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Author



Robin Russell
Partner, Andrews Kurth, LLP

About Robin Russell

Robin is a fellow in the American College of Bankruptcy. She combines a depth of experience in bankruptcy restructuring and litigation with financial transactions. She has represented banks, institutional lenders and corporate borrowers in commercial loan transactions and debt restructurings and is a frequent speaker on banking, bankruptcy and financial restructuring related topics. Robin received her LL.M. in Banking Law from Boston University and her J.D. from Baylor University.

Five Focus Points for Commercial Lease Due Diligence

Proper assessment of your prospective borrower's future cash flow from rental income involves both a qualitative and quantitative analysis of the underlying leases. A sample "[Lease Abstract Form](#)" is provided to facilitate the compilation of relevant information. Discussed below are five key aspects of a commercial lease which drive this analysis.

The Property

The old adage: "location, location, location" still applies and the significance of rent rates in a specific area cannot be underestimated. Beyond that, has someone inspected the property to determine if it is well maintained and being operated in compliance with zoning ordinances, deed restrictions and environmental laws? Is it owner managed or managed under a property management agreement? Have you seen the agreement to determine if it is managed (or is being used by an equity owner to syphon funds) and what do you know about the manager?

The Interested Parties

Beyond the landlord and tenant, other parties may have rights with respect to the lease. Has the tenant granted its lender a lien on the leasehold and/or superior purchase money liens on tenant improvements? Does that Purchase Money Security Interest (PMSI) lender have a right to receive notice of the tenant's default and an opportunity to cure? Is the lease subordinate to the mortgage? Are there guarantors? Has a bank issued a letter of credit on behalf of the tenant to support the lease? If so, an assignment of the landlord's letter of credit rights is recommended.

The Tenant's Rights

Savvy tenants want maximum flexibility and may have negotiated for renewal, cancellation, contraction, expansion, assignment and/or subletting options, any of which may limit a landlord's options in a changing market. There may be a purchase option or a right of first refusal? A tenant's obligations may also be contingent upon certain "anchor tenants" remaining in place. Seeking an estoppel letter from each tenant should flesh out disputes, if any, between the tenant and landlord. Disputes must be identified and addressed.

The Landlord's Responsibilities

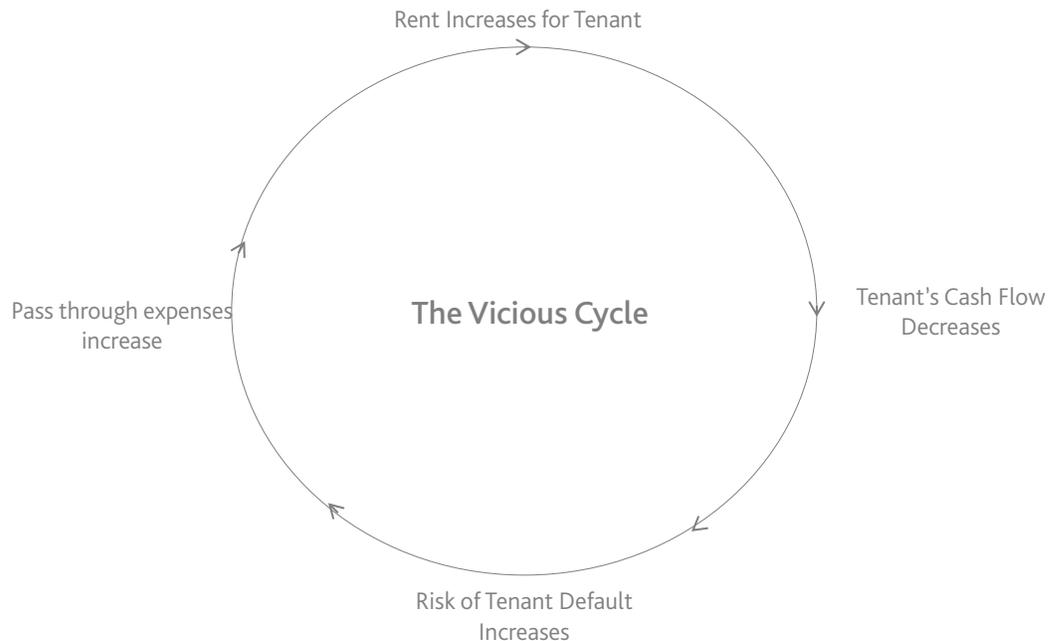
Landlords desperate to rent space may take on numerous responsibilities in addition to standard obligations. Who is responsible for building out the space? Were tenant allowances given? How and for how long do they effect cash flow? What are the maintenance obligations and has the landlord been historically accurate in budgeting for maintenance and capital expenditure?

The Rent Stream and Its Vulnerability

Leases typically are characterized as a gross lease where the landlord pays all expenses (taxes, insurance and common area maintenance (CAM)) or a net lease where the tenant covers all or some of these expenses. Even with a gross lease, certain chargebacks may be allowed in the face of excess consumption of utilities. The CAM is a pro rata allocation based on square footage rented. The so called "Absolute Triple Net Lease" goes so far as to make the tenant responsible for rent even in the face of destruction or condemnation of the building. Do you fully understand the economics of each lease?

Understanding these drivers will allow you to prepare a rental rate sensitivity analysis to stress test the projected income and determine your loan commitment level. The "[Due Diligence Checklist for Commercial Leases](#)" will guide you in the due diligence documents to request and the questions to ask.

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