

Premises due diligence

User guide 2.9 – Premises due diligence

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'Related tenant guides & tools'

Reference & Topic	Tool	Refer
What makes a commercial lease '.....?'	User guide	UG1.1
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"Getting to a 'tenant friendly'....."	User guide	UG1.2
"Getting to a 'tenant friendly'....."	Video guide	UG1.2-VIDEO
'Premises due diligence'	Video guide	UG2.9-Video
'Premises due diligence'	Checklist guide	UG2.9-CHECKLIST
Glossary of leasing terminology	User Guide	UG-GLOSSARY



The LPC User Guide Series

'Overview of the User Guides'

Key focus – Optimising your lease agreement & tenancy

Optimise your lease – The LPC guide

#1 – Before the lease

- 'Clarify' business objectives
- 'Right' needs analysis
- 'Right' premises brief
- 'Right' premises search
- 'Right' evaluation of shortlist
- 'Right' Heads of Agreement
- 'Right' premises due diligence
- 'Right' lease terms
- 'Right' fit-out
- 'Right' relocation or refurbishment

#2 – During the lease

- 'Never' miss a critical date
- 'Never' overpay your rent
- 'Never' overpay your outgoings
- 'Never' miss an opportunity
- 'Ensure' your landlord complies
- 'Ensure' you comply
- 'Ensure' the premises comply
- 'Ensure' a safe workplace
- 'Ensure' a productive workplace
- 'Ensure' leverage for the future

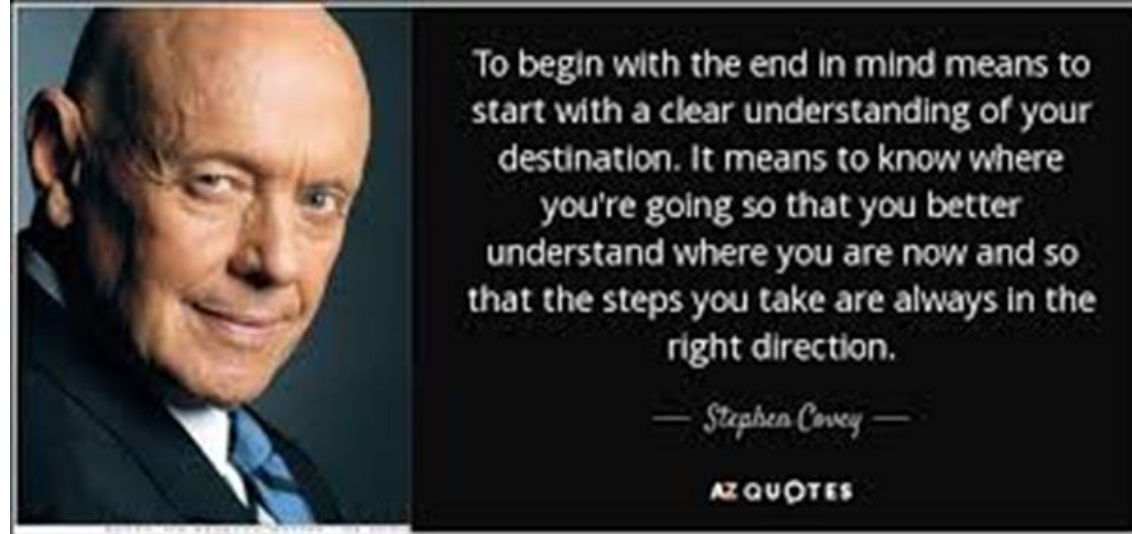
#3 – Exiting the lease

- 'Clarify' strategic objectives
- 'Assess' option to renew
- 'Assess' opportunity to restructure
- 'Assess' rights to surrender
- 'Assess' rights to sub-lease or assign
- 'Assess' make good obligation
- 'Assess' relocation impacts and cost
- 'Execute' decision re stay or go
- 'Execute' make good or refurbishment
- 'Execute' relocation & lease exit

#1 – Before the lease

- ❑ 'Clarify' business objectives
- ❑ 'Right' needs analysis
- ❑ 'Right' premises brief
- ❑ 'Right' premises search
- ❑ 'Right' evaluation of shortlist
- ❑ 'Right' Heads of Agreement
- ❑ **'Right' premises due diligence**
- ❑ 'Right' lease terms
- ❑ 'Right' fit-out
- ❑ 'Right' relocation or refurbishment

These **User Guides** focus on activities that take place **'before the lease'**, to help lessees **clarify** their business strategy, their related **accommodation needs**, and they **guide lessees** through a process that results in a **'tenant friendly lease'**.



