

# DUE DILIGENCE

<b>Reference:</b>	ANZVGP 206 – Due Diligence
<b>Published Date:</b>	25 June 2021
<b>Effective Date:</b>	1 July 2021
<b>Owner:</b>	Manager Professional Standards

## TABLE OF CONTENTS

1.0	Introduction .....	1
1.1	Scope of this Guidance Paper .....	1
1.2	Status of Guidance Paper .....	1
1.3	Comprehensive and Probing Investigation .....	1
1.4	Numerous Issues .....a checklist.....	1
1.5	Necessity of Engaging a Team of Experts .....	1
1.6	Advice on Changes to the Law .....	2
2.0	Valuation .....	2
2.1	General .....	2
2.2	Importance of Establishing Value .....	2
2.3	Appoint a Valuer to establish Market Value. ....	2
2.4	Forced Sale Price .....	2
2.5	Valuation Methodologies .....	2
2.6	Contents of Valuation Report .....	4
2.6.1	Location of the property .....	4
2.6.2	Site description and services .....	4
2.6.3	Town planning/Resource Management.....	5
2.6.4	Improvements .....	5
2.6.5	Environmental Issues .....	5
2.7	Market Overview .....	6
2.7.1	Valuation Approach.....	6
2.7.2	Valuation .....	6
3.0	Structure .....	6
3.1	General .....	6
3.2	Engage Structural Engineer and others .....	6
3.3	Co-ordination of Reports into one.....	6
3.4	Due Diligence Process.....	7
3.4.1	Building Code Compliance .....	7
3.4.2	Inspection of Property .....	7
3.4.3	Design Criteria .....	7
3.4.4	Durability .....	7
3.4.5	Serviceability .....	7
3.4.6	Wear and Tear .....	7

3.4.7	Exterior of Building .....	8
3.4.8	Building Interior .....	8
3.4.9	Occupational Health and Safety .....	8
4.0	Mechanical & Electrical Condition .....	8
4.1	General .....	8
4.2	Condition of Building Services .....	8
4.3	Mechanical and Electrical Engineer .....	8
4.4	Report on Compliance and Cost to Upgrade .....	9
4.5	Other Specialists May be Required .....	9
4.6	Due Diligence Process .....	9
4.6.1	Inspection of Property .....	9
4.6.2	Design Criteria - report on issues such as:- .....	10
4.6.3	Operation and Maintenance .....	10
5.0	Legal Due Diligence .....	11
5.1	General .....	11
5.2	Ownership Structures .....	11
5.3	Joint Ownership .....	11
5.4	Importance of Accountants' and Solicitors' Advice .....	11
5.5	Determining Ownership Vehicle .....	11
5.6	Types of Title .....	12
5.7	Planning Controls / Resource Management .....	13
5.8	Value Affected by Town Planning .....	13
5.9	Use Regulated by Planning Controls .....	13
5.9.1	Issues Affecting Development Potential .....	14
5.10	Copy of Development Approval .....	14
5.10.1	Foreign Investment Review Board (Australia) .....	14
5.10.2	Overseas Investment Office (New Zealand) .....	15
6.0	Taxation Issues .....	16
6.1	General .....	16
6.2	Specific Tax Issues .....	16
6.3	Acquiring Property .....	16
7.0	Stamp Duty (Australia) .....	16
7.1	General .....	16
7.2	Due Diligence Issues .....	16
8.0	Locational Influences .....	17

8.1	Location Considerations .....	17
8.2	Office Buildings .....	17
8.3	Industrial Buildings.....	17
8.3.1	Retail Shopping Centres .....	18
9.0	Design Influences .....	18
9.1	Design Considerations.....	18
9.2	Office Buildings .....	18
9.3	Industrial Buildings.....	19
9.4	Retail Shopping Centres.....	19
10.0	Leases .....	19
10.1	General / Legal Issues.....	19
10.2	Tax Issues.....	21
11.0	Contamination – Environmental Audit.....	21
12.0	General .....	21
12.1	Consider the managerial styles that may be used for a property, for example: .....	22
13.0	Effective Date .....	22
14.0	Annexure 1- Suggested Due Diligence Check List.....	23

## **Guidance Papers**

### **Objectives**

The principal objective of a Guidance Paper (GP) and Resource Pack (if applicable) is to clarify professional and industry processes, best practices, and procedures and to discuss their use and implementation.

A GP is designed to be of assistance to Members and those who use Members' services. They serve as a guide and measure of acceptable professional practice and conduct of a Member.

The intention of a GP is to:

- a) provide information on the characteristics of different types of assets that are relevant to the advice.
- b) provide information on appropriate practices and their application.
- c) provide information that assists Members in exercising the judgements they are required to make in specific situations.
- d) convey elements of what is considered "competent professional practice" for Australian Property Institute (API) Members and "best practice" for Property Institute of New Zealand (PINZ) Members.

A GP is not intended to provide comprehensive training, instruction or prescriptive practices and procedures, or direct that a process, professional approach, or method should or should not be used in any specific instruction or situation.

### **Member Obligations**

The Member is responsible for choosing the most appropriate approach in a matter based upon the task and instruction. It is a matter for each Member to decide the appropriate practice in any situation, and if they are unclear, seek professional advice from others, or contact the Institute(s). Members have the responsibility of deciding when it is appropriate to depart from the guidance and practices contained in a GP.

