

Better the tenant you know...

Gaining comfort about a tenant's ability to pay is increasingly important, both in terms of cashflow and the value of the underlying asset, particularly in uncertain economic times. There are also significant advantages in having financially sound tenants occupying property. This can be achieved by conducting a tenant appraisal - an approach relevant to existing as well as prospective tenants.

What is a prospective tenant appraisal?

This is essentially an independent assessment of a tenant's ability to meet its annual rental obligation. It helps landlords manage the risk of a tenant becoming unable to pay its rent - thus providing reassurance about future income streams.

This can be particularly important in an uncertain economic environment, where retailers and other occupiers may face poorer than expected trading conditions and suffer reduced cash flow.

What is involved in a prospective tenant appraisal?

A variety of methodologies can be used, depending on specific circumstances and the landlord's requirements. However, in general, a tenant appraisal would combine the application of financial and corporate advisory skills to review the tenant's financial statements, as well as its credit ratings. A face to face interview with the tenant's finance director may be involved to help put the figures in context.

Having an understanding of the tenant's business sector is also important when forming a view as to the tenant's ability to meet rental payments as they fall due.

Why is it important to conduct existing tenant appraisals?

Even tenants who have been reliable in the past can struggle to meet future rental commitments during an economic downturn. Operating results and cash flow can be affected rapidly, whether by reduced consumer or business spending. Essential advice for any landlord is, therefore, to 'know your tenant'.

What are the risks associated with a tenant defaulting on its rent?

The landlord will suffer a period of loss of rental income and, should an existing tenant become insolvent and cease trading, finding a

replacement quickly can be time consuming and costly, particularly during an economic slowdown. The more empty space there is in a property, the more difficult it can become to attract new tenants.

What warning signs can alert a landlord to the fact that a tenant may be facing financial difficulty?

Depending on the property, there are some telltale signs that a vigilant landlord, building manager or managing agent can look out for. For example, for a tenant occupying premises in a shopping centre, warning signs could include reduced customer footfall, fewer staff in the store, or a change in stock levels. A reduction of stock could suggest insufficient cash to buy in goods, while excessive, slow moving stock could indicate low sales and poor controls.

For all tenants, any delay in payment of service charges should also sound the alarm. It is particularly important to ensure that service charge payments are up to date - these are highly unlikely to be recovered should a tenant become insolvent.

If a tenant appears to be in trouble, what can the landlord do?

The first rule is to act fast. If the tenant is found to be facing a cash flow problem, there are a number of options open. The landlord could enter into an arrangement with the tenant and, for example, defer the rent for a set period - perhaps three to six months - to help the tenant avoid insolvency in exchange for the landlord obtaining additional security. Conditions can be attached, requiring the tenant to work with financial experts, such as Moore Stephens, to achieve a turnaround in its performance.

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What advantages are there for the landlord?

By taking control of the situation, the landlord achieves a stronger position. Firstly, by helping the tenant to continue trading and avoid insolvency, the landlord reduces the risk of a long-term loss to its rental income. When tenants enter insolvency, landlords are typically a long way down the list in terms of recovering any monies due. Meanwhile, as noted above, finding a new tenant quickly is likely to be costly and time consuming.

Should the tenant improve its financial position, the landlord will ultimately benefit not only from a restored rental stream, but also from the ability to charge interest on the deferred rent.

What can managing agents do to help landlords?

Managing agents can alert landlords about the importance of keeping an active watch on existing tenants, as well as the need to appraise prospective ones. It is essential that landlords know the warning signs to look for, and understand that they can take control of a situation to help reduce the risk of rental defaults.

How can Moore Stephens help?

Moore Stephens offers expertise in finance and corporate advisory matters, as well as property management and specific business sectors. This knowledge enables us to perform efficient appraisals of both current and prospective tenants.

Should a landlord have concerns about an existing tenant's ability to continue making rental payments, Moore Stephens can help by working with the tenant to improve its operating performance. In this way it can reduce the risk of the tenant defaulting on rental payments and potentially becoming insolvent.

Further information

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