of landlord to perform any of its obligations under the Lease and for any abatement of rent caused by landlord's actions or inactions
 - Fully amortizing with no more than 5% uninsured balloon (residual value insurance is available for certain transactions)
 - All rents must be paid directly to lender or trustee
 - Loan provisions restrict borrower actions with respect to Lease and tenant
 - Termination or abatement due to casualty or condemnation must be mitigated by third party "special risk insurance"
 - Potential phantom income tax concerns for equity
 - Not available as widely for shorter term leases (under 10 years)

Trends in Credit Tenant Loans

- Build-to-suit construction
- Tenants /public credits
- Lease types
- A1/A2 Structures
- Ratings
- Balloons and Residual Value Insurance
- Special Risk Insurance
- Cross-Border

Legal and Structural Concerns

- Lease Structuring
 - **NET LEASE:** For cleanest CTL execution, a true “triple-net” or “double-net” lease with strong “net lease” clause is desired:
 - **SAMPLE CLAUSE:** This is an absolutely net lease to Landlord. It is the intent of the parties hereto that the Basic Rent payable under this lease shall be an absolutely net return to the Landlord and that the Tenant shall pay all costs and expense relating to the Premises and the business carried on therein, unless otherwise expressly provided to the contrary in this Lease. Any amount or obligation relating to the Premises that is not expressly declared to be that of the Landlord shall be deemed to be an obligation of the Tenant to be performed by the Tenant at the Tenant’s expense. Basic Rent and Additional Rent shall be paid by Tenant without notice or demand, setoff, counterclaim, abatement, suspension, deduction or defense.

Legal and Structural Concerns (cont'd)

- Lease Structuring

- NET LEASE SAMPLE CLAUSE (Continued):** This Lease shall not terminate, nor shall Tenant have any right to terminate this Lease (except as otherwise expressly provided to the contrary in Sections ____), nor shall Tenant be entitled to any abatement of rent, nor shall the obligations of Tenant under this Lease be affected, by reason of any of the following: (i) any **damage to or destruction** of all or any part of the Premises from whatever cause regardless of whether the improvements may be rebuilt following such damage or destruction to be the same as they were before such event because of applicable Legal Requirements or otherwise; (ii) **the taking** of the Premises or any portion thereof by condemnation, eminent domain, requisition or otherwise; (iii) the **prohibition, limitation or restriction of Tenant's use** of all or any part of the Premises, or any interference with such use; (iv) **any eviction** by paramount title or otherwise **(including constructive eviction)**; (v) any **Landlord default** under this Lease or under any other agreement to which Landlord and Tenant may be parties; or (vii) any other cause whether similar or dissimilar to the foregoing, any present or future law to the contrary notwithstanding. It is the intention of the parties hereto that the obligations of Tenant hereunder shall **be separate and independent covenants and agreements**, that the Basic Rent and the Additional Rent shall continue to be payable in all events, and that the obligations of Tenant hereunder shall continue unaffected in all events, unless the requirement to pay or perform the same shall have been terminated pursuant to an express provision of this Lease.

Legal and Structural Concerns (cont'd)

- Lease Structuring

- NET LEASE:**
 - Tenant may retain separate right to make claim against landlord or landlord's principal. Note specifically the inclusion of "constructive eviction". Also, best to specifically identify any section where abatement is permitted (usually casualty or condemnation only).
 - For best CTL execution, the tenant should not have the right to terminate the lease for any reason nor any right to abate or set off rent. Note, however, that termination in connection with material casualty or condemnation events are common.
 - Leases often have a "Landlord Default" provision without any specific landlord obligations which introduces ambiguity.
 - Any right of tenant to abate rent or terminate the lease will be analyzed thoroughly and likely will require specific indemnity from principals as well as monetary reserves and/or special insurance.