The Institute(s) do not warrant that anything contained in this, or any GP is the definitive or final statement on any issue. Members must perform their own work pursuant to their own professional expertise and experience and if required, seek additional advice which might include legal advice.

### **Court or Tribunal Reliance**

A court or tribunal may consider the contents of any relevant GP or other document relating to a recommended professional practice published by Institute(s) in deciding whether the member acted to a standard required by law.

### **Currency of Publication**

Case law and relevant legislation may change over time and whilst the Institutes(s) consider this GP current at the time of publication, Members and those who use Members' services should have regard to legislative changes and new rulings and if necessary, seek further advice prior to having regard to this GP.

### **Departure or Non-Compliance**

Where a Member considers that a circumstance exists that warrants the departure from or non-compliance with any of this GP, the Member's report (or other advice) must include a statement that outlines:

- (a) the reasons for the departure or non-compliance with this GP; and
- (b) any impact the Members departure or non-compliance may have on the content of the report.

Members are advised to seek legal and/or other advice before departing from practice recommended in a GP.

### **Enquiries**

If any Member considers any information or advice in this GP to not be accurate or up to date, or wish to raise any issue for consideration arising from the contents of this GP, please refer this to

API contact: [standards@api.org.au](mailto:standards@api.org.au)

PINZ contact: [standards@property.org.nz](mailto:standards@property.org.nz).

## **1.0 Introduction**

### **1.1 Scope of this Guidance Paper**

This Guidance Paper is to provide a guide to Members as to the due diligence process which a prudent purchaser would undertake prior to entering into a contractual obligation to acquire a commercial property.

### **1.2 Status of Guidance Paper**

Guidance Papers are intended to embody recognised 'good practice' and therefore may (although this should not be assumed) provide some professional support if properly applied. While they are not mandatory, it is likely that they will serve as a comparative measure of the level of performance of a Member. They are an integral part of the Valuation and Property Standards Manual.

### **1.3 Comprehensive and Probing Investigation**

These guidelines are intended to provide a guide to the due diligence review process which a prudent purchaser would undertake prior to entering a contractual obligation to acquire commercial property. There is no single definition of "due diligence", although the expression is now in common usage, particularly in relation to securities law where a specific due diligence defence is available to directors of companies in certain circumstances. In general terms, however, a due diligence exercise is taken to involve the type of comprehensive and probing investigation which a prudent adviser would bring to bear on the matter in question.

### **1.4 Numerous Issues .....a checklist**

These guidelines also aim to alert interested parties to the numerous issues which ought to be examined and addressed to ensure that such parties are fully informed regarding the attributes of a particular property, and the risks associated with a proposed transaction.

Whilst we have aimed to make the guidelines as comprehensive as possible, they have been drafted to provide no more than a checklist of points and issues which ought to be considered in a property transaction. (A checklist is included as Annexure 1).

### **1.5 Necessity of Engaging a Team of Experts**

It is not intended that these guidelines provide a do-it-yourself checklist for property investors and other relevant parties. Indeed, the numerous issues set out in this document should alert users of the guidelines to the necessity of engaging a team of qualified professionals to undertake the due diligence review. This team may include experts such as valuers, land economists, structural engineers, consulting engineers, solicitors, architects, financial and taxation consultants, quantity surveyors, urban consultants, etc.

## **1.6 Advice on Changes to the Law**

Though efforts are made to keep guidance notes current, advice should be obtained regarding any changes to the law and practice in more recent times.

## **2.0 Valuation**

### **2.1 General**

Advice that may be obtained from a Valuer or Member could include following matters.

### **2.2 Importance of Establishing Value**

Any purchaser of property must, of necessity, form a view as to what the particular property is worth. Ultimately, one's assessment of value will be a key factor in determining how much to pay for a property or an interest in property and, from the point of view of a vendor, how much to accept for the sale of a property. Equally, the value of a property will be of critical importance to a lender who proposes to advance money against the security of a property. Valuations may also be required for the purposes of financial statements, for insurance purposes, and to assist in analysing investment performance.

### **2.3 Appoint a Valuer to establish Market Value.**

[Definitions - Market Value]

To obtain an expert and impartial assessment of the value of a property, a suitably qualified, experienced and (where required) registered or licensed valuer (being a Member of the Institute) should be appointed to prepare a valuation of the property on an appropriate basis. Usually, this will involve an assessment of the property's "Market Value" which is defined by the International Valuation Standards

(whose definition has been adopted by the API and PINZ).

### **2.4 Forced Sale Price**

On occasions, a valuation report may include advice concerning the price that might be achieved for a property in the circumstances of a forced sale. Similarly, an assessment of the replacement cost of a property may sometimes be required.