#2 – During the lease

- ❑ 'Never' miss a critical date
- ❑ 'Never' overpay your rent
- ❑ 'Never' overpay your outgoings
- ❑ 'Never' miss an opportunity
- ❑ 'Ensure' your landlord complies
- ❑ 'Ensure' you comply
- ❑ 'Ensure' the premises comply
- ❑ 'Ensure' a safe workplace
- ❑ 'Ensure' a productive workplace
- ❑ 'Ensure' leverage for the future

These **User Guides** focus on activities that take place **'during the lease'**, to help lessees **optimise** lease arrangements through **mitigating** common lease management **mistakes** made by lessees, together with **guidance** as to how to avoid common mistakes.

Leases need to be overseen,
not overlooked

RECAP -
What
problems
are we
solving?

Lease Management Solution



Never enter into a bad lease !



Never miss a critical date !



Never overpay !



Never miss an opportunity !



IFRS 16 Compliance !

#3 – Exiting the lease

- ❑ 'Clarify' strategic objectives
- ❑ 'Assess' option to renew
- ❑ 'Assess' opportunity to restructure
- ❑ 'Assess' rights to surrender
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- ❑ 'Assess' relocation impacts and cost
- ❑ 'Execute' decision re stay or go
- ❑ 'Execute' make good or refurbishment
- ❑ 'Execute' relocation & lease exit

These **User Guides** focus on activities that take place **'to exit the lease'**, to help lessees **optimise their exit** having regard to the **lease constraints**, and to the occupier's **business risks and business objectives** into the future.



Definitions & context

'Premises due diligence'

Key focus – Ensuring the leased premises works for the lessee!

What do we mean by 'premises due diligence'?

Premises Due Diligence is an **investigation carried out by a prospective tenant** to establish all the facts (known & unknown) & the risks associated with leasing a specific property. This process is carried out by inspecting the premises, auditing the available records, testing & engaging specialist consultants where required.

In relation to the negotiation of a commercial lease, the key & underlying reason for undertaking a premises due diligence is to **ensure the premises suits & supports the tenant's business plan** over the lease Term. From this perspective, the backdrop for the technical aspects of the premises due diligence is the tenant's business plan.

In the negotiations of the HOA & the lease, a tenant does well to **seek landlord disclosures & warranties relating to the premises**, that provide comfort & assurance to the prospective tenant as to the premises being fit for the tenant's business purpose. This is an additional risk management action to the actual premises due diligence, which adds to tenant assurance.

Although a premises due diligence is a technical activity, it is an **important activity to be included in the lease negotiation process**. A tenant cannot execute a 'tenant friendly lease' if there are any risks that the premises may not be fit for purpose.

The **next slide** provides an overview of items that one focuses on when undertaking a premises due diligence.



What do we mean by 'premises due diligence'?

As stated in the previous slide, premises Due Diligence ('DD') is an **investigation carried out by a prospective tenant** to establish all the facts (known & unknown) & the risks associated with leasing a specific property. The DD focuses on the following:

- Annual fire safety statement & related compliance
- As built records & related risks
- Building site conditions & condition / suitability
- Building class & fit for the future
- Building Code of Australia & compliance
- Bushfire risk & safety
- Disability Act 1992 & compliance
- Engineering Infrastructure & suitability
- Environmental & compliance
- Flood & tidal inundation & safety
- Flora & Fauna & inability to utilise
- Hazards & inability to utilise
- Heritage & related constraints
- History of the site & implications
- Land title & right to lease
- Noise / vibration & impacts
- Parking / access & fit for purpose
- Development without consent & implications for the tenancy
- Development application & implications for the tenancy
- Site survey & related constraints on the lessee
- Tenant fitout manual & related parameters



Why & when to do a premises due diligence?