Legal and Structural Concerns (cont'd)

- Lease Structuring

- **TAXES:** Make sure to include assessments, impact fees and charges, “rent tax” and a catch all provision if the means of tax assessment changes:
 - **SAMPLE CLAUSE:** if at any time during the Lease Term, the method of taxation shall be such that there shall be assessed, levied, charged or imposed on landlord a capital levy or other tax directly on the rents received therefrom, or upon the value of the Premises or any present or future improvement or improvements on the Premises, then all such levies and taxes or the part thereof so measured or based shall be payable by tenant, and tenant shall pay and discharge the same as herein provided.
 - **CTL Drafting note:** Tenant should be required to pay all such taxes directly rather than reimburse landlord to avoid a tax reserve under the CTL loan document.

Legal and Structural Concerns (cont'd)

- Lease Structuring

- **FINANCIAL STATEMENTS:** Include a provision requiring delivery by tenant and any lease guarantor of annual audited financial statements (to both landlord and lender) (NAIC Requirement)
- **MERGER:** Include “no merger of estates” clause (NAIC Requirement):
 - **Sample Clause:** There shall be no merger of this Lease or of the leasehold estate hereby created with the fee estate in the Premises by reason of the fact that the same Person acquires or holds, directly or indirectly, this Lease or the leasehold estate hereby created or any interest herein or in such leasehold estate as well as the fee estate in the Premises or any interest in such fee estate.
- **ALTERATIONS:** Alterations should not be permitted without consent that would reduce the fair market value of the property or cause structural changes. May need tighter parameters if residual value insurance is sought for insured balloon.

Legal and Structural Concerns (cont'd)

- Lease Structuring

- Assignment and Subletting:** Assignments and subleasing are not problematic so long as tenant is not released (and lease clearly states this), however, releases of tenant or lease guarantor even where assumed by person with same credit rating are strongly disfavored.
 - Non-disturbance for subtenants is also disfavored because forces lender to accept tenant other than CTL tenant
- INSURANCE:** Required insurance must be issued by insurers with at least an investment grade rating. Insurance provision should include landlord as additional insured and lender as additional insured and loss payee/mortgagee for property insurance.
 - Any right of the tenant to self insure must require both: (i) that tenant has at least a net worth of \$100,000,000 AND (ii) tenant's long term unsecured debt is rated at least investment grade. (NAIC Requirement)
 - Make sure to include "business interruption insurance" for at least the period of time that it could take to rebuild if tenant is permitted to abate rent during reconstruction after a casualty event.
- REPAIRS AND MAINTENANCE:** Avoid using concept of tenant reimbursing for "Operating Expenses" that does not clearly obligate tenant for entire cost (i.e., only permits increases in operating expenses by CPI) and avoid having a specific list of operating expenses which are often ambiguous and may result in landlord retaining obligations.

Legal and Structural Concerns (cont'd)

- Lease Structuring

- CASUALTY/CONDEMNATION:**
 - Bondable lease = rejectable offer to purchase property upon casualty or condemnation events and no right to abate
 - If lease permits termination for casualty or condemnation events, then Special Risk Insurance will be required which pays off CTL at par upon terminations due to casualty or condemnation and/or pays CTL for any permanent abatement after a partial condemnation
 - NAIC Guidelines permit termination of the lease during the last 3 years of the original term so long as insurance proceeds are available and sufficient to pay off CTL lender
- COVENANTS OF RECORD:** Include provision that tenant is required to fulfill all obligations under instruments recorded against title which can contain hidden landlord obligations:
 - SAMPLE CLAUSE:** tenant covenants to perform and observe all terms, covenants and conditions of any easement, restriction, covenant, declaration or maintenance agreement, including without limitation, all easements, rights and obligations set forth in the Declaration of Easements (collectively, "*Easements*") to which it may at any time be a party or to which the Premises are currently subject or become subject pursuant to this Lease, whether or not such performance is required of landlord under such Easements, including without limitation, payment of all amounts due from landlord or tenant (whether as assessments, service fees or other charges) under such
- EXCLUSIVE USE:** Watch provisions that extend exclusive use covenant to affiliates or indirect owners of property and that are too wide in scope. Breach of exclusive covenant will be a recourse carve out in CTL loan documents.