### **2.5 Valuation Methodologies**

There are several valuation methodologies which may be used in assessing the value of a property, and different methodologies may often produce different outcomes. It will often be appropriate for more than one methodology to be considered, and a valuer needs to form a view as to which method or methods best suit the particular property. Methodologies commonly used in valuing a property are:

- (a) comparable sales - points to be considered in relation to both the subject property and comparables include:
  - location
  - size and type of the property
  - lease and tenancy characteristics
  - rental income



- outgoings
  - age and condition of the property and building services.
  - potential for rental growth / redevelopment
- (b) capitalisation of income (market and / or passing rents) - points to be considered include:
- comparable sales evidence
  - alternate investments
  - rental received / rental growth potential / market rental levels.
  - lease terms
  - types of tenants / financial strength
  - type of ownership - freehold or leasehold
  - supply and demand
  - economic factors / inflation rate / bond yields
  - supply and demand
- (c) discounted cash flow / target internal rate of return - assumptions need to be made regarding:
- required discount or target rate.
  - rental income / future rental predictions.
  - covenant of the tenant(s).
  - taxation / capital gains.
  - Outgoings.
  - Inflation.
  - exit capitalisation rates.
  - terminal value.
  - forecast period.
- (d) hypothetical development (for development sites) - assumptions need to be made regarding:
- best permitted development for the site.
  - time required to obtain approvals, develop, and lease.
  - development cost.
  - future rental income.
  - initial yield.
  - development profit.

- valuation on completion of development.
- (e) summation method (direct comparison) - points to be considered include:
- land value rate.
  - building value rate.
  - comparable sales evidence.

(Note: Care should be taken with the use of this method in relation to properties with investment potential).

## **2.6 Contents of Valuation Report**

Although the contents of a valuation report will vary depending on the type of property and the purpose of the valuation a valuation will need to address the points listed below:

- (a) Basis of valuation
- i) Market Value.
  - ii) forced sale.
  - iii) replacement cost.
- (b) Land and title
- i) title reference.
  - ii) name of the registered proprietor(s).
  - iii) identification of encumbrances such as easements.
  - iv) covenants etc.
  - v) identification of registered leases.

### **2.6.1 Location of the property**

- (a) description of location.
- (b) commentary on access / public transportation.
- (c) proximity to major commercial / retail centres.
- (d) special features such as views, adjoining developments.
- (e) Demographics.

### **2.6.2 Site description and services**

- (a) land dimensions and area.
- (b) site accessibility.
- (c) Services.
- (d) site problems, ie. drainage, potential flooding, apparent contamination, soil characteristics, etc.

### **2.6.3 Town planning/Resource Management**

- (a) current zoning (including restrictions which may affect future potential of the property).
- (b) extent to which use constitutes a non- conforming use.
- (c) proposed amendments to planning scheme.
- (d) development codes, site ratios, development guidelines.
- (e) transferable floor area issues.

### **2.6.4 Improvements**

- (a) description of improvements and materials used in construction including, structure, floors, service core, walls, roof.
- (b) description of internal finish including, wall finishes, ceiling finishes, floor finishes, doors.
- (c) description of general accommodation including, toilet facilities, tea rooms etc.
- (d) commentary on age and condition of improvements and building services including, air conditioning, lifts, fire services, security system, backup power supplies.
- (e) analysis of net lettable area.
- (f) compliance with current building regulations.

### **2.6.5 Environmental Issues**

#### Tenancy details

- (a) description of all leases, licenses and agreements including commencement date, name of lessee / licensee, demised premises, term / options, current rental, rent reviews, lessee's obligations etc.
- (b) commentary as to whether leases have been executed.
- (c) comparison of actual rentals and market rentals.
- (d) consideration of current and potential future vacancy levels including timing and costs of re-letting premises.
- (e) consideration of impact of future rent reviews.
- (f) commentary on rental arrears.
- (g) review of outgoings.
- (h) commentary on financial strength of tenants.
- (i) detail current incentives / financial obligation to tenants (ie. carpet, painting, fit out etc).

## **2.7 Market Overview**

- (a) general market overview (including legal, political, economic).
- (b) overview of specific region in which property is located.
- (c) both overviews would usually address factors including;
  - i) demand and supply.
  - ii) vacancy factors.
  - iii) rental movements.
  - iv) demographics / population growth.
  - v) any other trends in the market.

### **2.7.1 Valuation Approach**

- (a) rationale behind method or methods of valuation.
- (b) details of comparable sales and other market evidence.
- (c) reconciliation of the various valuation approaches.

### **2.7.2 Valuation**

- (a) valuation amount and date.
- (b) note qualifications, assumptions and disclaimers.

## **3.0 Structure**

### **3.1 General**

Professional advice should be obtained on any structure.

### **3.2 Engage Structural Engineer and others**

A Structural Engineer should be engaged to examine and report on the structural condition of the property. It may be appropriate for a structural engineer to be engaged together with other specialist engineering disciplines and / or, depending on the nature of the building, also an architect. For example, on a high rise building with a curtain wall facade, there would normally be a need for an architect with specialist ability in this technology to work with the structural engineer. Clearly, the types of report required will vary, depending on the size and nature of the subject property.

### **3.3 Co-ordination of Reports into one**

Where a building is significant, it may be advisable for an architect to co-ordinate all the reports from the various engineers into one "Condition Report". This report should not only identify problem areas, but also provide an indication of the cost to rectify and when rectification will be required.

### **3.4 Due Diligence Process**

The Due Diligence process should involve: Review of documentation including:

- (a) as built architectural drawings.
- (b) structural drawings.
- (c) structural calculations.
- (d) geotechnical report.
- (e) other specialist reports such as wind engineering, facade testing.
- (f) shop drawings, particularly of performance specified facades.
- (g) construction quality control reports.
- (h) any reports on building problems.
- (i) Warranties.

#### **3.4.1 Building Code Compliance**

- (a) Advise on whether the structure meets relevant building code or other legislation as well as cost to upgrade the building to comply (if viable).

