

COMMERCIAL PROPERTY INVESTMENT – DISCLOSURE OF THE TENANT’S ACCOUNTS

by Tim Hart

November 2016

For an investor considering the purchase of a commercial property, the covenant strength of the tenant(s) and any guarantor(s) is of central importance. Investment properties are purchased for the benefit of an income stream and an investor will wish to be as certain as possible that that stream will continue to flow. Likewise, a financial institution considering lending to the owner of an investment property will wish to have comfort that the rental income will continue to be paid so as to service the loan.

Historically in Jersey, with a more domestically oriented property market, it was not common for purchasers or funders to seek to obtain up-to-date financial information in relation to existing tenants or guarantors. If a building was let to, say, a local law firm with personal guarantees from the partners, purchasers and funders could generally satisfy themselves based on their own knowledge of the local business community.

The commercial property market has, of course, evolved significantly and continues to do so. Whilst there remains a body of local investors, many investment properties are acquired by institutions or funds with no day-to-day involvement in Jersey business. Furthermore, the profile of tenants and their guarantors is increasingly corporate. If a guarantee is provided, it will generally be provided by another corporate entity in the tenant’s group rather than by individuals.

For these reasons, up-to-date financial information in respect of corporate tenants and guarantors is of increasing importance for investors and funders. A certain amount of information can be obtained from public sources but much cannot. Crucially, Jersey companies (with the exception of public companies and their subsidiaries) are not required to file accounts. In the circumstances, it has become common for landlords to require the inclusion in new commercial leases of express covenants requiring the provision of financial information.

Such covenants will typically require the landlord to be provided with annual accounts of the tenant and any guarantor, if the relevant company does not publish its accounts, within a defined period after the accounts are prepared. In addition, the landlord will be permitted to disclose such accounts to financial institutions proposing to lend money to the landlord and to potential purchasers of the property, on condition that any such recipient enters into a confidentiality agreement (non-disclosure agreement) with the tenant/guarantor. In order to minimise the scope for argument as to the form of the confidentiality agreement, an agreed form can be scheduled to the lease.

There are a number of possible refinements of these clauses. For example, where a tenant is concerned at the prospect of its full accounts being made available to a competitor, an alternative can be provided for, such as a certificate from its auditors confirming certain key financial indicators.

In the absence of any contractual obligation such as this, a tenant or guarantor cannot be compelled by the landlord to disclose its accounts, and the landlord may have to offer something in return if it wishes to have accounts supplied. It is understandable therefore that landlords are anxious to include such obligations when negotiating new leases and indeed when an existing lease requires to be varied for any reason.

Sight of a company's latest accounts are valuable when it comes to assessing covenant strength but at the same time their limits should be acknowledged. A company's accounts provide a snapshot of its financial position at a defined point each year. Material changes could have occurred in the period between the year-end date and the date upon which a purchaser or funder receives a copy of the accounts. Trading performance could have improved or deteriorated to a material degree or the ownership structure could have changed. Nevertheless, they are an important element in the due diligence carried out by prospective purchasers and funders and it is clear therefore that tenants and their guarantors must expect to have to assume disclosure obligations when entering into commercial leases.

This article has been written by:

Jersey

Tim Hart

Partner

Global Group Head, Property

+44 (0)1534 818 043

thart@applebyglobal.com

Tim Hart is a Partner in the Property Department at Appleby. A copy of this column is available on the firm's web site at applebyglobal.com