Legal and Structural Concerns (cont'd)

- Lease Structuring
 - **Purchase OPTION:** Disfavored unless the purchase option clearly states that the minimum purchase price must always pay off the debt entirely (including any make-whole amount), otherwise it should state that tenant would have to assume debt on a recourse basis if it purchases the property.
 - **RIGHT OF FIRST REFUSAL:** Generally acceptable so long as ROFR is on same terms as landlord contract to sell and is clear that it does not apply to lender's foreclosure or deed-in-lieu, etc.
 - **HAZARDOUS MATERIAL:** Seek as broad of indemnity as possible from tenant (including with respect to third-party caused environmental conditions) and seek to avoid tenant right to terminate or abate rent.
 - **EVENTS OF DEFAULT:** Payment defaults should be immediate without notice and lease should contain an event of default for voluntary and involuntary bankruptcy of tenant.
 - **LEASE GUARANTY:** To the extent the credit to be relied upon is that of a guarantor, the guarantee of the lessee's obligations must be irrevocable and unconditional, and must guarantee payment and performance of all obligations of the tenant under the lease.

Legal and Structural Concerns (cont'd)

- Lease Structuring
 - **Shopping center syndrome:**
 - Avoid references to property other than leased premises in the lease that could cause (or imply) landlord to be obligated to insure, maintain, indemnify or otherwise enforce properties, buildings, common areas, parking lots or parcels beyond the leased premises
 - Often arises where landlord owns entire shopping center and is developing various parcels and knows the other parcels will be leased by tenants that will perform such obligations
 - NAIC Guidelines require that any obligations must be paid for from rent under CTL lease, therefore, reserves will be required to cover such costs and obligations even if already paid for by other tenants, which negatively impacts proceeds

Legal and Structural Concerns (cont'd)

- Lease Structuring
 - **Condominium:**
 - Similar problem arises in a condominium structure where landlord is declarant and agrees with tenant of specific condominium to ensure common areas are maintained, that roof and structure of building are repaired and replaced, that insurance is maintained, etc.
 - If a condominium is being leased, the tenant should be obligated to look to condominium association for common area maintenance, roof and structure, casualty and condemnation rebuilding and should not have right to terminate or abate if condominium association fails (rights should be under condominium declaration)

Legal and Structural Concerns (cont'd)

- Lease Structuring
 - **GENERAL TIPS:**
 - Be explicit with warranty periods in leases to avoid open-ended latent defect obligations
 - Rent commencement requirements should be specific and defined, use delivery of a certificate of occupancy or other definite standard
 - Watch “hidden” landlord obligations: indemnities, warranties, obligations to “enforce” other agreements on behalf of tenant, shopping center and condominium issues
 - Analyze every “landlord shall” or “landlord will” in the lease for landlord obligations
 - For larger transactions (and specifically for bond lease and public credit leases) require tenant to provide representations and warranties in the lease as well as a tenant opinion
 - Provide specific timeframe for delivery of estoppel certificates, ensure CTL lender is able to rely on estoppel certificate and provide

Legal and Structural Concerns (cont'd)

- SNDA Provisions (in addition to standard provisions)
 - **CTL drafting point**—include strong form of SNDA as exhibit to lease that includes the following:
 - Amendments, consents, modification, terminations of the lease must be subject to mortgagee consent (not subject to “reasonable consent”)
 - **Compromise provision:** mortgagee sole discretion applies to amendments or consents that (i) reduce or provides for any offset against rent or changes the timing of the payment of rent, (ii) modifies assignment or subletting by tenant, (iii) shortens the term of the lease, (iv) provides tenant with any right to terminate the lease, (v) materially modifies the leased premises, (vi) changes any termination or cancellation provision of the lease, (vii) modifies the permitted uses under the lease, (viii) imposes any additional obligations or liability upon landlord, or (ix) reduces any obligations or liability of tenant to landlord under the lease, without in each case obtaining mortgagee’s prior written consent
 - Lender notice and cure rights (at least 30 days beyond landlord’s cure period)

Legal and Structural Concerns (cont'd)