#### **3.4.2 Inspection of Property**

- (a) Inspect together with building superintendent (or other person familiar with maintenance of the building).
- (b) Obtain information regarding problem areas, maintenance program, any major maintenance items (i.e. roofing replacement) etc.
- (c) Inspection of tenant fit outs - do fit outs comply with statutory requirements?
- (d) Talk to occupants.

#### **3.4.3 Design Criteria**

- (a) Review basic design loads for different parts of the building.
- (b) Examine how design loads relate to codes and industry standards, including floor live loads, wind loads and earthquake loading.

#### **3.4.4 Durability**

- (a) Report on durability problems, such as rust staining, spalling of the surfaces, and comment on implications and reparability.
- (b) Comment on any potential durability problems having regard to specification of the materials and known general industry practices at the time of construction.

#### **3.4.5 Serviceability**

- (a) Examine performance of structures in delivering and maintaining a flat floor.
- (b) Consider necessity for confirmation survey to respond to signs of lack of flatness.

#### **3.4.6 Wear and Tear**

- (a) Itemise all items of defect in the structure, floor and wall finishes, and comment on reparability.

### **3.4.7 Exterior of Building**

- (a) Review all exterior coverings.
- (b) Report on condition of the roof and sealants.
- (c) Report on availability of a building maintenance unit (BMU).
- (d) Inspection of facade using BMU.
- (e) Consider water penetration from all exterior surfaces, both above and below ground.

### **3.4.8 Building Interior**

- (a) Report on finishes on the interior of the building.
- (b) Note presence of cracks in floor or wall finishes, delamination of cladding, poor performance of joint filling materials, condition of tiles in bathrooms, floors and walls, presence of cracks in masonry walls and the like.

### **3.4.9 Occupational Health and Safety**

- (a) Asbestos survey.

## **4.0 Mechanical & Electrical Condition**

### **4.1 General**

The quality of building services is becoming an increasingly important influence in the value of a property.

### **4.2 Condition of Building Services**

The condition of building services is an important factor to be evaluated by a purchaser of property, as it will affect the demand for rental space and the operational costs of the building, with a flow-on impact on the value of the property. Indeed, the quality of the building services is becoming an increasingly important influence in the value of a property, as tenants begin to appreciate the benefits of a “smart” building in terms of productivity and flexibility.

### **4.3 Mechanical and Electrical Engineer**

A mechanical and electrical engineer should be engaged to report on the status of the systems within a building, such as:

- (a) heating, ventilating and air conditioning systems.
- (b) electrical systems.
- (c) fire protection systems.
- (d) Hydraulics.
- (e) Lifts.
- (f) Communication.

- (g) security systems.

#### **4.4 Report on Compliance and Cost to Upgrade**

The report should include advice as to the extent of compliance with current regulations and cost to upgrade to comply if systems are currently inadequate.

#### **4.5 Other Specialists May be Required.**

It may be appropriate for other specialists, such as architects, quantity surveyors or building regulation specialists, to also be engaged to report on these systems.

#### **4.6 Due Diligence Process**

The Due Diligence process should involve: Review of documentation including:

- (a) architectural drawings
- (b) design drawings for each discipline:
  - i) heating, ventilating and air conditioning.
  - ii) Electrical.
  - iii) fire protection.
  - iv) Hydraulics.
  - v) Lifts.
  - vi) Communications.
  - vii) security systems.
- (c) specifications for each of the above disciplines.
- (d) as built drawings for the above disciplines.
- (e) maintenance manuals.
- (f) maintenance reports and logs.
- (g) information in relation to building outgoings.

##### **4.6.1 Inspection of Property**

- (a) Inspect property together with building superintendent or other party with experience with the operation of the systems in the building and understanding the maintenance trends.
- (b) Talk to occupants.

#### **4.6.2 Design Criteria - report on issues such as:-**

- (a) air conditioning and heat loads (and after-hours capabilities).
- (b) power requirements.
- (c) air filtration.
- (d) location and maintenance of cooling towers.
- (e) life safety systems including sprinkler systems, ventilation for smoke removal, location of firefighting devices.
- (f) flexibility to meet tenants' requirements Installation - inspect the installation to ascertain.

consistency between the design and what has been installed

- (g) quality of the installation works.
- (h) simplicity of servicing the systems.
- (i) years of operation.
- (j) life expectancy (if appropriate, report on replacement costs or costs of remedial works).

#### **4.6.3 Operation and Maintenance**

- (a) Review of as built drawings and maintenance manuals to determine how well maintenance and operation has been carried out.
- (b) Inspection of maintenance records and logs to ensure there has been regular systematic maintenance of the various systems.
- (c) Inspection of records relating to maintenance of fire protection items, e.g. extinguishers, hose reels, fire panels, evacuation systems, etc.
- (d) Summary of maintenance contracts and standard of service.



## **5.0 Legal Due Diligence**

### **5.1 General**

The legal aspect of the due diligence process calls for a consideration of the issues relevant to ownership of the property including the ownership structure, the nature of the title and the various matters that impact on use, enjoyment, and value. In the case of properties which are leased, the legal due diligence process also calls for a detailed review of the lease or leases. Expert legal advice should be obtained in each case. (Note: Legislation relating to property varies from State to State).

