

Credit Tenant Lease Rating Methodology

This methodology provides a description of Transparency Analytics, Inc.'s (TA) criteria for assigning credit ratings to credit tenant lease (CTL) transactions. CTL transactions are a category of commercial real estate finance that is based on the property tenant's corporate credit rating and the net rent stream and bondable quality of the lease terms between the lessee, the landlord lessor, and the debt issuers. The typical objective of the CTL structure is to achieve a level of credit risk and resulting credit rating equivalent to that of the corporate credit of the tenant.

As described in detail in this methodology document, TA's credit rating process for CTL transactions consists of tenant credit rating and lease cash flow analysis, review of structural features, and loss given default analysis.

Tenant Credit Rating and Lease Cash Flows Analysis. TA evaluates the tenant's corporate credit rating, which can be provided by TA under the Corporate Credit Rating Methodology or by another rating agency. TA also evaluates the sufficiency of the lease payments to cover debt interest and principal amortization requirements. Characteristics of the tenant and transaction are considered to determine debt service coverage requirements.

Structural Features. CTL structures are designed to ensure tenant performance under the lease and insulate debtholders from real estate risks enabling reliance on the corporate credit of the tenant for repayment. Evaluation of transaction structural elements that accomplish these objectives is an important element of the rating process. TA's analysis includes evaluation of lease structure, landlord structure, trust structure, casualty and (if applicable) residual value insurance considerations.

Loss Given Default. TA considers factors that influence the relative recovery levels of CTL debtholders in an event of a tenant bankruptcy: a) likelihood of lease rejection by the tenant in bankruptcy, and b) dark value of the property, should lenders be forced to rely on property value for repayment in the event of a lease rejection.

Debt instruments secured by concentrated pools of real estate assets that rely on property cash flows and asset value for repayment (rather than on a CTL) are rated under TA's Commercial Real Estate Single-Asset Single-Borrower Credit Rating Methodology.

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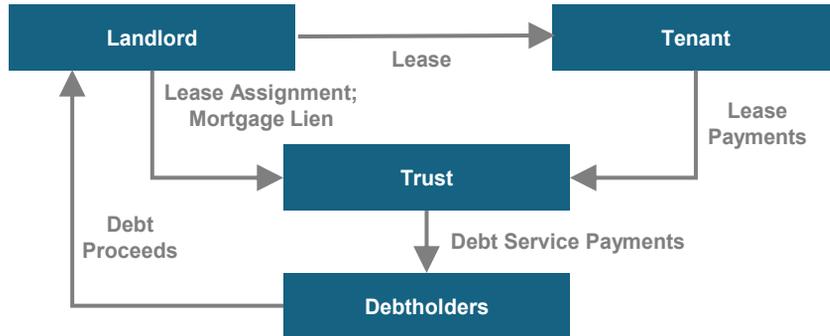
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I. OVERVIEW OF METHODOLOGY

Credit tenant lease (CTL) is a commercial real estate debt financing structure designed to be supported by the corporate credit of the tenant. The following description outlines characteristics of CTL transactions.



The CTL structure creates a debt obligation that relies for repayment on a long-term lease with a credit tenant. Key features of a CTL structure typically include:

- **Tenant:** The tenant has an acceptable corporate credit rating from a credit rating agency.
- **Lease Cash Flows:** Lease payments are sufficient to cover debt interest and principal amortization.
- **Lease Structure:** The lease is a bondable, triple-net (NNN) lease.
- **Lease Term:** The lease is coterminous with the debt maturity or residual value insurance is available.
- **Landlord:** The landlord is a bankruptcy-remote, special purpose vehicle (SPV) entity.
- **Trust:** Payments are made through a trust for the debtholders via an escrow account.
- **Lease Assignment:** The lease is assigned to the trust for the debtholders.
- **Mortgage Lien:** Debtholders have the benefit of a first mortgage lien on the property.
- **Casualty:** Tenant ensures that lease payments are not interrupted by any damage to the property.

The typical credit rating objective of a CTL structure is to achieve a rating for the debt instruments that is in line with the corporate rating of the tenant, at a debt quantity that results in a Debt Service Coverage Ratio (DSCR) approaching 1.0x. If some of structural features are less advantageous to the debtholders, a higher DSCR ratio may be required or a difference between the CTL transaction rating and the tenant’s corporate rating may result. Additionally, analysis of Loss Given Default characteristics of the transaction may result in an increase or decrease of the rating.