- Ground Lease
 - **NAIC Guidelines on Ground Leases:**
 - Tenant under CTL lease must be obligated to perform majority of obligations under ground lease (including specifically payment of ground rent)
 - Term of ground lease generally must exceed term of CTL lease
 - CTL lender must have standard leasehold mortgagee protections:
 - Right to notice and extended opportunity to cure defaults
 - Right to “reject” ground lessor’s rejection of ground lease in bankruptcy
 - No amendment or termination of ground lease without CTL lender consent
 - Right to “new lease” if ground lease is terminated for any reason

Legal and Structural Concerns (cont'd)

- Ground Lease
 - Permitted use under ground lease must not be restrictive or limited
 - Ground lessor should acknowledge ground sub-lease and CTL tenant (i.e., ground sub-lessee)
 - “**Sandwich lease**” (ground lessor and CTL tenant are same party)
 - No default by CTL tenant should cause a default under ground lease
 - If CTL tenant is in default under ground sub-lease then ground lease rent should be nominal and term of ground lease should be extended until CTL lender is fully paid off (otherwise ground lessor receives windfall for its own default)

Legal and Structural Concerns (cont'd)

- Credit Tenant Loan Financing Structure
 - Security Instrument
 - Note Purchase Agreement / Loan Agreement
 - Indemnity and Guaranty / Recourse Carve out Guaranty
 - Hazardous Material Indemnity
 - Assignment of Leases and Rents
 - Cash Management Agreement / Escrow and Servicing Agreement
 - If construction, Construction Escrow Agreement, Collateral Assignment of Construction Documents and Surety Bonds
 - Rent Direction Letter
 - Pass Through Trust Structure

Legal and Structural Concerns (cont'd)

- Lease Financeability Issues: Public Credits
 - **Appropriation Risk:** make sure a public university or other public credit lease:
 - contains an unconditional obligation of the tenant to pay its rent
 - does not expressly state that such rent is payable solely from “legally available funds” or some other reference to the tenant's general fund
 - does not purport to obligate the applicable governmental body (legislature, board of trustees, etc.) to appropriate funds to pay all or any portion of the rent
 - does not purport to obligate the tenant or any government unit to levy and collect taxes to pay rent
 - is a multiyear lease (i.e., long term) and not subject to termination before the end of its stated term for failure to appropriate
 - **Essentiality of Use/Special Use Facility**
 - **Waiver of Sovereign Immunity**

Balloons and Residual Value Insurance

- NAIC Guidelines provide that CTL may not have a balloon of more than 5% of the debt nor have a maturity date more than 6 months beyond the initial term of a Lease.
 - Provides coverage for a lender that the fair market value of a designated property subject to a lease (Covered Property) will be at least an amount (Insured Value) at the end of the lease term.
 - Residual Value Insurance is procured at the outset of a transaction with an upfront premium payable for the term and is tied to a balloon payment due on the underlying Note at maturity.
 - Residual Value Insurance is not a financial guaranty (while a Balloon Guaranty is), but an indemnity for loss incurred by a Lender as Loss Payee due to a decline in fair market value of the Covered Property. Although the property owner/borrower may be the technical Insured under the RVI Policy, the payout to the Lender as Loss Payee in the case of a claim would be by a sale of the Note from Lender to the RVI Insurer (at par) and the RVI Insurer would be subrogated to the Lender's rights against the property owner/borrower.

Balloons and Residual Value Insurance

• Critical Factors in Claim:

- Return Condition: The Return Condition of the Covered Property is a critical factor in determining the amount of a claim. The Return Condition under the RVI Policy generally requires that the Covered Property (i) has been maintained in accordance with the Lease, (ii) is free of title defects (other than permitted encumbrances), (iii) is in compliance with applicable laws and (iv) is free from hazardous materials.
- In processing any Claim, a determination whether the Covered Property is in compliance with the Return Conditions will be made. If the Covered Property is not in compliance with the Return Condition, the Insured retains an opportunity to remedy the noncompliance within a designated time period. If noncompliance is not remedied within the designated period, the amount of deficiency in appraised value (Deficiency Amount) due to noncompliance will be determined and will reduce the amount of the Claim paid under the RVI Policy.
- In addition to the Deficiency Amount, other common reductions in the amount of a Claim are (i) amounts received from condemnation awards and other insurance (except to the extent such proceeds are used to restore the Covered Property or to pay the outstanding principal of the Note), (ii) unpermitted encumbrances and (iii) unpaid expenses of the Insured payable to the Insurer.
- Upon payment by the RVI Insurer to the Loss Payee, the Loss Payee must assign over the Loan Documents to the Insurer (or, if there has been a foreclosure, the Loss Payee must convey the Covered Property to the Insurer).

