Due Diligence Analysis – A Key to Successful Property Transactions
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The pre-purchase investigation and evaluation of real property, widely referred to as "due diligence," is a crucial step in a successful acquisition. Depending on the nature of the property and the planned use, the due diligence team may include not only a real estate broker and real estate lawyer but also real estate appraisers, professional engineers, surveyors, architects, accountants, environmental professionals, soil scientists, land planners and, perhaps, other specialists and experts. Team members attempt to find out all relevant facts about the property and then evaluate those facts against the planned uses for the property. The results of that investigation and evaluation drive the "go" or "no go" decision to proceed with the purchase.

Although the investigations follow a standard general pattern, just as each parcel of real estate is different from every other parcel, and perhaps for that reason, the due diligence process for each parcel is a bit different. Investigators need to follow the trail that they develop to increase the chance that all relevant factors are evaluated and all issues addressed.

All of the due diligence investigators should include a visit to the site as part of their work. The site reconnaissance may turn up interesting and important issues. For example, in one shopping center transaction in which I was involved on behalf of the mortgage lender, the survey showed that the property included a 100-foot-wide strip that gave frontage on a public street. It appeared to be the principal access to the center. The site visit revealed that actual access was through an adjacent shopping center; however, the deed to the strip expressly prohibited using it for access or driveway purposes. This strip had been acquired only to satisfy the required minimum frontage on a public street under the zoning regulation. Those facts, in turn, led to a search for easement rights in favor of the center to support the actual exclusive access. The easement documents were then reviewed to confirm that their support of current operations.

However, further research relating to the easement revealed a consent by the shopping center owner to the construction of a bank branch building within the easement area. The location did not interfere with practical access but did interfere with the visibility of the center from the road. The consideration for the consent was a sharing of the rent from the bank branch building. The annual rental amount was enough to make a material difference in the net cash flow from the shopping center. This discovery led to a purchase contract amendment to provide for an assignment of the shared rent in favor of the shopping center's purchaser. This income increment might have been missed but for a comprehensive review of documentation relating to the access easement.

The center included a typical collection of stores and a multiscreen cinema. A large pylon sign used for advertising the movie attractions and identifying the other tenants of the center was located on the adjacent shopping center. Research in the land records showed no easement in favor of the shopping center for maintenance of the sign. As it turned out, the right to place and maintain the sign ran in favor of the entity that operated the theater, which was an affiliate of the entity selling the shopping center. As long as the shopping center and theater operations were owned by affiliates, the arrangement worked. The purchaser of the center was able to negotiate an acceptable arrangement for rights in the sign to satisfy signage obligations under tenant leases and retain and attract tenants.

Fortunately, most deals do not have the same complexities as described above. The lesson from this deal is obvious. If the due diligence had not included a site visit and a comprehensive review and evaluation of the facts revealed against other available information, the buyer of the shopping center (and the mortgage holder) may well have found itself in, to say the least, the awkward and potentially expensive position of being without proper access, without proper signage and without a significant piece of cash flow.

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