

Appendix D

Due Diligence Checklist (Initial Steps)

1. Summarize key dates based upon the PSA, that is, when escrow commences, when due diligence starts, when due diligence ends, when deposit monies are due and earned, when financing contingency ends, when escrow is scheduled to close, and so forth.
2. Assemble key documentation for review. As set forth in Chapter 7 under the section entitled “Initial Screening,” the following might be a short list of where to get started: current rent roll, leases, income and expenses, existing debt information, ground lease (if applicable).
3. Make a list of key players involved in the purchase and sale process and note their contact information. Include attorneys, sales broker, leasing agent, loan broker, insurance agent (note insurance company, coverage period, and policy number), escrow agent (note escrow number), lender, surveyor, title company (note title order number) and appraiser, along with companies that issue the environmental report, property condition report, seismic report, and so forth.
4. Discuss project with insurance agent.
5. Bid third-party reports, that is, title, Phase I and Phase II (if applicable) property condition report, seismic study, survey, appraisal, and so forth. It’s important to initiate the reports since this is usually the timing stumbling block to closing. Nonetheless, the buyer must be cognizant of the fact that the lender may desire to direct and/or control the third-party reports. Hence, if the selection of the vender is not coordinated with the lender, the result could be costly since a second report may be required.
6. Review seller disclosures, required as part of the PSA, regarding physical or environmental issues concerning the property.
7. Determine if project is in a special hazard zone, for example, flood, earthquake, hurricane, and so forth.
8. Prepare a detailed income and expense financial analysis, preferably using Argus or a similar long-term projection.
9. Coordinate and plan the timing of estoppels. Remember, like the third-party reports, the project lender may want to control the substantive items in the document and have an input into the form used.

Marketing and Leasing Material

1. All leasing material including, without limitation, brochures, promotional flyers, newsletters, and so forth.
2. Site and aerial photographs.
3. Location maps, that is, regional, local, and street maps.
4. Sales comparables.
5. Rent comparables.
6. A copy of any outstanding lease proposals or letters of intent.
7. Visit competitive properties.
8. Determine market vacancy and compare to project.
9. Assess depth of market.
10. For retail projects, determine traffic count and demographic statistics.
11. Identify and understand effect of existing and proposed competitive projects.
12. Determine the closest schools, public parks, public services such as fire, police, and city hall, religious groups, transportation, daycare, and so forth.

Overall Income and Expense Analysis to Review

1. The prior two years' tax returns for the property.
2. CAM reconciliation statements for the past two years.
3. Seller's past two years and current annual projected operating budget.
4. Compare the actual income and expenses to the seller's scheduled or budgeted income and expenses.
5. Complete a 10-year Argus run showing all projected income and expenses including loan costs, reserves, projected downtime, tenant improvements, and free rent. The Argus spreadsheet should reflect net cash flow and the unleveraged and leveraged IRR.

Income Analysis

1. A current rent roll, which should include as much detailed information as possible including, without limitation, each tenant's name, lease term, CAM reimbursement amounts, concessions granted, square footage,

rent per square foot, lease commencement and expiration dates, options, lease type, security deposits, guaranties, cancellation rights, notes covering any unusual provisions, and so forth.

2. Tenant invoices for the past two years.
3. Trailing 12 months as well as prior two years' income.
4. Current year operating budget.
5. Delinquency aging report for past two years and current year and disclosure of any rent prepayments.
6. Schedule of all percentage rent collected for the past two years, if any.
7. For retail tenants, historical sales figures for all tenants contractually obligated to provide such numbers, including all tenants subject to paying percentage rent.

Expense Analysis

1. Trailing 12 months as well as prior two years' expenses.
2. Current year operating budget.
3. Property tax bills for past two years.
4. Utility bills for past two years.
5. Last two years' capital improvements, that is, all major replacements and improvements.
6. A schedule showing all major repairs during the past two years.
7. Past two years' schedule of tenant improvements.
8. Copies of any current insurance policies and bills.
9. Review actual operating expense collections.
10. Determine slippage, if any. What are the reimbursable expenses versus the nonreimbursable expenses?