### **5.2 Ownership Structures**

The following ownership matters should be considered:

Apart from ownership by an individual in his or her own name, there are basically four legal structures that may be used for property ownership, being: -

- (a) Company.
- (b) trust (unit or discretionary).
- (c) Partnership.
- (d) joint venture (incorporated or unincorporated).

### **5.3 Joint Ownership**

In addition, where interests are being acquired jointly by two or more parties, consideration needs to be given as to whether the owners should be "joint tenants" or "tenants in common".

### **5.4 Importance of Accountants' and Solicitors' Advice**

The selection of the wrong ownership structure is likely to have serious implications in terms of the taxation treatment of the investment and costs involved in rectifying the situation may be prohibitive with the likely imposition of stamp duty on the transaction. Accordingly, it is extremely important that advice is obtained from accountants or solicitors regarding the most appropriate ownership vehicle.

### **5.5 Determining Ownership Vehicle**

In determining the property ownership vehicle, regard should be had to the following: -

- (a) income tax.
- (b) capital gains tax (Australia).
- (c) ability to utilise income and capital losses.
- (d) stamp duty (Australia).
- (e) transferability of shares / units.
- (f) proposed level of borrowings.
- (g) administration and management.
- (h) liability of the beneficial owners.
- (i) the number and type of beneficial owners.

## 5.6 Types of Title

There are basically four types of title, each of which is briefly described below. When acquiring a leasehold interest, particular care needs to

be paid to the terms and conditions affecting the leasehold, including the term of the lease, restrictions on the use of the property, rights to purchase etc.

*Torrens* - This is the modern system of title where a certificate of title issues in the name of the registered proprietor showing all registered interests. This category includes units in "strata" developments.

*General / Old System/Law Title* – In Australia, this is the common law system which was in place before the adoption of the Torrens system by the various States. Pockets of it remain today. A feature

of this system is that "title" is actually a chain of documents tracing ownership backwards from the present owner to either the original Crown Grant or at least to a good "root of title" which, in most jurisdictions, must be at least 30 years old.

*Crown Leasehold* – In Australia, this interest is derived from a lease with the Crown which traditionally will be for a long term. The interest may include a right of purchase on the lessee - usually conditional upon the lessee carrying out certain improvements. Since the Wik decision, leasehold interests which do not give exclusive occupancy, are potentially vulnerable to Native Title claims. It should be ascertained:

- (a) whether a claim has been lodged with the NNTT, and/or determined.
- (b) whether it is likely a claim will be forthcoming from potential native title holders.
- (c) what the effect of the above is on the activities currently carried out under the lease.

Crown Land - Vacant Crown Land is also potentially open to a Native Title claim in Australia and Waitangi Treaty claim in New Zealand. Similar inquiries to the first two points above should be made.

Leasehold - This is the interest that every lessee acquires whether under a head lease, sub-lease, ground lease, riverbed lease etc.

### Matters Affecting Title and Purchase Price

The following matters should be considered for their effect on Title and Purchase Price:

- (a) Occupation / title boundaries (site survey to determine horizontal and vertical encroachments)
- (b) Mortgages and charges.
- (c) Unpaid rates and taxes.
- (d) Restrictive covenants.
- (e) Easements (expressed and implied).
- (f) State Planning Agreements.
- (g) Caveats.
- (h) Sewers and drains.
- (i) Rules of body corporate (where applicable).
- (j) Leases.

- (k) Confirm lettable floor areas (by reference to an accepted method of measurement eg. Property Council of Australia or PCNZ/PINZ).
- (l) Planning status (including rezoning ability, future roads, future flight path, proximity to heritage buildings).
- (m) Heritage status.
- (n) Unauthorised structures.
- (o) Non-compliance with Building Regulations.
- (p) Certificate of Occupancy and classification.
- (q) Flood levels.
- (r) Notices relating to planning/building matters.
- (s) Contamination and hazardous building materials (refer API and PINZ guidance papers relating to contaminated land).
- (t) Retail tenancy legislation.
- (u) Notices of resumption.
- (v) Quarantine orders (in relation to farmland).
- (w) Filling.
- (x) Fencing notices.
- (y) Currency of defects rectification rights and plant warranties.
- (z) Vegetation protection.

## **5.7 Planning Controls / Resource Management**

Town Planning matters should be examined.

## **5.8 Value Affected by Town Planning**

The value of a property will be directly affected by the town planning/resource management regulations which relate to that property, particularly in so far as those regulations constrain the development potential of the property. Where it is intended that a property be acquired for the purposes of redevelopment, it is extremely important that detailed inquiries be made to ascertain the planning controls which apply to the particular property by legislation, lease control or some other method.

## **5.9 Use Regulated by Planning Controls**

The use to which a property may be put is regulated by the planning controls. The status of a property may vary as follows:

- (a) use as of right - permit not required.
- (b) entitlement to permit if premises meet specified requirements.
- (c) entitlement to permit if specified conditions satisfied.
- (d) prohibited use.
- (e) non-conforming use.

- (f) amendment of the planning scheme required.

