



## Property Acquisition Due Diligence - Lease Abstracting

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### **ABSTRACTING THOSE LEASES PROFESSIONALLY ... OR ELSE!**

Can you imagine having invested hundreds of thousands, or millions, of dollars in a major commercial real estate property and not knowing exactly what's in all those lease contracts that you'll be inheriting and having to live with for years? Just think of all of those unexpected surprises ... a Tenant Right to Terminate Early being exercised during a cash crunch of yours ... a lease-mandated mid-term Tenant Improvement Allowance a tenant is now asking for ... a period of Free Rent in the initial months of each Lease Year of a tenant's lease ... a lease-mandated return of a tenant's Security Deposit at the start of Year 4 of their term ... and the list goes on and on. It sure would've been a good idea (and a smart one) to have been told of these things and to have prepared for them!

### **Be Forewarned**

Capturing significant future dividends when investing in a commercial property is a main goal for every investor. With that said, one of the most critical components of the acquisition process is the buyer's clear understanding of the leases they will inherit after escrow closes.

Many times this part of the Due Diligence process is not thought through and/or managed well. A buyer typically assigns it to either an expensive attorney or to an overworked property manager who doesn't have time to pay attention to, or the skills to ascertain, the critical details. Attorneys may be expert on what the lease language legally means, but not knowledgeable enough on the relevance of the various lease components to the ongoing operations, administration, and leasing of the property. And busy or "not-so-well trained in the art of lease abstracting" property managers? Well, you'll get what you sign up for!

### **The Solution**

What is needed is a professionally performed abstracting of the commercial real estate leases that details exactly what these leases contain and require. This will have a direct affect on the accuracy of the buyer's purchase price, financial modeling, leasing, and strategic planning for the investment, and ultimately, the property's future success. An investment in this package will help maximize dividends in the future.

A viable, comprehensive, and effective process involves the following steps:

- A *detailed, page-by-page review of copies of all tenant lease documentation* with relevant phrases "highlighted" for easy future reference, and clear and concise pencil notes inserted in the columns identifying "what this means in this case" or "this is how this has been interpreted." These particular copies of the leases should subsequently become the day-to-day working copies in the property manager's lease files.
- The "*abstraction*" or identification and summarization of over 190 relevant lease components, each referenced back to a particular provision in the lease, all on a standardized, 1-page abstract form for each tenant lease. Most company's lease abstracts are multi-page documents that are between 4 and 11 pages long and tend to have certain lease paragraphs re-typed in their entirety (so much for "abstracting"), a method that in fact creates potential errors. Real estate executives and property managers need a quick information source that also directs them back, if needed, to the relevant high lighted provision/page of the lease document itself for further details, not another copy of the lease just written on a different form. Performing such a comprehensive

effort ensures a full understanding during Due Diligence and saves time later on after the acquisition closes.

- The *identification of missing lease documentation* such as pages, exhibits, lease amendments, addendums, etc. With this comprehensive listing, a buyer can inform the seller well in advance of the close of escrow of the missing documents needed for the future operation of the property, thus putting the onus on the seller to ensure the delivery of all lease documentation to the buyer.
- The *compilation of a summary listing of the property's tenants, tenant addresses, security deposit amounts, square footages, and lease commencement and expiration dates.* This report provides the buyer a quick look at, and confirmation of, the total square footage for each of tenant, lease expiration dates, and security deposit amounts so they will be appropriately transferred in escrow.
- The *compilation of a summary listing of the lease options and ticklers for all of the tenants in the property*, including all lease cancellation options, renewal options, expansion options, rights of first refusal/offer, and other important reminder "ticklers." This is probably one of the most important acquisition, and future operations, reports the buyer can get. It enables them to have plenty of advanced notice of important events in order to plan for the appropriate course of action.
- The *review and any needed correction of financial modeling (e.g., Argus runs) assumptions* using the abstracted-in-detail data to verify such items as base rent amounts and steps, expense escalation information and pro rata share percentages, square footages, renewal option rates, etc.

A thorough, accurate, and professionally performed abstracting of the commercial real estate leases during the acquisition Due Diligence process is an exceptional tool for the buyer who needs to be able to quickly understand certain tenant/landlord aspects of the particular real estate asset. Such information provides many benefits including:

- The revelation of not only obvious items such as upcoming lease termination provisions and renewal options, but also of the typically "buried" landlord or tenant special maintenance requirements and differences in current operations versus what is required by the leases.