'Before signing an HOA' –

Getting to tenant friendly HOA requires a tenant to:

- ❑ **Define their needs** – to clarify the accommodation criteria that match the tenant's future business objectives & risks. Important to define key 'premises must haves' at this point.
- ❑ **Establish options** – that meet the accommodation criteria to create a basis for effective negotiations & leverage. 'DD' is limited at this stage to validating the 'premises must haves' in the brief that have to be complied with by responders.
- ❑ **Assess alternatives** – to enable informed negotiation & leverage applied to the preferred alternatives. Part of this process is to do a limited 'DD' on shortlisted options to identify premises related risks & constraints that need to be considered in the quantitative & qualitative assessment of the alternatives.
- ❑ **Implement the best option** – via the negotiation of a 'HOA' & subsequent lease execution. The tenant needs to 'make sure' that the premises works for the business requirement & to get this right at the HOA stage via a more complete 'DD' for the preferred premises. The 'DD' strengthens the lease negotiation process undertaken by the lessee. 'DD' outcomes will often underpin further lease negotiations & occupancy cost savings.

The **next slide** provides more detail on the need for 'DD' before lease execution.



Why is a 'premises due diligence' important?

Know the facts when you decide.

Getting stuck with a 'bad lease' will invariably have its origins in an unfriendly HOA, while getting stuck 'in a bad premises' will often be tracked back to an inadequate premises due diligence. A positive tenancy is built on ensuring a tenant friendly HOA is negotiated & a tenant friendly lease is executed, which necessitates that the tenant 'makes sure' that both the commercial terms & the premises match the business requirement into the future.

Not knowing the facts when.

We have included a case study of a client who did not undertake an adequate 'DD' before executing the lease only to discover heritage constraints after signing. The impacts of this omission on the tenant were similar to the many other instances of inadequate 'DD' we have come across, and these impacts include:

- Holdover rent on the exit premises
- Rent without utilisation on the new premises
- Unbudgeted fit-out & premises & consultant costs
- Relocation stress with a drain on management time
- Premises due diligence saves money, time, and effort!



When to do a due diligence on the premises?

'Before signing an HOA' –

Getting to tenant friendly HOA requires a tenant to:

- ❑ **Define their needs** – to clarify the accommodation criteria that match the tenant's future business objectives & risks be sure to include 'premises must have's'.
- ❑ **Establish options** – that meet the accommodation criteria to create a basis for effective negotiations & leverage. 'DD' is limited at this stage to validating the specific premises requirements in the brief that have to be complied with by responders.
- ❑ **Assess alternatives** – to enable informed negotiation & leverage applied to the preferred alternatives. Part of this process is to do a limited DD on shortlisted options to identify premises related risks & constraints that need to be considered in the quantitative & qualitative assessment of the alternatives.
- ❑ **Implement the best option** – via the negotiation of a 'HOA' & subsequent lease execution. The tenant needs to 'make sure' that the premises works for the business requirement & to get this right at the HOA stage via a more complete DD for preferred premises. The DD strengthens the lease negotiation process undertaken by the lessee. **DD outcomes will often underpin further lease negotiations & occupancy cost savings.**

The premises due diligence adds tenant leverage during the HOA & lease execution phases, & builds leverage in line with the **objective of a 'tenant friendly' HOA & lease outcome for the selected premises.**

The **next slide** covers the need for 'DD' before lease execution, illustrated by a case study where the due diligence undertaken was inadequate.



Task 1 – The importance of a ‘premises DD’

Task 1 – Checkpoint | Your brief for a premises DD

At this stage we suggest you consider:

- How more attention to the DD process prior to lease execution would have improved your relocation & your current tenancy;
- List the DD items you would be sure to include in the Brief you would issue to market when and if your business decides to seek a new tenancy arrangement.