Lease Analysis

1. A copy of all leases, including any cell site leases and any exhibits, addenda, amendments, or riders thereto, and all guarantees, letters of credit or other credit support documents pertaining thereto.
2. Lease abstracts, if available.
3. Review all leases with a focus on any future monetary concessions that bind the landlord, such as free rent or tenant improvements.
4. Review all leases for any special provisions such as rights to terminate, options to purchase, options to extend, options to expand, rights of first refusal, signage rights, exclusivity rights and operating covenants, death and disability clauses, co-tenancy provisions, "go dark" language, and so forth.
5. Review the leases with a focus on conflicts between tenants and with other documentation, for example, violation of use restrictions or

expansion rights or CC&R or ground lease provisions that conflict with tenant operation practices.

6. A digital copy of the lease form used for new tenants.
7. Tenant interviews.
8. Review the tenants' financial statements and credit reports.
9. Review tenant lease files with a focus on tenant written complaints.
10. Compose a list of security deposits and check against the seller's disclosure.

Third-Party Reports and Other Documentation

1. A copy of all existing third-party reports, for example, appraisals, environmental reports including tests and studies, inspection assessments, environmental audits, environmental insurance policies, monitoring reports, asbestos testing studies, seismic and/or proximate maximum loss (PML) reports, soils reports, water tests, physical condition reports, surveys, topographical studies, engineering reports, any measurement analysis or report calculating the load factor, and so forth.
2. Building plans including, without limitation, mechanical, electrical, plumbing, and elevation plans.
3. As-built floor plans for each floor and each individual suite.
4. Preliminary title report and all items that show in the report.
5. Survey showing all locatable easements and any encroachments.
6. Parking plan showing location and number of parking spaces.
7. All certificates of occupancy and building permits.
8. Any existing inspection reports relating to the project and/or specific equipment located therein, such as air conditioning or electric equipment.
9. Obtain any certificates of occupancy.

Real Property

1. Site plan.
2. Plans and specifications for building and any tenant suites.
3. Floor plans and "as-builts" for any tenant suites.
4. Review signage.

5. The location and capacity of all utilities servicing the property, especially all electrical meters. Verify availability of and determine provider for all utilities and other services such as water, sewer, gas, electric, telephone, Internet, cable, streetlights, police, fire, and trash collection.
6. Note specific attributes depending on the type of property involved, for example, if industrial property, ceiling heights, number and type of loading docks, if retail, shop depth and sales per square foot, if a hotel, the amenity package, and so forth.
7. Make a detailed assessment of any deferred maintenance items.
8. Make a detailed list of any capital improvements needed.
9. Verify square footage and usable versus rentable.
10. Number and type of parking spaces.
11. Check out all code-required items such as ADA compliance. Common problem areas include:
 - a. Path of travel from handicap spaces must comply with code grade requirements.
 - b. Common area bathrooms need a five-foot radius and a grab bar.
 - c. Bathroom counters must comply with handicap height rules.
 - d. Elevators must have brail floor buttons.
12. Review adequacy of parking spaces and code compliance relating thereto.
13. Review Phase I Environmental Assessment. A Phase I study should test for the presence of asbestos if visual observation suggests asbestos might be present. Verify that the project does not have any underground storage tanks, radon, methane gas, or other toxic material. A Phase II Environmental Assessment should be commissioned if recommended in the Phase I study. A Phase II study involves drilling to take soil samples, which are then tested for the presence of hazardous materials.
14. Check out that the project has proper drainage. Verify no water table issues such as seepage into ground floor suites.
15. Verify no leakage problem from the roof, decks, balconies, and so forth.
16. Review any warranties made by the seller relating to the physical condition of the property.
17. Hire consultant(s) or use in-house staff to check out all major property areas such as:
 - Parking lot condition
 - Roof condition
 - HVAC system
 - Structural integrity
 - Exterior skin, that is, masonry and/or glass
 - Exterior painting
 - Landscaping, especially automatic sprinkler system

- Elevators
- Electrical system
- Plumbing
- Interior sprinkler system
- Back-up generators
- Lighting
- Floor coverings
- Ceiling condition including ceiling tiles
- Common area bathrooms

Personal Property

1. Obtain a list from seller of all tangible and intangible personal property.
2. Compare the seller's list of all tangible and intangible personal property owned by the seller and used in connection with the property with the buyer's understanding of the personal property to be acquired.

