

Why Lease Abstract?
By David I. Tesler, Esq.

Whether you are a company or an individual that **owns, manages** or **acquires** commercial real estate, a lender **underwriting** an acquisition, or a management company, attorney or broker involved in a transaction – the underlying retail, office or industrial leases are the foundation of the asset to be purchased and at the heart of the income stream feeding the property.

Therefore, a review of the complete lease file is not only warranted, but must be an essential component of the due diligence process. In short, it is vital that each lease be thoroughly reviewed and abstracted.

A lease abstract is a summary of key financial, business and legal information in a commercial real estate lease. In addition to summarizing the standard lease provisions, a lease abstract should, at a glance, bring to the reader's attention any unusual lease provisions, financial obligations or other issues of import.

The abstract's specific level of detail should depend on the purpose of the abstract – Are the leases being reviewed for acquisition, management, a merger - or for underwriting and lending purposes?

At the very least, each abstract should contain **Basic Information** about the lease and provide quick access to the identity of the Landlord and Tenant, description of premises, square footage, term of the lease, commencement and lease expiration date.

Each party involved in a transaction, (purchaser, lender, analyst, attorney, manager, broker) must obtain, or confirm as the case may be, the **Financial Information** contained within the lease. Financial data such as rent, renewal rent, security deposits, late fees and interest, real estate taxes, common area maintenance (CAM) costs and percentage rents are critical components affecting the transaction. Provisions detailed within the lease, such as, what is specifically included or excluded (i) in gross sales for purposes of determining percentage rent, or (ii) within the CAM provision for determining operating expenses, can have a significant impact on the income stream.

The number and type of **Options** available to Tenant or Landlord could also significantly alter the value of the assets. Does the Tenant have the option to renew the lease? May the Tenant expand, contract or relocate the premises? Does the Tenant have a right of first refusal to purchase the property? Most importantly, does the Tenant (or Landlord) have the right to terminate the lease? Understanding and accounting for Tenant and Landlord options is of utmost importance.

Retail leases have their own set of unique lease provisions that can significantly impact the transaction. Gross sales (inclusion and exclusion), break points, sales reporting, tenant's obligation to join a marketing fund, signage restrictions, radius restrictions, exclusivities, merchant's associations, co-tenancy and required business hours are all retail specific provisions typically reviewed and abstracted.

A **lender** or **investment bank**, in addition to all the aforementioned lease provisions, will be particularly interested in understanding the lease's casualty and condemnation provisions, subordination and non-disturbance (SNDA) language, estoppel certificate requests and the insurance requirements dictated by the lease. Although a majority of leases contain subordination clauses, some may be insufficiently drafted for the first priority lender. Upon review, many lenders will even require an amendment to the lease to impose their own preferred SNDA language upon the parties to the lease.

There are a myriad of other provisions that should be of interest to most **buyers** and **current owners** of commercial real estate, among them:

Is the Tenant limited in the manner it could utilize the Premises? Does the Tenant have an exclusive use that no other Tenant on the Premises may share? What parking rights is the Tenant endowed with? What are the Landlord's rights to audit the books of the Tenant for purposes of confirming percentage rent? What occurs in the event the Premises 'go dark'? What happens if the Tenant goes into default? Can the Tenant assign or sublet the Premises? Are there any rent abatements available to the Tenant? Is the Tenant's obligation to pay rent dependent upon another tenant or tenants being open for business?^[1]

Reviewing a complete lease file is often more complicated and time intensive than first meets the eye. There is no substitute for reviewing each and every document contained within the lease file. Important lease provisions are often hidden (sometimes purposely!) within the lease and can be found in unexpected places. Additionally, controlling lease provisions are sometimes found in additional documents or agreements outside the lease, such as amendments, addenda, memoranda, riders, side letters, assignments, confirmations and even unilateral notice letters.

Like much of the due diligence process, lease abstracting can be tedious, painstaking work. Yet, before any decisions are made about the acquisition, management or underwriting of a commercial real estate asset, a complete understanding of the underlying asset should be obtained. Without a detailed and thorough lease review or abstract, such an understanding is difficult to achieve.

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