Key focus – Ensure your premises is fit for purpose



'A closer look at the Premises DD'

'If you want a tenant-friendly lease outcome, make sure the premises is fit for purpose'

Rebecca Pelling, LPC Project Service

Summary – key DD items & our guidance

GUIDANCE – The DD must ensure **premises are fit for purpose**, leaving no room for nasty surprises post lease execution. These are essential DD items & our guidance on each.

DD Item	Essential
#1 – The Annual Fire Safety Statement	Request a copy of the Annual Fire Safety Statement (AFSS) / Form 15, this should normally be displayed in the building entry foyer. An AFSS must be issued each year & include all the essential fire safety measures that apply to a building. The statement also verifies that a competent Fire Safety Practitioner has inspected & confirmed that the exit systems in the building are in compliance with the Regulation.
#2 – As Built Records	Request copies of the Operations & Maintenance Manuals (O&M) & Work As Executed (WAE) drawings or auto-cad copies of drawings, & notations made as to changes. Ensure no constraints in relation to your business & to ensure you can adapt your premises use to a changing environment.
#3 – Building Site Conditions	Check: the building/tenancy against the As Built Records; the building condition; the ceiling height & grid set-out; ceiling plenum clearance; beams location & depth; clearance to install supplementary air-conditioning units; condition of the flooring; floor loading design; any nominated stair penetration or void areas; number, location and capacity of building services risers; window treatments/furnishings included; the conditions of the female and male bathrooms
#4 – Building class	Validate Building Classification for the proposed use; building may require planning approval & engagement of a Town Planner and other specialist consultants which adds cost & time & uncertainty
#5 – Building Code of Australia	Validate compliance with the Building Code of Australia (BCA) provides the minimum necessary requirements for safety, health, amenity and sustainability in the design and construction of new buildings throughout Australia. We recommend a Private Certifying Authority (PCA) consultant reviews compliance of the existing building against the BCA. Many buildings, although compliant at the time of construction, do not comply to the current requirements. Fitting out a tenancy may, in certain circumstances, trigger upgrades which can be costly. If not identified before signing a lease then the obligation to carry out the works falls to the tenant and not the landlord.

Summary – key DD items & our guidance

GUIDANCE – The DD must ensure **premises are fit for purpose**, leaving no room for nasty surprises post lease execution. These are essential DD items & our guidance on each.

HOA item	Essential
#6 – Bushfire risk	Check if the site is in a bushfire zone? Has a study/assessment of the risk associated with the site has been undertaken and, if so, ensure a copy of that document is provided
#7 – Disability Discrimination Act 1992	Check premises compliance with the Act related 2010 Standards. We recommend engaging a Private Certifying Authority consultant to review compliance of the existing building against the BCA.
#8 – Engineering Infrastructure	Engage (if needed) a Services Engineer to investigate if the engineering infrastructure servicing the tenancy is fit for purpose. If there are non-compliance issues or upgrades required then the Services Engineer can advise of these costs.
#9 – Environmental & tidal & fauna/Flora	Check if a Geotechnical & Environmental Assessment Report required, & if the site is subject to tidal inundation, storm surge and/or is flood prone, & if there are endangered or protected flora and fauna on the site?
#10 – Hazards	Check for hazards (including overhead power lines, restricted access or egress, hidden or concealed services or restrictions) that may affect the work to be undertaken or health and safety of workers.
#11 – Hazardous materials	Check for asbestos, petrochemicals, industrial residues or other hazardous materials. Statements that say there 'may be hazardous materials on site' create risk for the tenant. Require landlord reports & / or warranties. If a HAZMAT Report is not available then consultants need to be engaged to investigate and advise. Hazardous materials on site requires specific materials handling /building methods to be applied.
#12 – Heritage	Check if the premises has heritage significance, aboriginal significance, & then take a view tenancy after understanding the tenancy implications.
#13 – History of the site	Review the history of occupation. Understanding the historical uses of the site will serve to inform of potential opportunities and issues.

