

EXCLUSIVE Last updated: December 4, 2007 09:19am

Arbitration Sets \$56M Rent for Sony Offices

By Bob Howard

CULVER CITY, CA-Sony Pictures Entertainment will pay rent of \$56.1 million to landlord Transpacific Development Co. over the next five years as the result of what is believed to be the largest rent arbitration ever decided on the West Coast. The arbitration decision in favor of Transpacific came after Sony and the Torrance-based building owner failed to reach an agreement during negotiations over rent for Sony's approximately 330,000 sf of office space at 10000 W. Washington Blvd.

Sony occupies the entire building at 10000 W. Washington, which is also known as Sony Pictures Plaza, under a 35-year triple-net lease that began in 1993. The entertainment firm's lease provides that the rent be adjusted once every five years rather than through yearly CPI increases, and that the new rent be established by arbitration if the parties can't agree on a figure.

In the recent arbitration, Sony proposed a new rent of \$870,000 per month for the next five years, compared with the \$710,000 per month that the entertainment firm has been paying for the past five years. Transpacific proposed a rent of \$935,000 per month for the 330,000 sf of office space and a 400,000-sf parking garage totaling 1,100 spaces that is covered by the lease.

Sony's proposal would have totaled \$52.2 million over the five years, compared with the \$56.1-million Transpacific proposal. The decision was made according to what is known as baseball-style arbitration, so named because of its use by Major League Baseball, in which matters in dispute are decided by arbitrators who must choose either one or the other of the two proposals submitted by the opposing parties.

Sony did not return calls seeking comment on the arbitration, but those who were involved on the Transpacific side tell GlobeSt.com that the case is a sign of the growing number of rent arbitrations now under way in the L.A. area. Transpacific president Tom Irish, attorney Tony Natsis of Allen Matkins Leck Gamble Mallory & Natsis, and CB Richard Ellis appraiser Dave Zoraster all tell GlobeSt.com that the already rising number of rent arbitrations appears likely to keep increasing.

"This is something that is really starting to take off," Zoraster says. The CBRE appraiser says he is working on six or seven rent arbitration appraisals right now. Natsis says that he is working on 10 rent arbitration cases now, compared with only 20 that he worked on for the first seven years of this decade, and Irish says that he knows of 25 or so that are in the works in the Los Angeles area.

Natsis points out that rent arbitrations occur primarily in two circumstances: in the case of an extremely long-term lease like Sony's that adjusts the rent mid-term, or in a more standard-length lease that comes up for renewal. He says that the rising number of arbitrations lately reflects supply-and-demand market conditions that have turned the Westside into one of the tightest and most expensive office markets in Southern California, as well as the determination to push rents substantially higher on the part of landlords who paid top dollar for their properties and need to achieve higher rents to pay for them.

In rent disputes, as Natsis explains, the arbitrators typically are appraisers. The three arbitrators include one chosen by the landlord, one chosen by the tenant and one neutral third party that both parties agree upon.

The tenant's arbitrator and the landlord's arbitrator each submits a number representing what they believe the fair market rent should be, and neither party knows what the other's number is until the figures are exchanged at arbitration. When the arbitration is baseball style, Natsis points out, the neutral third party arbitrator is the one who makes the decision by choosing one of the two figures.

Natsis says that in theory, at least, baseball arbitration encourages both sides to submit figures more toward the middle ground because the neutral third party arbitrator is likely to reject any number that is excessively high or low. In practice, however, landlords and tenants are still sometimes miles apart in their perceptions of what the rent should be.

A case in point was the previous arbitration between Sony and Transpacific five years ago, when the two parties were \$20 million apart in their proposals. Natsis, who along with Zoraster also represented Transpacific in that case, says that \$20-million difference is the largest spread ever that he is aware of in rent arbitration and that the \$56.1 million is the largest rent figure he knows of that has been arbitrated on the West Coast.

Zoraster says that no two arbitrations are alike because the leases vary so much in how they are structured and in the array of factors that must be considered in determining fair market rent. The appraiser must first look at the lease, to see what it specifies regarding the obligations of the landlord and the tenant, and then must research a host of factors, including comparable leases of similar facilities. Appraisal work for leases is "a lot more complex than looking at a sale value," Zoraster says.

Natsis and Irish both credit Zoraster with producing comprehensive and accurate appraisals that won the case for Transpacific both in this arbitration and in Transpacific's previous arbitration with Sony. The Torrance-based investment and development firm bought Sony Pictures Plaza in 2000, when the 35-year lease was already in place, and although Transpacific has prevailed in both of its arbitrations, Irish says that he would prefer not to have to go through the process because it is both costly and unpleasant.

"We prefer to reach agreement with our tenants through negotiation rather than arbitration," Irish says. "If we agree, both parties are satisfied. If we go to baseball-style arbitration, one side wins and one side loses, which is not conducive to a positive landlord/tenant relationship--especially if the rents are significant."

The Sony lease commenced on Jan. 1, 1993, so the new rent will be for years 16 through 20 of the 35-year lease. Irish points out that although it's a 35-year lease, Sony is only locked into the building for 20 years and both parties have the option to terminate at the end of the next five years.