

Lease **Abstracts**: Tedious, Time-Consuming, Crucial

BY DAVID TESLER

LEASE ABSTRACTS, or brief summaries of key lease provisions, are a vital but often undervalued element of the due diligence process for most commercial real estate acquisitions. A concise, accurate lease abstract can also serve as an effective business tool for leaseholders, property managers, brokers, investors and lenders.

The preparation of a lease abstract is, however, a tedious and time-consuming task, and in an effort to save time and/or ward off boredom, even experienced lease abstractors can make mistakes. And those mistakes can be costly.

Lease language being what it is, one is naturally tempted to skim through the documents, particularly the sections that appear to be boilerplate. But beware: A single missed sentence buried among thousands of pages of commercial real estate leases can cost a client hundreds of thousands of dollars.

Consider this real-life example based on a retail mall acquisition project in which a group of attorneys and paralegals spent many hours in their war room reviewing leases.

What They Missed: Buried on the third page of a seemingly endless default provision, in the middle of a paragraph, lay a provision that allowed the tenant to terminate the lease upon 30 days' notice.

David Tesler is founder and CEO of *LeaseProbe*, a lease abstracting company.

It was an unusual provision placed (read: purposefully buried) in an unusual location within the lease.

The Consequences: One of the largest leases in the property and a significant percentage of the property's income stream were at risk because of the tenant's ability to independently exercise a termination option. The

attorneys' failure to identify and address this risk surfaced less than a year after the acquisition, when the tenant exercised its right to terminate. The client suffered a significant monetary loss and the firm responsible suffered a serious stain on its reputation.

Be aware of the following typical traps to avoid similarly unfortunate results.

Best Practices: How to Abstract a Lease

- **Know the Client.** Is this abstract for a future landlord? Tenant? Lender? Consider what items are most important to this client.
- **Understand the Transaction.** Keep the specific nature of the transaction and the unique qualities of the underlying property in mind. This practice helps identify critical lease issues for this specific property.
- **Abstract Backwards.** Read the leases and related documents in reverse chronological order (so as to avoid discovering that a later amendment changes everything that has already been read and abstracted).
- **Read and Abstract the Entire Lease.** Do not pick out individual provisions and just fill in the blanks on an abstract form. Do not skim.
- **Study the Recitals.** The Recital section of the lease is a rich source of information and will often reveal data that is missing from other sections of the lease file.
- **Be Consistent.** Use a consistent style and approach throughout the entire abstract and for multiple, related leases.
- **Summarize.** Do not copy and paste.
- **Calculate Any Numbers or Formula.** Be sure to make a note that the resulting figures were calculated by the abstractor.
- **Footnote.** Provide sources for every data point on the abstract
- **Proofread.** Confirm the accuracy of each data point on the abstract. Preferably, have the proofreading done by a second person.

Avoid These Common Pitfalls

The common pitfalls that can easily lead to critical errors or omissions include the following:

- *Failure to Abstract Hidden Provisions.*

A “hidden” provision can detail critical information such as termination options, co-tenancy clauses, important notification requirements, and/or exclusive uses, to name just a few. Failure to inform the client of the existence and specific details of these terms can have a meaningful impact for the owner of the property (or the lender or tenant) ranging from interruptions in the income stream to inter-tenant relations to even potential liability.

As illustrated by the example above, the most important provisions are often buried in the middle of paragraphs filled with mundane boilerplate language, lulling the reader into a false sense of security. The reclusive nature of these provisions may result from an intentional effort to obfuscate, or more innocently, poor draftsmanship. Either way, the reviewer must remain alert for them.

Typical hiding places include long default provisions and the miscellaneous provisions at the end of the lease—just the kind of thing most reviewers are likely to skim. Another area in which a reviewer is likely to spot hidden provisions is in the middle, or at the very end, of a long provision detailing a related concept.

- *Failure to Capture All the Facets of a Provision.* It is important to read the complete provision, assimilate its content and then abstract only the most critical information based on the client’s requirements. Too often, an abstract captures only the primary aspect of a provision, leaving aside secondary, although equally important information.

The opposite approach—simply cutting and pasting most of the lease language into the abstract—yields equally unclear, unsatisfactory results. This forces the reader to determine what is important, effectively defeating the purpose of the abstract.

Consider something as basic as the typical renewal option provision, which describes the tenant’s and/or landlord’s rights to renew the lease beyond its initial term.

The typical abstract entry reads something like this: “Tenant has two additional terms of five years each.” Or, alternatively, the abstractor just copies and pastes the three paragraphs devoted to the renewal option from the lease to the abstract.

Beyond the simple “two additional terms,” however, are other facets to this very simple provision. For example, is the right to renew the lease personal to the original tenant or is it transferable in the event of an assignment or other transfer? If the former is true, and the current tenant is not the initial tenant, the renewal option no longer exists. The absence of a viable renewal option could wreak havoc among all parties involved in a transaction and can alter the fundamental assumptions of a deal.

Another facet of the renewal option worth mentioning is the notification requirement. Typically, there is a limited and very specific window of opportunity in which to exercise the renewal option.

For example, the tenant may be required to give written notice between 60 and 90 days prior to the expiration date, with failure to exercise the renewal option within that timeframe cancelling the option. Alternatively, some leases allow for automatic renewals absent specific notice from the tenant to the contrary. Although secondary to the provision itself, these details are nonetheless critical to an assessment of how the lease may impact a proposed transaction.

The renewal option example is merely archetypal. Every lease provision has subtlety and nuance that the reviewer should consider—and perhaps add to the abstract so that the client is adequately informed about the lease and the underlying property. If details like financial provisions (e.g., penalties and/or rebate opportunities) or critical timeframes are omitted, the consequences for the client—and, ultimately, for the reviewer’s firm—can be significant.

- *Failure to Review Exhibits.* Unfortunately, many reviewers stop reading a lease in earnest when they reach the execution page of the document. However, the exhibits and schedules that follow the signature pages often have critical information that must appear in the abstract.

Examples of such information abound.

Rent abatements and delayed commencement dates often appear in exhibits detailing construction and work completion information. Co-tenancy, exclusive use, radius restrictions and prohibited use provisions are frequently set forth in an exhibit appended to the lease. Estoppel, form SNDA (subordination non-disturbance agreement) and commencement date agreements often appear in the exhibits and schedules attached to the lease. Therefore, failure to review these sections carefully often results in missing critical information.

- *Failure to Review Correspondence.* Frequently reviewers focus exclusively on the leases themselves and ignore the myriad assorted documents that appear in a complete lease file. There is some justification for this practice since a good deal of the documentation contained in a lease file may have no bearing on the lease whatsoever. However, one should not overlook correspondence.

A careful reading of the correspondence can reveal important information such as notification of the exercise of renewal options; festering problems surrounding the premises, such as a leaky roof or faulty air conditioning; complaint letters that provide insight about the tenant; and, important history and information that fill in the gaps and provide narrative to the lease documents.