Balloons and Residual Value Insurance

• Common Exclusions

- Termination of Lease due to casualty or condemnation (typically Special Risk Insurance would cover this risk)
- Modification of the Lease without the prior written consent of the RVI Insurer
- Modification of the loan documents without the prior written consent of the RVI Insurer
- Invalidity of the Mortgage
- Certain uninsured casualty events

• Key Notes

- As with any insurance policy, reading the policy and understanding the coverage, limitations and exclusions will be critical. Knowledge of required notifications and the related time periods will be important.
- RVI Insurer may require affirmative rights in the underlying finance documents. Early involvement of the RVI Insurer will be important in ensuring timely execution.
- Review the RVI Policy to ensure any required endorsements, including the Loss Payee Endorsement, are included as part of the RVI Policy
- Confirm relevant transaction details in the Policy Declarations, including parties, dates, Covered Property description and Insured Amount(s). Review (i) Schedule of Assumptions and Applications to ensure conformance with Lease, (ii) Permitted Encumbrances under the RVI Policy to ensure the same reflect the liens contemplated by the Lease and the Loan Documents and (iii) requirements of the RVI Insurer to ensure that the underlying documents that must be provided to the Residual Value Insurer (e.g., environmental assessment, appraisal, SNDA) will be delivered.

Special Risk Insurance

- Provides coverage for a Lender in connection with a loss of rents under an insured lease (Lease) due to a termination of the Lease or a reduction of rents under the Lease as a result of the occurrence of certain casualty or condemnation events.
- Special Risk Insurance is procured at the outset of a transaction with an upfront premium payable for the term.
- Special Risk Insurance is not a financial guaranty, but an indemnity for loss incurred by the Lender due to loss of, or reduction in the amount of, rents under the Lease resulting from insured events.
- **Claim Process**
 - Notification to the Insurer as soon as practicable in connection with an insured event will be important. Submittal of a sworn statement in proof of loss setting forth the circumstances giving rise to the Claim and the amount of loss is vital to any Claim.
 - Special Risk Insurance is in addition to, not in lieu of, existing casualty insurance. Accordingly, any casualty proceeds (or condemnation award) received by the Lender will be deducted by the Special Risk Insurer in determining the amount of the Claim.
 - A Claim may be paid periodically or in a lump sum. Note that a lump sum endorsement is required by most lenders.
 - Upon payment by the Special Risk Insurer to the Lender, the Lender must assign over the Loan Documents to the Insurer (to the extent assignable) and the Insurer will be subrogated to the rights of the Lender in recovery of any amounts in connection with the insured event to the extent of the payment.

Special Risk Insurance

- **Common Exclusions**
 - A transfer of the property without the prior written consent of the Special Risk Insurer
 - Bankruptcy or insolvency of the Owner (i.e., the property owner) or a bankruptcy of the Tenant
 - Condemnation of which the Lender had knowledge at the inception of the Special Risk Policy
 - In connection with a casualty event, the occurrence of a Flood (if the property is located, wholly or partially, in a Special Flood Hazard Area (Zone A, V or B)) or an Earthquake (if the property is located in designated jurisdictions)
 - In connection with a casualty event, physical damage with respect to the property which the Lender had knowledge at the inception of the Special Risk Policy
 - Modification of the loan documents that increase the exposure of the Special Risk Insurer without the prior written consent of the Special Risk Insurer
- **Key Notes**
 - As with any insurance policy, reading the policy and understanding the coverage, limitations and exclusions will be critical. Knowledge of required notifications and the related time periods will be important.
 - Special Risk Insurer may require affirmative rights in the underlying loan documents. Early involvement will be critical.
 - Confirm relevant transaction specific details in the Declarations, including parties, dates, the Lease description and Insured Amount(s). Review the Special Risk Insurance Policy to ensure that any required endorsements, including the Lump Sum Endorsement, are included as part of the Special Risk Policy.

