

Why Independent Financial Due Diligence Is Critical!

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The large, bold typed disclaimers that adorn the first pages of any major commercial real estate brokerage's offering memorandum makes the case for the absolute necessity of conducting independent financial due diligence. The following quotes are taken verbatim:

“This marketing Brochure has been prepared to provide summary, **unverified** [original emphasis] information to prospective purchasers and to establish only a preliminary level of interest in the subject property.”

“The information contained herein is not a substitute for a thorough due diligence investigation.”

“[Name of National Broker] has not made any investigation, and makes no warranty or representation, with respect to the income or expenses for the subject property.”

“All potential buyers must take appropriate measures to verify all of the information set forth herein.”

Sellers of commercial real estate via their representative brokers compile professional offering memoranda, complete with property description, income and expense data, market comparables, and perhaps even an Argus run demonstrating future cash flow analysis. All this information is bundled into an attractive book or brochure that has but one single purpose: enable the subject property to be sold at the highest price in the shortest amount of time.

Similar to an online dating ad where a suitor puts his or her best foot forward, a seller describes its property in the best possible light. A picture of the property on a sun-drenched afternoon with a full parking lot, optimistic projections about tenant renewals and a hesitancy to highlight depressed market comparables are de rigueur for what is typically found in offering memoranda.

Without stretching the analogy too far, suffice it to say, there are typically more warts and pimples on a property than the offering memorandum depicts. As the disclaimer examples quoted above make clear, these memoranda are not meant to take the place of an exhaustive, independent due diligence exercise. Their job is to sell the property; your job is to know exactly what you are being sold before you buy.

Conducting internal due diligence or outsourcing such work to a trusted and independent specialty company is a critical step in the acquisition process. The analysts reviewing a potential acquisition on behalf of the Purchaser should be objective and have no motivation to portray the financial health of the property to be anything other than what it is.

The due diligence analyst(s) must painstakingly review the property's historical financial statements, projected budget, income and expenses and compare them against the numbers provided by the seller/broker. It is critical to not only validate the numbers offered by the seller but request a series of additional items necessary to paint a complete picture of the property. Such requests are not always immediately forthcoming and the importance of maintaining and following up with such a request list cannot be understated.

It is not the numbers alone that provide complete insight into the financial health of the property. Much information can be learned from ancillary documents, such as invoices, tenant complaint letters, internal memoranda and the like. Sometimes, potential pitfalls can be intuited from what is *not* found within the files – raising legitimate questions and concerns by a knowledgeable analyst.

It is a commitment to detail, comprehensiveness and the desire to “leave no rock unturned” that yields positive results in the due diligence process. The more information that the purchaser has to negotiate the purchase price and make an investment decision – the more likely that decision will be a wise and informed one.. and ultimately lucrative one.