Summary – key DD items & our guidance

GUIDANCE – The DD must ensure **premises are fit for purpose**, leaving no room for nasty surprises post lease execution. These are essential DD items & our guidance on each.

HOA item	Essential
#14 – Land title	Check the formal titular description of the property including easements and other encumbrances.
#15 – Noise & vibration	Check if there are noise hazards (ambient noise, vibration, flight paths, sports arenas, main roads etc) which may impact on the proposed use of the site?
#16 – Parking & access	Check if there enough parking on the site? Certain uses (such as Medical Centres) require a specific number of car parks per staff. Expectations regarding the frequency, sizes and types of vehicles expected to visit the facility should be considered.
#17 – Planning Approval	Request a copy of the Section 10.7 Certificate to get information that the local Council has on file about planning controls and other property issues that affect the site. Determine the relevant approval pathway(s) for the project. They all have varying requirements, timelines and associated costs so its important to understand these.
#18 – Exempt Development	Check if there are minor non-structural works and demolition needed or completed, noting need to validate compliance with the BCA and Australian Standards. No formal certification required.
#19 – Complying Development (CDC → OC)	Check no unapproved development has been carried out or will need to be carried out . Is planning and construction approval needed for your premises use? Is floor space to be increased and / or a change to the change external building aesthetics required? All works must comply with the BCA and Australian Standards.



Summary – key ‘DD’ related items & your lease

The way in which key premises due diligence items are addressed & captured in the ‘HOA’ and in the lease will impact how ‘tenant friendly’ the lease and the premises are. For the tenant, it is important to ensure the risk of non-compliance or impaired utilisation resides with the landlord, and that the landlord has complete and detailed obligations in relation to the premises such that the premises works for the tenant throughout the lease Term. It is useful to use the premises due diligence to add detail to the landlord obligations and warranties relating to the premises and captured in the ‘HOA’ and in the lease.

	‘Tenant unfriendly’	Key DD Item	‘Tenant friendly’
1.	No warranties related to premises compliance with tenant obligations relating to premises compliance	Warranties – premises compliance	Landlord warranties relating to premises compliance with all current and future codes
2.	No warranties / obligations relating to premises ‘grade’ & premises attributes through the lease Term	Warranties – premises ‘grade’ & facilities	Warranties relating to premises ‘grade’ & premises attributes through the lease Term
3.	Narrowly defined premises use with no warranties related to premises use	Warranties – premises use	Broadly defined premises use with landlord warranties regarding the premises use
4.	Risk transfer to the tenant of obligations and costs relating to the premises compliance into the future	Obligations – landlord & tenant	Strong landlord obligations relating to premises compliance, maintenance, attributes.



Task 2 – The premises ‘DD’

Task 2 – Checkpoint | Optimise your premises

A tenant friendly tenancy requires the Right Lease & the Right Premises:

- Review the landlord warranties and landlord obligations in your current lease that relate to the leased premises**
- Reflect on additional landlord warranties and landlord obligations that would have improved your tenancy**

Key focus – Ensure the HOA fits your business needs.



Common due diligence mistakes & lessons learnt'

"Know where the mistakes are & don't go there"

John Reed, LPC

'DD' – Common mistakes & their impact

Common mistakes	Impacts
Assuming that the building has the right Class of Use.	Having to lodge a Development Application for a Change of Use.
Assuming there are no Heritage constraints.	Having to lodge a Development Application to fitout.
Not checking that the building complies with current BCA and DDA Codes / Standards.	Tenant has to pay for upgrades / installation of additional amenities to achieve compliance.
Assuming that the base building mechanical services have been maintained properly and can adequately service the tenancy.	Poor levels of thermal comfort, i.e. too hot or too cold.
Assuming that the Distribution Boards have surplus capacity or are to current Code.	Incurring delays and costs associated with upgrading / replacing the Distribution Board(s).
Assuming that there is adequate mains power.	Having to upgrade the mains power into the building / premises.
Assuming that there are no Hazardous Materials onsite.	Incurring delays and costs associated with removing and disposing of hazardous materials.
Not requesting copies of the As-Built Base Building Architectural and Engineering Services drawings.	Difficulties documenting the design without knowing what the existing infrastructure is.
Not carrying out site measure checks and verifying the As-Built records.	Incorrectly designing and documenting the works leading to subsequent delays and costs associated with redesign.
Not checking that the Building has current Annual Fire Safety Statement.	Not being able to secure planning approval for the fitout.