The structure creates a strong alignment of debt obligation payments with the lease payments and minimizes risks apart from the tenant credit risk that could disrupt lease payments. This creates a commercial real estate financing that is supported by corporate credit risk of the tenant rather than the value or cash flows of the underlying property.

This methodology document describes in further detail the elements of TA’s credit rating process for CTL transactions.

Section II: Tenant Credit Rating and Lease Cash Flow Analysis

Section III: Structural Features

Section IV: Loss Given Default

II. TENANT CREDIT RATING AND LEASE CASH FLOWS ANALYSIS

CTL structures are designed to be supported by the corporate credit of the tenant, and the evaluation of the tenant's corporate creditworthiness and lease cash flows is an important element of the rating process.

Tenant Corporate Credit Rating: In order for a transaction to be rated as a CTL, the tenant must have a corporate credit rating from a rating agency. If a tenant does not have a corporate credit rating, TA can provide a corporate credit rating to the tenant based on TA's Corporate Credit Rating Methodology. The corporate credit rating is the basis of the tenant's corporate creditworthiness view for the CTL rating process. If a tenant already has a corporate credit rating from a rating agency, TA may accept such rating for its assessment of the CTL rating. In most cases, the rating of the unsecured debt obligations of the tenant is used for the CTL rating process. If the tenant is an unrated subsidiary of the rated corporate entity, the corporate entity is expected to provide an unconditional guarantee of the obligations of the tenant including the lease payments. Any changes in the corporate rating of the tenant during the life of the CTL transaction have a direct effect on the rating of the CTL transaction.

Lease Cash Flows Analysis: Sufficiency of the lease cash flows to cover debt service requirements is measured by the Debt Service Coverage Ratio (DSCR). The following tables provide the definition of the DSCR ratio in the CTL context.

| <i>Table 1</i> | |
|---|--------------------------------------|
| Metric Derivation: Debt Service Coverage Ratio | |
| | Lease Payment = Net Operating Income |
| <i>Divided by</i> | Debt Service Costs |
| <i>Equals</i> | Debt Service Coverage Ratio |

| <i>Table 2</i> | |
|--|-------------------------------------|
| Metric Derivation: Debt Service Costs | |
| | Interest Payment Requirements |
| <i>Plus</i> | Principal Amortization Requirements |
| <i>Equals</i> | Debt Service Costs |

The lease payment is typically equal to net operating income because NNN lease contemplates that all expenses required to operate the property are paid separately by the tenant. If any such expenses are not covered by the tenant under the terms of the lease, they are subtracted from the lease payment to derive the Net Operating Income used in the DSCR calculation.

DSCR Threshold Considerations: For transactions that involve credit tenants with strong corporate credit ratings and meet structural characteristics of CTL transactions listed in this methodology, DSCR levels of approximately 1.0x are generally deemed acceptable to support ratings in line with the unsecured corporate credit rating of the tenant. If some of the structural characteristics are less advantageous to the debtholders, a higher DSCR ratio may be required to achieve a rating equivalent to the unsecured corporate rating of the tenant, or alternatively the rating may be lower than the unsecured corporate rating of the tenant.

Lease Renewal or Refinancing Risk Considerations: The term of the lease in a CTL structure generally should be coterminous with the full amortization of the transaction debt principal. If the lease terminates prior to the full amortization of the debt principal, debtholders are exposed to lease renewal or debt refinancing risk. In such situations, a Loan-to-Value (LTV) analysis is performed based on the vacant ("dark") value of the property and the remaining debt principal at lease termination. A sufficiently low LTV can support the rating level and DSCR ratio threshold requirements.

Multi-Credit Tenant Transactions: For transactions that involve more than one tenant, the rating for the CTL transaction is generally set at the level equivalent to the unsecured corporate credit rating of the tenant with the weakest credit rating. An exception can be made in situations with a significant DSCR cushion, in which the borrower may be able to service the debt without relying on the rental income from the tenant with the weakest credit rating.

III. STRUCTURAL FEATURES

CTL structures are designed to ensure tenant performance under the lease and insulate debtholders from real estate risks enabling reliance on the corporate credit of the tenant for repayment. Evaluation of the transaction's structural elements that accomplish these objectives is an important element of the rating process. Relative strength or weakness of structural features can provide support or pressure the rating level for a CTL transaction.

Lease Structure: CTL transactions generally involve a bondable, triple-net (NNN) lease, which creates an unconditional obligation for the tenant to make lease payments without any set-offs, deduction or counterclaim. The NNN lease requires the tenant to pay the three significant categories of costs required to manage a real estate property including property tax, insurance and maintenance, and the lease payment to the landlord is owed "net" of these three expense categories. Lease terms generally exceed 10 years and are often as long as 20-30 years, which ensures sufficient time to amortize the debt principal. To the extent the lease is not fully triple-net, any costs not covered by the tenant are subtracted from the lease payment in the DSCR calculation, and the DSCR threshold or rating level could be increased.