Recourse Carveouts and other Mitigants

- **Recourse Carveouts:**
- include traditional “fraud, misrepresentation, misappropriation”
- also include landlord’s failure to perform its obligations under the lease (broadly picks up landlord obligations under lease)
- failure to comply with special risk policy and
- “full recourse” events related to any material amendment or termination of the lease or any lease guaranty without lender consent or voluntary bankruptcy filing. Often a minimum net worth of indemnitor is required.
- Will need financials of indemnitor and minimum net worth and liquidity covenants for indemnitor

Recourse Carveouts and other Mitigants

- To the extent of any landlord obligations that require ongoing reserves, debt service coverage must be at least 1.05x after reserving for such obligations
- All rent payments must be assigned to and paid directly to CTL lender (or a trustee) and borrower only receives excess after payment on debt and all reserves are paid (no “license back” concept)
- A lease event of default or bankruptcy by tenant (or lease guarantor) is a default under the CTL
- Borrower is restricted from taking unilateral actions with respect to the lease, the tenant, the leased premises related to any consent, amendment, waiver, default, etc.

Construction to Permanent Financing

- **Construction financing:**

- Letter of credit securing CTL until rent commences
- “Fixed rent commencement date” in lease
- GMP
- Surety bonds
- Construction engineer
- Construction escrows
- Borrower equity
- Construction completion guaranty
- Final disbursement closeout

Cross-Border CTL

- **Cross-Border CTL Primary Issues**

- **Tax Indemnity**
 - The payment of debt service to US investors from the Landlord may trigger withholding tax under local law. A firm understanding whether there will be withholding tax imposed on any debt service and if so, the indemnity, if any, that will be furnished with respect thereto is required. Typically this indemnity would come from the underlying credit in the transaction (in this case, the Tenant). Note, however, that since the debt is not being issued by the Tenant, the Tenant may object to providing such a withholding tax indemnity (unless it is a Tenant-initiated financing).
- **Swap Breakage**
 - To the extent that an investor does not fund in the currency in which the rent will be paid, an indemnification for any swap costs or breakage relating thereto will be required. Again, this would typically come from the credit in the transaction and investors would seek to have the Tenant undertake this obligation in the Lease. Similar to the withholding tax indemnity, however, unless the transaction is a Tenant-initiated financing, the Tenant may object thereto.
- **Local Law Regime**
 - The requirements relating to the filing of any mortgage under local law
 - Whether title insurance is available or necessary under local law

Cross-Border CTL

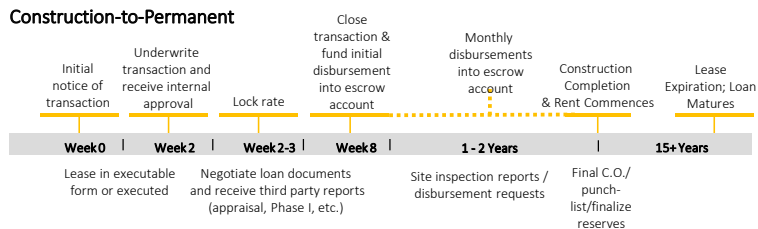
Cross-Border CTL Primary Issues (continued)

Local Law Regime

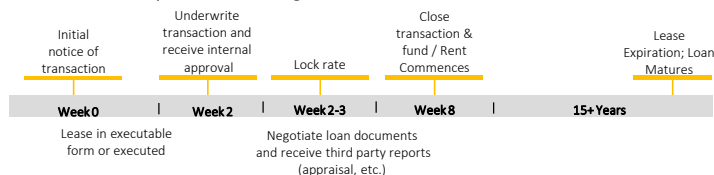
- Whether condemnation/eminent domain may be exercised under local law (and if so, the mechanics/regime relating thereto)
- The treatment of the lease in bankruptcy (whether the Tenant's or the Landlord's)
- Whether the Tenant would be released from its obligations under the Lease upon assignment
- Liability for hazardous materials, including migration (to the extent the Tenant does not assume the same under the Lease)
- Any statutory or civil rights the Tenant may have under the Lease to abate rent, terminate the lease or have "self-help"
- Acceptance of SNDA/Tenant Estoppel
- Local counsel opinion will be required

