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Tenants to Pay Increased Rents in 2002

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SPECIAL TO THE TIMES

Businesses that rent office, industrial or retail space will have to pay higher rents next year to cover their share of fast-rising premiums for commercial property insurance.

How much more tenants will have to pay will vary, depending on such factors as whether the buildings are considered high risks for terrorist attacks, whether the owners carry earthquake insurance and the specific provisions of each tenant's lease.

But tenants almost surely face double-digit increases because many landlords are already reporting hikes of 30% to 100% in their insurance premiums, and landlords typically pass the increases along to their tenants.

The higher premiums are a result of the Sept. 11 attacks and of the changing insurance industry conditions that make coverage more expensive and harder to find, said Jenny Jones, president of Elkins/Jones, a Los Angeles insurance brokerage specializing in commercial properties.

"You're going to be seeing landlords looking at rate increases they wouldn't have considered paying a year ago and just grabbing them because it's the only insurance they can get," Jones said.

She cited the case of a Los Angeles landlord who owns 53 office and retail buildings who paid a premium of \$373,000 last year and had to pay \$559,000 this year—an increase of nearly 50%—to get the same coverage.

Insurers are boosting premiums in part to help cover losses from Sept. 11—estimated at \$60 billion to \$100 billion—but also to make up for years of underpricing premiums, according to Jones and others in the insurance industry.



ANNIE WELLS / Los Angeles Times

Jenny Jones, of L.A. insurance brokerage Elkins/Jones, says insurers are trying to recoup losses from the Sept. 11 attacks and for under-pricing premiums in recent years, making coverage for commercial properties more expensive and more difficult to find.

Rates already had risen by 20% to 25% before Sept. 11, said insurance broker Alexandra Glickman, because many insurance companies needed to raise premiums to make up for declining profits from their stock market investments.

Many carriers "were not making profits on the premiums they charged but instead were counting on profits from investing those premiums in the stock market," said Glickman, an executive vice president at Arthur J. Gallagher & Co. in Woodland Hills.

"In the past, they could afford to charge lower rates because they knew they could turn a profit by investing the premiums," Glickman said. "As the equity markets declined, they had to increase their rates."

The increases generally run higher for

offices, said Tom McAndrews, president of Newport Beach-based Tiarna Real Estate Services.

McAndrews cited a 150,000-square-foot office building in Encino where the premium rose to \$120,000 from \$57,000 last year, a 200,000-square-foot industrial building in Camarillo where the premium rose to \$54,000 from \$32,000 and a 100,000-square-foot office property in Newport Beach that paid \$60,000 on renewal, up from \$45,000 last year.

But McAndrews said these figures applied to buildings that are not high-profile office towers, sports stadiums or other properties that might be perceived as potential targets of terrorism.

Rates for industrial properties generally are lower and are rising less, he said,

because industrial buildings cost less to build and their values generally are lower. Industrial properties also are much less likely to be considered “trophy” properties or to be occupied by tenants that would be likely terrorism targets.

Most industrial tenants will see the insurance increases under “net” leases that bill them directly for actual costs of insurance and other operating expenses, said real estate attorney Paul Rutter of Gilchrist & Rutter in Santa Monica.

Office tenants, Rutter said, will see the higher insurance charges in two ways.

First, they will see higher monthly assessments for their share of a building’s operating costs, which also include other expenses such as security, janitorial services and utilities.

Second, they will see higher charges in a yearly accounting the landlord provides, usually in March or April, that compares estimated expenses with actual expenses. If actual expenses exceed estimates, the tenant must pay the landlord the difference. If actual expenses are below estimates, the tenant gets a credit toward future rent.

Although rising insurance rates suggest that nearly all tenants could be hit with higher bills for operating expenses, general counsel David Swartz of Los Angeles-based Arden Realty says higher expense bills are not a certainty.

If a landlord’s annual accounting of actual operating expenses shows that some of a building’s costs have climbed and others have declined, Swartz said, the two could cancel each other out and tenants might not have to pay any increased expenses.

Swartz said Arden, the largest office landlord in Southern California with 18.4 million square feet, doesn’t yet know how much its premiums will rise when its property insurance comes up for renewal in March.

Besides generally rising rates, one of the issues facing commercial property owners is how available terrorism coverage will be and how much it will cost.

“Right now, going into the new year, there is a tremendous amount of confusion” about terrorism coverage, said Jones of Elkins/Jones.

A number of companies have said they no longer will offer terrorism insurance, or will do so only at much higher rates, Jones said, and Congress is considering a measure that would provide a national terrorism insurance program comparable to the national flood insurance program.

Many landlords already have received notices that their commercial property insurance policies will not be renewed next year, Jones said, because carriers don’t want to provide terrorism coverage, are cutting back on the amount of insurance they write and say they can’t provide the same coverage at the old premiums.

But those cancellation notices are not as dire as they sound, according to Jones, who said insurance companies will work to figure out ways to keep good accounts that pay their premiums on time and don’t file a lot of claims.

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