Landlord Structure: CTL transaction structure is intended to ensure that possible disruptions related to the landlord do not interfere with the flow of the lease payment from the tenant to the debtholders. The landlord is typically a special-purpose vehicle (SPV), with business purpose limited by transaction and organizational documents solely to owning the leased property and issuing the debt. The SPV is structured to be bankruptcy-remote such that a bankruptcy of the landlord does not impact the lease payments. Additionally, substantive non-consolidation opinions are considered to ensure the landlord cannot be consolidated with its owner in the case of owner bankruptcy. The landlord typically has no obligations under the lease and does not have responsibilities for operating the property. The tenant agrees to indemnify the landlord from any losses related to the real estate or the transaction.

Trust Structure: As security for the debt issuance under the CTL, the landlord assigns the lease to a trustee for the debtholders. The landlord also grants to the trustee a first mortgage lien on the property, which serves as a secondary source of repayment in an event of a rejection of the lease in a tenant bankruptcy. Under the lease assignment, the tenant makes all payments under the lease directly to the trustee for the debtholders, and the landlord is not involved in the payment stream. The trustee maintains an escrow account which holds funds for the benefit of the debtholders and disburses the funds according to the terms of the transaction documents.

Casualty: Lease payments may not be interrupted due to damage to the property. In the case of damage, the tenant is required to apply all insurance proceeds to restore the property to its prior condition and value. If insurance proceeds are not sufficient to restore the property, the tenant is required to make up the difference. If it is economically impractical to restore the property, the tenant generally has the option to terminate the lease by paying an amount sufficient to retire the outstanding debt. The tenant is expected to carry risk insurance for full replacement value of the property and name the borrower as an additional insured party.

Residual Value Insurance: The term of the lease generally should be coterminous with full amortization of the debt principal, and any lease renewal or refinance risk results in an LTV evaluation at lease termination based on the dark value of the property as described in Section II. Another alternative available in situations involving renewal or refinance risk is utilization of residual value insurance. If residual value insurance is utilized, the insurer must unconditionally cover the residual payment risks in full, and the credit rating of the insurer must be at least equal to the rating of the tenant. If these requirements are met, the lease and residual value insurance are deemed to fully cover debt service requirements and the LTV evaluation is not undertaken.

IV. LOSS GIVEN DEFAULT

TA considers factors that influence the relative recovery levels of CTL debtholders in an event of a tenant bankruptcy: a) likelihood of lease rejection by the tenant in bankruptcy, and b) dark value of the property, should lenders be forced to rely on property value for repayment in the event of a lease rejection.

Under the Corporate Credit Rating Methodology, TA assumes average recovery rates for corporate debt instruments of 50% of the total claim balances, with a standard deviation of 25%. In the case of CTL transactions, if after considering the likelihood of lease rejection and the dark value of the property TA believes that CTL debtholders' recovery rate can be significantly higher or lower than 50%, the rating of the CTL debt instruments can be adjusted accordingly, with the magnitude of the adjustment limited to up or down by one notch from the initial CTL transaction credit rating.

Likelihood of Lease Rejection: The evaluation of the likelihood of lease rejection in bankruptcy considers two factors. First, TA assesses the likelihood that in a hypothetical bankruptcy the tenant would reorganize rather than liquidate. Second, TA assesses the strategic importance of the underlying property to the tenant's business. If the tenant is deemed to be highly likely to reorganize in bankruptcy, and if the property is deemed to be essential to the operations such that in a stressed situation the tenant would need to continue to operate it in order to maximize its business potential, the likelihood of lease rejection may be deemed to be below average.

Dark Value of Property: In the event of a lease rejection by the tenant in bankruptcy, the CTL debtholders would take possession of the property and would rely on the property's value and potential cash flow generation for repayment. However, under such circumstances the property would be received vacant (dark), and the relevant value for the assessment is the dark value of the property. TA reviews the dark value appraisal to determine the potential rate of recovery by the CTL lenders in the event of a tenant lease rejection. The dark value appraisal value is reduced by charges for lost rent, retenanting costs, brokerage fees, unreimbursed maintenance and other holding period expenses. If the dark value analysis indicates a very high or very low rate of recovery, the CTL transaction rating can be adjusted up or down by one notch accordingly.