'DD' – Common mistakes & their impact

Common mistakes

Assuming that the building has the right Class of Use.

Assuming there are no Heritage constraints.

Not checking that the building complies with current BCA and DDA Codes / Standards.

Assuming that the base building mechanical services have been maintained properly and can adequately service the tenancy.

Assuming that the Distribution Boards have surplus capacity or are to current Code.

Assuming that there is adequate mains power.

Assuming that there are no Hazardous Materials onsite.

Not requesting copies of the As-Built Base Building Architectural and Engineering Services drawings.

Not carrying out site measure checks and verifying the As-Built records.

Not checking that the Building has current Annual Fire Safety Statement.

Impacts summarised

- ❑ Transfer of premises obligations & cost from landlord to tenant
- ❑ Unexpected premises capex costs to get premises fit for purpose
- ❑ Time delays & cost increases related to development approvals
- ❑ Premises use restricted by regulation or infrastructure or compliance work
- ❑ Delayed utilisation of the premises due to premises works
- ❑ Double rent obligations while rectification works are occurring
- ❑ Management distraction & employee dissatisfaction
- ❑ Worst case is a lease obligation but unable to use the premises



'DD' – Lessons learnt about due diligence

The common mistakes point to some key lessons:

- ❑ **Doing a premises due diligence will reduce occupancy cost & tenant risk**
- ❑ **The finding of a premises due diligence will help you in the lease negotiations**
- ❑ **The aim & scope of a premises due diligence needs to be targeted at ensuring 'fit for purpose'**
- ❑ **The 'DD' findings are a factual basis for negotiating related landlord warranties**



Lease exit – Case study | Failing to do a 'DD'

" Know where the mistakes are made & don't go there"

John Reed for LPC

Case study #1 – Failing to undertake a 'DD'

Situation

A new client requested LPC to assist with a situation they had gotten into as a result of not conducting an appropriate premises due diligence. The client had negotiated favourable commercial terms & had executed the lease, to then discover that heritage constraints disallowed certain internal changes needed to make the premises fit for purpose.

Impacts on the tenant

The absence of a premises DD resulted in 4 months extra rent of the old premises, double rent, unexpected fit-out costs, unexpected consultant costs, a drain on management time, & employee & client dissatisfaction.

Solution

LPC advisors negotiated a month by month holdover at the exiting premises, together with part waiver of the rent on the new premises, & facilitated other concessions & efficiencies that contained the negative impacts on the tenant business. Whilst these measures partially offset the negative impacts,

Lessons learnt

This case study illustrates that a lease can be entered into with tenant friendly commercial terms agreed to, but that the failure to undertake a premises due diligence to verify the premises could be utilised as planned, had multiple negative impacts on the tenant's business. The lessons learnt are:

- to require or negotiate landlord disclosures & warranties related to the intended use & fit-out of the premises
- to undertake a DD informed by the intended use & fit-out
- it can be wide to have a condition precedent in the lease that specifies that the premises needs to be validated as 'fit for purpose'
- the premises DD produces information that informs the lease negotiations & can be the basis lowering the rent, increasing the incentive, and / or strengthening the landlord obligations



Task 3 – LPC Due diligence checklist

Task 3 – Checkpoint | Use the LPC Checklist

At this stage we suggest you :

1. Review the LPC Due Diligence Checklist
1. Apply the checklist to your current premises?

Key focus – Ensuring a tenant friendly premises



Premises due diligence

User guide 2.9 – Premises due diligence

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