### **5.9.1 Issues Affecting Development Potential**

There are numerous planning issues which may affect development potential. These include:

- (a) zoning i.e. residential (ranging from single family to high density dwelling), business, industrial, rural.
- (b) height controls.
- (c) floor space ratio.
- (d) transfer of plot ratio.
- (e) Setback.
- (f) Overshadowing.
- (g) loss of views.
- (h) traffic generation.
- (i) sight lines.
- (j) car parking ratios.
- (k) access to the property (proposed road works, traffic islands, restricted highways etc).
- (l) minimum frontages / lot sizes.
- (m) density controls / number of employees.
- (n) approvals (adjoining owners, cash in lieu payments).
- (o) heritage / conservation issues.
- (p) Aboriginal interests / claims.

### **5.10 Copy of Development Approval**

A copy of the original development approval should be obtained to ensure that the building complies.

#### **5.10.1 Foreign Investment Review Board (Australia).**

The need for certain proposed real estate acquisitions by foreign interests to be examined by the Foreign Investment Review Board should be considered.

The Foreign Acquisitions and Takeovers Act 1975 is a federal statute regulating foreign investment in Australia. Under the terms of this Act, all proposed real estate acquisitions by foreign interests must be submitted to the Foreign Investment Review Board ("FIRB") for examination, unless the acquisition falls within a specific exemption category.

The Foreign Acquisitions and Takeovers Act defines a foreign interest as: -

- (a) a natural person not ordinarily resident in Australia; and
- (b) any corporation, business, or trust in which there is a holding of 15% or more by a single non-resident person or foreign corporation or holdings of 40% or more in aggregate by two or more non-resident persons or foreign corporations.

The exemptions to the requirement for obtaining FIRB approval are set out in the Foreign Acquisitions and Takeovers Regulations and include: -

- (a) Acquisitions of an interest in land on which a dwelling will be constructed where the treasurer has certified that the sale of the interest to foreign persons is not contrary to the national interests (usually conditional on an undertaking from the developer that no more than one half of the units in any
- (b) development will be sold to foreign interests).
- (c) Acquisitions of industrial or commercial real estate that are wholly and directly incidental to the conduct of the business of the foreign interests.
- (d) Acquisition of direct interest in non-residential commercial real estate with a value of less than \$5 million.
- (e) Acquisitions of residential real estate by intending migrants who have received approval to take up permanent residence in Australia.
- (f) Acquisitions of interest in timeshare schemes where the entitlement of the foreign interest is less than four weeks per year.

#### **5.10.2 Overseas Investment Office (New Zealand)**

In New Zealand, the need for certain proposed real estate acquisitions by foreign interests to be examined by the Overseas Investment Office, should be considered.

(Note: Both the legislation and rules relating to foreign acquisitions are subject to change)

## **6.0 Taxation Issues**

### **6.1 General**

Commercial investment properties are generally acquired for the specific purpose of providing short- or long-term income and capital growth. Prima facie, both income and capital gains are subject to taxation in Australia, and this may significantly alter the after-tax rate of return of a particular investment. In New Zealand there is currently no capital gains tax. Both the vehicle, which is used to acquire a property and the way an acquisition is structured and financed may have a significant bearing on the tax effectiveness of the investment, and it is therefore extremely important that expert tax advice is sought prior to entering into a property transaction.

### **6.2 Specific Tax Issues**

A range of specific Tax Issues affecting various processes in dealing with property should be examined.

### **6.3 Acquiring Property**

Tax Issues on Acquiring Property:

- (a) Ascertain tax depreciable value on purchase of plant and equipment and building.
- (b) Determine appropriate allocation of total consideration to plant and equipment (depreciable items should be listed in the contract)
- (c) Application of depreciation deeming provisions to transfers of plant and equipment between parties not dealing at arm's length.
- (d) Determination as to whether properties constitute trading stock.
- (e) Determination as to whether properties constitute revenue or capital assets.

## **7.0 Stamp Duty (Australia)**

### **7.1 General**

In any property acquisition in Australia, stamp duty is likely to represent a material cost to the purchaser and should be considered when evaluating the returns from the property. Stamp duty is levied on legal instruments and, in relation to property conveyancing, will generally be payable on a sliding scale based on the value of the property. (Note: The rate of duty may vary from State to State.) Stamp duty is also payable on leases (being a percentage of the rental payable during the term of the lease) and on loan securities.

### **7.2 Due Diligence Issues**

Issues which may need to be considered for due diligence include:

- (a) Determine appropriate jurisdiction.
- (b) Identify dutiable instruments and deemed instruments.
- (c) Consider ex gratia, reconstruction, and other relief entitlements.
- (d) Consider specific exemptions from duty.

- (e) Consider specific concessions from duty, such as in relation to off the plan purchases.
- (f) Determine rates.
- (g) Ascertain stamping requirements for all documentation, including financing and lease documents, with particular emphasis on.
- (h) method of stamping, period for lodgment of documents and period for payment of duty
- (i) When acquiring shares in a company or units in a trust which owns property, regard must be had to the potential application of the land rich entity provisions which may affect the rate of duty payable on such transactions.

## **8.0 Locational Influences**

### **8.1 Location Considerations**

Locational influences vary according to the type of building. It may be appropriate, particularly in significant commercial property transactions, to commission a suitable qualified consultant to report on the strengths, weaknesses, opportunities, and threats (SWOT analysis) in relation to locational influences. The most important considerations for the major categories of non-residential commercial property are listed below.

### **8.2 Office Buildings**

Location Considerations for Office Buildings:

- (a) Proximity to retail facilities.
- (b) Proximity to public transport.
- (c) Availability of parking, either on-site or publicly provided nearby.
- (d) Proximity to leading hotels and restaurants.
- (e) Commentary on surrounding areas including future development and land use, vacancy rates.