Representative Deal Timeline

Construction-to-Permanent



Sale / Leaseback or Acquisition Financing



Case Study



PennState Health

Company Information

Business Overview	Based in Hershey, PA, Penn State Health is a non-profit integrated healthcare system owned by and affiliated with Pennsylvania State University, providing care to patients through hospitals, surgery centers, and home health providers.
Date of Initial Investment	December 2017
Property	Construction of a Class A medical office building

Investment Details

Type	Construction-to-permanent financing
Construction Period	12 months I.O., with monthly draws into a construction escrow account (reduces negative arbitrage)
Details	13 year average life / 21 year maturity

Transaction Background

Use of Proceeds	To fund construction of the Property and pay fees / expenses
Background	Prudential Private Capital worked with developer to negotiate a lease with Penn State Health to ensure eligibility for CTL execution
Advantage	- Structured to fund monthly draws during the 12 month construction period into an escrow account, subject to date certain rent commencement - Strong lease enabled the developer to achieve maximum proceeds 1.05x DSCR / LTV: 85%

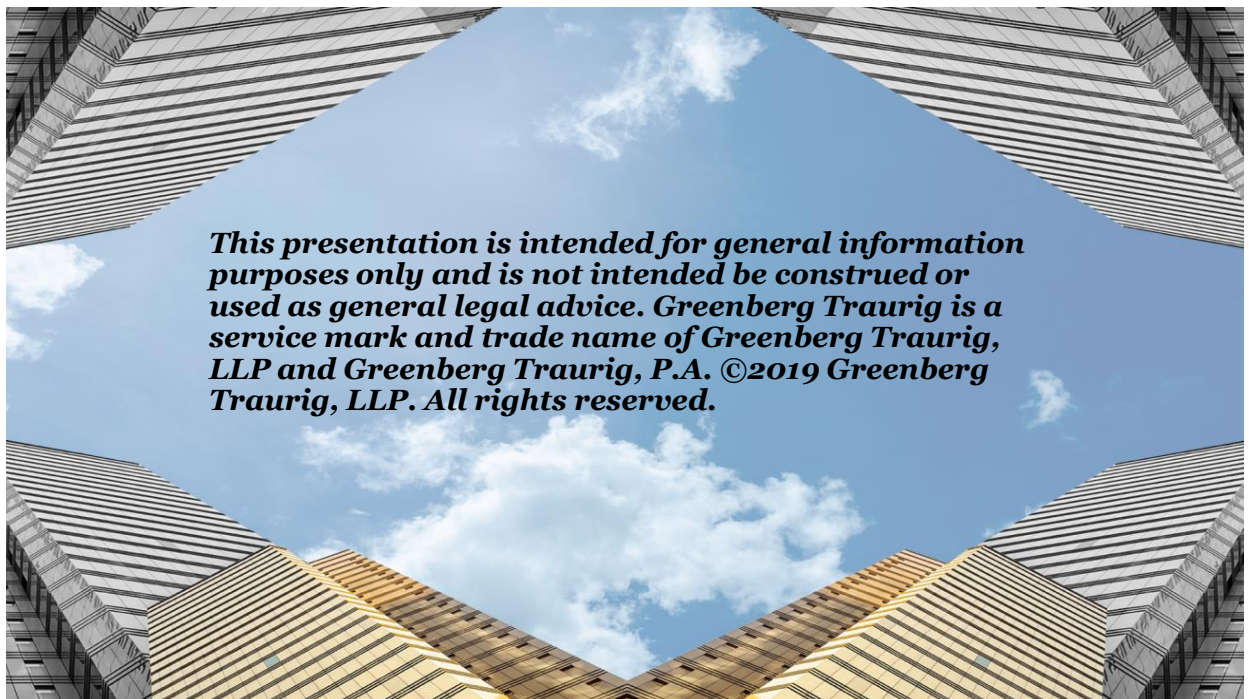


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