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Scrutinizing Owners' Financial Soundness

Leases: More tenants are concerned about landlords' viability in shaky office market.

By Andrea Alegria

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Office vacancy rates in the San Fernando Valley have doubled in the past two years - in some areas like the Warner Center, vacancy rates are close to 20 percent.

In today's market tenants are being choosier and more careful than ever when deciding on a space, especially when there might be a risk that a property may be underwater or end up being foreclosed on by the lender.

Today tenants are evaluating property owners more extensively, inquiring about the owner's finances, debt level and overall viability before signing lease agreements, said Scott Romick a principal at Lee & Associates- LA North/Ventura Inc.

"It's interesting, now tenants are interviewing the owners making sure that they are viable," said Romick, who is in the process of closing a lease transaction with a national institution interested in relocating to an 8,000 square foot space in Sherman Oaks.

Romick, who represents the property owner, said the non-conventional space would have to be gutted and rebuilt to accommodate the national institution's requirements, which would translate into approximately $300,000 in tenant improvements or $40 per square foot.

The tenant, he said, is requesting to review the property owner's finances and debt structure in order to make sure that those tenant improvement dollars are available and will be paid – a request that is becoming more and more common these days.

There's always the risk that an owner in financial trouble may not be able to meet tenant improvement and building maintenance obligations as well as commissions and broker fees involved in the lease transactions.

Taking it one step further, more tenants are now requesting the landlord provide them with a non-disturbance agreement from its lender before they sign a lease.

A non-disturbance agreement is a document whereby the landlord's mortgage lender agrees that the tenant may remain in possession of the premises if the lender takes the property back in foreclosure. Without such an agreement, the lender may be able to foreclose on the property and require the tenant to vacate the premises.

Getting these agreements from the lender adds another layer of work that must be put into a lease transaction and it's not always easy to get a lender to agree.

According to Romick, the most important thing is to be upfront and honest with tenants in order to move these transactions forward. The property owners he represents, he said, have been meeting one on one with potential tenants.