Service and Other Contracts

1. All vendor contracts, that is, service or maintenance contracts used in connection with the ownership, operation, or maintenance of the property. These contracts typically cover janitorial services, HVAC maintenance, pest control, landscaping, trash removal, security, day porter, parking lot sweeping service, fire-life-safety issues including fire alarm and fire sprinkler matters.
2. Obtain any warranties relating to the project, such as roofing warranties.
3. Review or create a property management contract.
4. Review parking agreement.
5. Review any vending machine or telephone contracts.

Financing

1. A disclosure as to the outstanding loan balance on any debt ("debt stack"), the current interest rate, amortization, maturity date, and whether or not the loan may be prepaid. If the loan cannot be paid off, when is a repayment permissible and what is the defeasance penalty, if applicable?

2. A demand statement from the lender and/or an authorization from the seller allowing the buyer to verify the loan data directly with the financial institution that holds the paper. It is prudent to confirm the loan disclosures made by the seller.
3. A copy of a recent bill and receipt is helpful since it contains the loan number and the contact information for the loan-servicing department.
4. A copy of all loan documents including, without limitation, the promissory note, deed of trust, loan agreement, environmental indemnities, guaranties, capital reserve agreement, holdback agreement, tenant improvement and leasing commission reserve agreement, and so forth.

Legal Material

1. Letter of Intent.
2. Purchase and Sale Agreement.
3. Buyer's formation documentation, that is, limited partnership or operating agreement, certificate of authority for execution, certificate of good standing, and so forth.
4. Assignment of PSA.
5. Documentation relating to transfer, that is, deed or assignment if a leasehold estate.
6. Bill of sale for the personal property.
7. Review of preliminary title policy and survey.
8. Review of any underlying documents to preliminary title policy such as easements and reciprocal easement agreements (REA). All locatable easements should be plotted.
9. Review final title commitment.
10. Review survey.
11. Review of any ground lease.
12. Review zoning and zoning compliance letter.
13. Review of loan documents.
14. Legal opinion letter relating to loan documents.
15. Review any association documents.
16. Review estoppel certificates and compare to rent roll and financial analysis.
17. Review any pending litigation including any evictions and any counterclaims made against the seller.
18. Review any required regulatory approvals such as zoning changes, conditional use permits, or other needed variances.
19. Review escrow closing statement.

Miscellaneous

1. Copies of any citations from any governmental agencies.
2. Copies of any mechanics liens.
3. Copies of all tenant insurance certificates.
4. A schedule specifying all insurance claims made by the seller with respect to the property during the last two years.
5. Any land use applications and minutes of governmental agencies relating thereto.

Pre-Closing

1. Determine location and time for execution of loan documents.
2. Coordinate changing utility billing name and address. Address utility deposit requirements.
3. Verify hazard insurance is in place.
4. Buyer to review closing settlement statement. Verify accuracy of prorations and charges. Escrow will typically prorate rents, service contracts, taxes, and insurance. Look over title charges. Are the lender's fee and interest charges accurate? Buyer to receive credit for security deposits and buyer's deposits plus interest thereon.
5. Change telephone service to new owner's number, for example, emergency telephone in elevators.

Post-Closing

1. Scan important documents such as leases and loan documents.
2. Complete lease abstracts. It is helpful for lease abstracts to indicate tenant contacts with office and cell numbers and e-mail address.
3. Deliver and/or give property manager access to all-important documents, including (usually) hard copy of leases.
4. Deliver leases and lease abstracts to accounting for imputing into system.
5. Send final closing statement to the accounting department.
6. Property manager to check accounting imputing to verify accuracy.
7. Joint letter from seller and buyer advising tenants of change of ownership and new billing address and contact information.
8. Property manager to interview and enter into service contracts for the

needed maintenance services, for example, janitorial, day porter, landscaping, HVAC, elevator, and telephone.

9. Transfer any warranties to new owner's name.

10. Pay any outstanding due diligence invoices.