

What is a "credit" tenant in connection with finance?

April 09, 2008 - Financial Digest

The term "credit" gets used often and not always correctly, so it is important to look at its definition. Credit in connection with finance and appraisal is most used in the retail sector of the commercial real estate market, but can be applied in other property sectors as well.

A "credit" tenant/company, in financing/appraising jargon, is one that carries a specific corporate bond rating by either Moody's and/or Standard and Poors (S&P). The purpose of a corporate bond rating is to provide investors with a uniform rating system for comparative purposes. We look to a corporate bond rating to fortify the value of the rent received from such a tenant.

Moody corporate bond ratings of Aaa, Aa, A and Baa are identified as "credits."

Moody ratings of Ba, B, Caa, Ca and C are credit ratings but are not treated by investors/owners/appraisers as "credit." In the case of Moody corporate credit bond ratings, it is a Baa or better that is considered "credit."

S&P corporate bond ratings of AAA, AA, A and BBB are considered "credits." S&P ratings of BB, B, CCC, CC, and C are credit ratings but are not treated by investors/owners/appraisers as "credits."

In commercial real estate finance, rent received from a "credit" tenant, as defined, can carry with it more favorable underwriting and valuing, due to the quality of the rent from that tenant. A credit rating by itself is not enough, because it is only the upper tiers of those ratings that qualify to be a "credit."

When speaking with a borrower or lessor, one often hears "I have a credit tenant" in a discussion about the tenancy of a property. If so, this can mean, depending on the data, more positive loan underwriting and valuing, for example:

- 1) A lower capitalization rate and therefore increased value
- 2) Averaged initial term rent
- 3) Better interest rates due to a smaller spread over the particular index (i.e. treasuries, libor, FHLBB, prime, etc.)
- 4) Lesser vacancy percentages

Some or all of these elements, as they relate to a "credit" tenants, will generally provide the borrower with more favorable underwriting and valuing and likely more financing dollars.

In summation, to give an example related to retail, when the rent is from a "credit" that is a single tenant (i.e. Walgreens, etc.) it is treated positively with regard to loan underwriting and appraising. A "credit" tenant's rent, among non-credits rent, may still entitle it to be treated favorably in the underwriting and appraising.

June Fish is partner at Ashworth Mortgage Corp., Newton, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540