### **8.3 Industrial Buildings**

Location Considerations for Industrial Buildings:

- (a) Ease of vehicular access to the site.
- (b) Proximity to public transport.
- (c) Proximity to customers (for minimising transport).
- (d) Proximity to raw materials, supplies and services.
- (e) Proximity to vocational training facilities.
- (f) Proximity to means of freight transportation (rail terminals, ports, airports).
- (g) Proximity to related industry.
- (h) Commentary on surrounding areas including future development and land use, vacancy rates.



### **8.3.1 Retail Shopping Centres**

Location Considerations for Retail Shopping Centres:

- (a) Population in the primary, secondary and tertiary trade areas.
- (b) Demography of trade area population.
- (c) Trading mix.
- (d) Configuration of the centre.
- (e) Any artificial or natural barriers (roads, rivers) which may affect the trade areas.
- (f) Ease of vehicular access to the site.
- (g) Prospects for competition (both present and future).
- (h) Marketing and promotion.

## **9.0 Design Influences**

### **9.1 Design Considerations**

Design influences can affect the ability of a property to operate to its maximum efficiency and effectiveness. Any prospective purchaser

should consider engaging the services of a suitably experienced architect to assess the appropriateness of the buildings which are being acquired as well as to assess what capital may be required to rectify any design shortcomings.

### **9.2 Office Buildings**

- (a) Design Influences for Office Buildings:
- (b) Condition of external cladding and ease of cleaning.
- (c) Lobby size, configuration, finishes.
- (d) Adequate lift facilities (including goods lift).
- (e) Adequate heating and air conditioning.
- (f) Column-free floor space (and flexible floor space for tenancy layouts).
- (g) Sound insulated windows.
- (h) Adequate car parking.
- (i) Adequate security system.
- (j) Adequate toilet and shower facilities.
- (k) Adequate facilities for the disabled.
- (l) Adequate after-hours occupation requirements (eg. air conditioning).
- (m) Sufficient floor to ceiling height.
- (n) Sufficient stand-by facilities for equipment and/or facility failures.
- (o) Compliance with occupational health and safety regulations.



### **9.3 Industrial Buildings**

Design Influences for Industrial Buildings:

- (a) Appropriate office to warehouse ratio.
- (b) Adequate level of natural light in the warehouse area.
- (c) Adequate load bearing capacity of the warehouse floor.
- (d) Adequate distance between columns in the warehouse allowing for use of forklift trucks.
- (e) Adequate loading and servicing facilities.
- (f) Adequate height between spans.
- (g) Adequate ingress / egress.
- (h) Adequate thickness of driveways.
- (i) Adequate room for trucks to manoeuvre once on site.
- (j) Ability to install gantries where needed.
- (k) Hard stand parking and storage.

### **9.4 Retail Shopping Centres**

Design Influences for Retail Shopping Centres:

- (a) Established anchor tenant.
- (b) Appropriate tenancy mix between anchor and specialty shops.
- (c) Uniform shop fronts and signage.
- (d) Width of shopping malls.
- (e) Adequate lighting facilities, either natural or artificial.
- (f) Appropriate heating and air-conditioning facilities.
- (g) Appropriate space allocation to entertainment facilities.
- (h) Appropriate sight lines.
- (i) Ease of access and egress from retail area to carpark.
- (j) Layout to ensure efficient retail operation.
- (k) Location of dead frontages.
- (l) Provision of adequate car parking and under cover car parking for wet weather conditions.
- (m) Provision for expansion.

## **10.0 Leases**

### **10.1 General / Legal Issues**

Leases are a vital component in most commercial properties and any due diligence process should include a thorough analysis of all lease covenants affecting the subject property. Issues which would ordinarily be considered include:-

- (a) Financial status of tenant.

- (b) Trading strength of tenant.
- (c) Whether and to what extent the lease has been stamped.
- (d) Term of the lease.
- (e) Is there an option for renewal? If yes, has it been exercised?
- (f) Does the lessee have a right of early termination?
- (g) Is the rent a market rent?
- (h) Is the rent based on turnover?
- (i) What provision is there for adjustment or review?
- (j) Can the rent reduce on a review?
- (k) Procedure for rent reviews.
- (l) Outgoing's recovery, including plant maintenance and replacement.
- (m) Repair obligations.
- (n) Tenant's obligation to contribute to a promotion fund.
- (o) Tenant's obligation to provide turnover information.
- (p) Redecoration obligations.
- (q) Make good at end of term.
- (r) Insurance obligations - lessor/lessee.
- (s) Does the lessor have any non-standard obligations?
- (t) Who owns the fit out?
- (u) Control in relation to use.
- (v) Restrictions on assignment and sub-letting.
- (w) Does lessor have the right to modify or alter the building?
- (x) Does lease deal with issues relating to base building comfort levels / performance criteria?
- (y) Are the termination and damages provisions adequate?
- (z) What are the provisions relating to damage and destruction?
- (aa) Are the premises "retail" premises? If yes, does the lease comply with the relevant legislation?
- (bb) Are tenancy areas properly defined in the lease?
- (cc) Arrears position.
- (dd) License Agreements (eg. parking).
- (ee) What security is held:
  - i) personal guarantees and indemnities.
  - ii) security deposit.
  - iii) performance bonds.
  - iv) bank guarantee?

