



## Chasing the true value of a property: Third party real estate due diligence

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Although growth in the overall economy remains sluggish, today's real estate market still provides the opportunity for attractive returns when taking advantage of property valuations. Successful acquisitions and sales depend as always upon a sophisticated combination of accounting, legal, real estate and property management skills, along with an understanding of the specific investment goals for each deal. Experienced investors often use in-house resources to conduct accounting and legal analysis for their real estate valuations. Nonetheless, an independent third-party financial due diligence expert offers important benefits when chasing the true value of a property.

Financial due diligence for commercial real estate depends upon a systematic examination and thorough analysis of the property. The goal is to reduce the uncertainties regarding a property's value and to identify any hidden risks. Financial due diligence permits the buyer to manage any obstacles uncovered in the purchase or sale of a property. But it must be conducted efficiently and effectively to prevent both missed opportunities and potentially catastrophic mistakes. This is especially true when the property has complex or multiple leases that need to be abstracted.

As skilled investors know, lease abstracting serves as the underpinning to real estate financial evaluations, uncovering and explicating the myriad details that ultimately impact upon a property's value. However, abstracts only have utility as investment tools when they are both meticulously accurate and broadly comparative. Independent abstracters will have the experience of abstracting many thousands of leases across a wide variety of property types and sizes. Drawing upon the scope of their background, they are often better equipped to recognize and highlight any lease anomalies, whereas an in-house team, no matter how talented, will generally have a more limited frame of reference to call upon.

### The Due Diligence Window of Opportunity

Timing is another critical area in the process. Investigation and analysis can only begin once a sales contract has been executed, at which point the due diligence window opens; it closes 30 to 60 days later. On average, a lease takes four to seven hours to abstract, which means that a shopping mall with 150 tenants requires 750 hours simply to have its leases abstracted. As the clock ticks down, investigators must also proactively search and synthesize the financial data; conduct and complete a comprehensive review of past statements; project budget, income and expenses; and compare these findings with those provided by the seller. The number of hours required for thorough due diligence can stretch the resources of even the largest in-house support staff, which generally has fixed staffing and resources.

The due diligence process generally separates legal and accounting processes, with attorneys conducting the lease abstracting and accountants providing the financial analysis. This is one option

for evaluating a complex property under the time pressure of the due diligence window, however it has many limitations. When two separate and unrelated entities work on one complex project, a fluid response system of question-and-answer between the two specialized teams can be difficult, if not impossible. This can lead to missed opportunities or increased risks if, for example, discoveries made while abstracting the leases are not rapidly analyzed and then used to further refine the abstracting process.

Many financial due diligence specialists are equipped to offer a full range of real estate valuation services. Ready to perform single property analyses, they are equally equipped to evaluate large and diverse portfolios. To help owners and property managers in the post-acquisition phase, some companies like Real Diligence, LLC, an affiliate of Lakewood, N.J.-based Madison Commercial Real Estate Services (MCRES), also offer complementary services such as CAM reconciliation and lease administration.

Chasing the true value of a commercial real estate property, whether large or small, is a cumbersome, paper-intensive process characterized by arcane technicalities and relentless deadlines. To be effectively and efficiently performed, it depends upon having specialized training, broad experience, careful analysis, flexible resources and meticulous attention to detail. With a growing reserve of assets now poised for acquisition, wise investors are proceeding with caution and with reputable, results-oriented financial due diligence experts at their side.

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