- The verification and/or correction of purchase price assumptions to better refine the buyer's pricing strategy and their operational and investment strategies for the property.
- The significantly reduced time and effort after the close of escrow to input tenant financial data into the buyer's property management accounting system for monthly rent statement billing purposes, etc.
- Lease abstracts for each tenant that can be easily updated in the future, and actually used at all times as "Executive Summaries" that effectively summarize decision-critical information.

Unfortunately, a not-so-thorough process during the Due Diligence also has its negative consequences including the sudden surprises of unforeseen events that can result in numerous legal battles, the expenditure of additional unbudgeted funds, and more.

The question you as a buyer have to ask yourself here is ... "Am I doing the complete Due Diligence package competently and completely, or am I short-changing the process, and therefore myself and my investment partners?"



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Mickey McClune is the President, Broker, and the Managing Principal of MKC Asset Management, Inc., a Long Beach-based commercial real estate property management firm. As President, Broker, and Managing Principal, Mickey is responsible for all activities of the firm, including new business acquisition, oversight of all property management activities, and the performance of all of the firm's commercial real estate consulting services. He is an experienced commercial real estate property management, asset management, and leasing specialist with an extensive institutional owner and corporate user background.

Mickey began his career in commercial real estate in the early 1980's with the preeminent national real estate firm, LaSalle Partners (now Jones Lang LaSalle), as its General Manager for all of the office and industrial properties that it had acquired in the Los Angeles and Ventura County areas, and as its Asset Manager for various client portfolios in the Western U.S. While at LaSalle, he was recognized for numerous accomplishments both by the company and the commercial real estate industry. In 1993, he left LaSalle to form his own property management company, New America Asset Management Services, where he was the President and the senior partner of this Long Beach-based commercial real estate property management firm. In late 1997, LaSalle acquired NAAMS and its two million square foot management portfolio, and Mickey then served as LaSalle's Regional Vice President for the Southwestern U.S. In 1999, he joined EPS Solutions, a national corporate services consulting firm, as a Director of Real Estate Services. While at EPS Solutions he assisted property owners with their property acquisition due diligences, their properties' annual Operating Expense Escalations, and with the abstracting of their tenant leases, and he assisted tenants by performing over 50 CAM/OE Escalation Audits for them of their landlords' billed rent charges. In 2001, he again formed another commercial real estate property management firm,

MKC Management Services, where he served as CEO and senior partner. Soon thereafter, MKC merged with New York City based Newmark & Company Real Estate and became its California-based Asset Management Group. In mid-2003, Mickey was instrumental in merging Newmark & Company's California-based Asset Management Group's operations into a new start-up entity that then became known as RiverRock Real Estate Group. At RiverRock, Mickey was its Senior Managing Director, where he established all of the firm's property management systems, oversaw selected property management teams, and was responsible for all of the firm's consulting business. In early 2006, Mickey left RiverRock to start MKC Asset Management.

Over the course of his 25+ year career in commercial real estate property management, Mickey has personally managed and leased well over 18 million square feet of commercial office, industrial, and retail space, abstracted over 5,000 leases, performed over 400 annual CAM/OE Escalations for landlords' buildings, saved clients well over \$4 million in cash savings, received four (4) "Management Excellence Awards" from LaSalle Partners, was a LaSalle Partners' "Manager of the Year", and was awarded by BOMA of Greater Los Angeles four (4) "Building of the Year Awards" (in "100,000-250,000 SF" and "Over 500,000 SF" categories) and two (2) "Special Achievement Awards" including one for "Overall Design Improvement".

Prior to entering the real estate industry, Mickey was commissioned as an officer in the United States Air Force and spent 11 years in the USAF and private industry with Hughes Aircraft Company specializing in the business management of major aerospace industry programs.

Mickey has a California Real Estate Broker License, and is RPA and FMA certified by the Building Owners and Managers Institute. He is a past Chairman of the Board and past member of the Executive Committee and Board of Directors of BOMA of Greater Los Angeles, has served on BOMA Orange County's and BOMA California's Executive Committees and Boards of Directors, and on BOMA International's Board of Governors and Strategic Planning Task Force. Mickey graduated from the University of Southern California with a Bachelor of Science degree in Civil Engineering and a Master of Business Administration (MBA) degree.