(ff) Determine whether the lease deals with issues of:

- i) Contamination.
- ii) hazardous materials.
- iii) ozone depleting substances.

## **10.2 Tax Issues**

Tax Issues which would normally be considered include:

- (a) Assessability / tax deductibility of lease incentives received / provided.
- (b) Assessability / tax deductibility of lease premiums received / provided.
- (c) Assessability / tax deductibility of lease surrender payments received / provided.
- (d) Timing of assessability / tax deductibility of lease payments received / paid in advance.
- (e) Tax deductibility of lease payments.
- (f) Categorisation of “lease” as either genuine lease or instalment purchase for tax purposes.
- (g) Consider disallowance of interest, depreciation and building allowance tax deductions for assets leased to public bodies and non-residents.
- (h) Application of withholding tax for leases involving non-residents.

## **11.0 Contamination – Environmental Audit**

Consider the desirability of having an environmental audit of the land and building, covering matters such as contamination, asbestos, air conditioning, filling, underground tanks etc, to be carried out by specialist environmental companies.

## **12.0 General**

The process should also involve a review of the following:

- (a) Access to Building Reports.
  - i) Condition Report.
  - ii) Asbestos Report.
  - iii) Contaminated Land Report.
  - iv) Plant and Equipment Report.
  - v) Depreciation Report.
  - vi) Current construction contracts, plans, specifications.
- (b) List of goods and chattels to pass with the sale.
- (c) Ongoing review of Sale Contract.
- (d) Preparation of rental arrears list.
  - Agreement as to treatment of rental arrears.

- (e) Files, books, and financial statements held by owners and managing agents.
- (f) Access to files.
- (g) Ownership of files on settlement.
- (h) Site Survey.
  - A surveyor should be employed to identify the boundaries of the subject property, and horizontal or vertical encroachments and to confirm the status of any improvements in relation to the boundaries.
- (i) Insurance - Details and claims records.
- (j) Bill of Sale over tenant's plant and equipment.
- (k) Talk to tenants and other occupiers. In many cases their practical experience will be an important indicator of building problems.
- (l) Property Management.
- (m) Outgoings.
  - Review building outgoing.
  - Sight receipts.
  - Review outgoing budget.

**12.1 Consider the managerial styles that may be used for a property, for example:**

- (a) owner manager.
- (b) joint venture manager.
- (c) external manager.

The due diligence process should include:

- (a) Interviewing existing property manager and building manager.
- (b) Reviewing maintenance and service agreements (management agreements, cleaning contracts, air conditioning contracts, lift contracts). Can they be assigned? Will they be terminated?
- (c) Management staff entitlements such as long service leave, superannuation, holiday pay.

**13.0 Effective Date**

This GP is applicable from 1 July 2021. Earlier adoption is permitted and encouraged.

This GP replaces *ANZRPNGN 6* which was in effect from 1 October 2009 and was withdrawn 30 June 2021.

## 14.0 Annexure 1- Suggested Due Diligence Check List

ACTIONS	RESPONSIBILITY	COMPLETION DATE	ESTIMATED COST
1.1 Approval to make Conditional Offer	Executive Level		n/a
1.2 Conditional Offer Delivered	Executive Level		n/a
1.3 Acceptance by Owner	Vendor		n/a
1.4 Selection of Consultants	Management Level		n/a
1.5 Consultant Approvals	Executive Level		n/a
1.6 Consultant Meeting	Management Level		n/a
1.7 Consultant Letters of Appointment	Management Level		n/a
2.0 Valuation	Experienced Valuer		\$
3.0 Building Structure	Engineer		\$
4.0 Building Services	Engineer		\$
Performance Testing			
Mechanical Services			
Electrical Services			
Hydraulic Services			
Fire Services			
Lifts and Vertical Transportation			
Security			
Technical Efficiency			
Communication Services			
5.0 Legal	Legal Consultant		\$
Title			
Town Planning			
Service Agreements			
Insurance			
Licenses			
General Counsel			
Site Survey			
Property Management Agreement			
Contract of Sale			
Acquisition Structure			
Settlement			

6.0 Accounting and Tax Audit	Accountant	\$
Depreciation Allowances	Quantity Surveyor	

ACTIONS	RESPONSIBILITY	COMPLETION DATE	ESTIMATED COST
7.0 Stamp Duty	Legal Consultant		\$
8.0 Location Influences	Economic and		
Economic & commercial Overview	Planning Consultant		\$
Traffic Management	Traffic Management Consultant		\$
9.0 Design Influences			
Architectural and Town Planning	Architect & Town Planner		\$
Quantity Surveyor	Quantity Surveyor		\$
10.0 Leases	Legal Consultant		\$
11.0 Contamination - Environmental Audit	Environmental Specialist		\$
12.0 Other Influences			
Documentation	Project Manager Audit		\$
Public Relations Audit	PR Consultant		\$
13.0 Final Approval for Purchase	Executive Level		n/a
14.0 Exchange of Executed Contract	Executive Level		n/a
15.0 Settlement of Contract	Legal Consultant		n/a
16.0 Management Systems	Management Level		n/a

Note: The above list of comprehensive actions is merely a guide, but would be endorsed by Auditors for due diligence examination.