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ask the expert

ASK THE EXPERT is a Q&A with TRANSWESTERN experts and leaders. In this edition, TRANSWESTERN chats with Dallas Agency Leasing Principal, Matt Hurlbut. The topic on hand? How credit issues affect tenant decisions.

SHOW YOUR STABILITY

With Principal, Matt Hurlbut

How owner debt issues are affecting the tenant decision-making process

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Question:

Landlord debt issues have been widely publicized in the last couple of years. How are these credit and financing issues affecting a tenant's decision when it comes time to sign a lease?

Matt Hurlbut:

During the economic decline, these issues were indeed highly publicized and as a result, tenants had to educate themselves. There have been several instances where a tenant vacated a building owned by a landlord who had reduced building maintenance, staffing or was simply unable to fund improvements. Even with today's reduced lease rates, tenants expect buildings to be properly maintained and adequately staffed. Tenants who have been in a building for some time will notice when a service or amenity disappears, or a favored staff member is let go. It also raises a red flag when landlords do not offer a tenant improvement allowance, or have a reputation for slow paying contractors and brokers. Larger or more sophisticated tenants are particularly sensitive to this and will often avoid buildings that fit this profile.

Q: What can landlords do to demonstrate that they are stable?

A: Some are offering large cash incentives to "buy-down" the high rental rate and will allow the tenants to spend the money on FF&E, rent or whatever else they may desire. I have witnessed some building owners arrive for property tours to personally speak to the financial stability of the ownership. Some of the more stable landlords have started to pay brokers 100 percent of the commission due upon execution of the lease to demonstrate that they are financially stable. It sends a good message.

Q: Are landlords focusing more on tenant credit during these challenging times?

A: Some of the more institutional owners attempt to be more discerning and request hefty letters of credit or personal or corporate guarantees for marginal tenants. However, owners looking to quickly fill their buildings will "roll the dice" and request little or no credit enhancement to sign a lease. This makes it challenging for the more cautious landlords to make deals, as most tenants would prefer not to tie up their funds with letters of credit or guarantees. Landlords must do more research on marginal tenants and their businesses in order to properly assess the risk involved in making a deal with little or no collateral to back it up.

Q: How can a prudent landlord mitigate their risk in this environment?

A: They can verify the tenant's payment history with previous landlords and obtain and thoroughly analyze their current financials through credit reporting agencies for evidence of prior lawsuits or other negative information. They can attempt to get a personal guaranty or letter of credit on only the landlord's out-of-pocket costs, even if the guaranty is limited to the first 12-36 months of the lease. Free rent can be spread throughout the term. Spec suites are also a good place to put these tenants, as the cost to build-out the space is already incurred. If a spec suite is built-out in a standard configuration - as most are - then the space should be inexpensive and easy to re-lease should the tenant default.

We have all had to adapt to a new and safer way of doing business. These practices will most likely be the standard going forward. Putting them in place now will keep landlords ahead of the curve.

MATT HURLBUT serves as a principal of agency leasing services in Transwestern's Dallas office. He directs the leasing and marketing efforts for several major office properties in the North Dallas and Las Colinas submarkets. A veteran of the commercial real estate industry, Matt began his real estate career in 1983 as an office-leasing agent with Southland Investment Properties, the developer of Las Colinas.

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