



Domus Holmes

Property Group

A Guide to Commercial Property Due Diligence

The 15 checks you should always
make before buying a commercial
property



About the Author



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Claire is a qualified commercial and residential property lawyer with over 10 years professional and personal experience in the London and Sydney property markets. As a lawyer, she has acted for a range of clients, from blue chip companies to high-net and ultra-high net worth private clients.

Being passionate about property, she founded Domus Holmes Property Group in August 2015 as an Independent Property Finder and Property Development and Investment company.

Your Commercial Property Due Diligence Checklist

When purchasing a commercial property undertaking thorough due diligence is paramount.

It will usually require expertise across a number of professions.

An extensive factual and legal analysis of the target asset – ie. the property or the holding company – must be completed prior to investing.

Whilst the relevant professionals will undertake the actual due diligence, it is essential that as the potential buyer you understand what aspects need to be examined.

Below, is a checklist which sets out the points of focus in commercial property due diligence.

Please note, the process is extensive and this list is far from exhaustive. The items are not listed in any particular order.

1. Look at Market Demand

Responsibility - Surveyor & Buyer

- Check whether the commercial property is needed or wanted by target consumers
- Consider the vacancy ratio of the building over a 10 year period

Your Commercial Property Due Diligence Checklist

2. Valuation

Responsibility – Valuer, Solicitor & Planner

- Study the value of similar properties in the vicinity
- Collect information on the rents demanded at other properties
- What type of tenants does the area attract
- Is the property easily accessible for the intended tenant type
- Are there planning/redevelopment proposals which may benefit or burden the property
- Is the property adaptable to changing demands/uses/accommodation styles/occupier requirements

3. Look at the Condition of the Property

Responsibility - Surveyor

- What is the state of repair of the property
- Are there any significant defects
- If there are tenants, are they on a full repairing and insuring lease and have they complied with the covenants in the lease
- If works have been undertaken, have all relevant certificates been provided

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4. Surveys

Responsibility - Surveyor

The following surveys should be commissioned:

- building survey
- site survey
- mechanical survey
- electrical survey
- measurement survey
- environmental/ground survey

5. Use and Planning

Responsibility – Solicitor & Planner

- What can the property be used for – does the property have appropriate planning permission
- Will you or your intended tenant need to change the use
- Are there any environmental impediments to using the property as intended
- What planning applications have been submitted relevant to the property and, if applicable, have all conditions been complied with

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5. Use and Planning (cont'd)

Responsibility – Solicitor & Planner

- Are there any planning projects in the pipeline that may impact on the intended use of the property, eg. improved transport links
- Is the property listed and, if so, what restrictions on use exist
- Have all requisite consents been obtained and complied with
- Have there been any enforcement notices/action and have they been complied with/completed

6. Insurance Policies

Responsibility – Solicitor

- What insurances are in place and who is responsible for the policies
- Has there been any insurance claim relevant to the property
- Are all premiums paid up to date
- Is the property adequately insured

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7. Maintenance Costs

Responsibility – Surveyor

- What repair and maintenance has been carried out on the property and at what cost
- Has any previous owner promised some additional amenities to the tenants
- What parking facilities are available and what are the maintenance costs
- Are there any maintenance costs which are not borne by the tenant

8. Property Title

Responsibility – Solicitor

A Report on Title will be prepared which investigates the legal issues and tests the assumptions made concerning the property.

The Report should include at least the following:

- Ownership and title – vendor should have good title, legally and beneficially
- Boundaries
- Existing charges, mortgages and encumbrances

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8. Property Title (cont'd)

Responsibility – Solicitor

The Report should include at least the following (cont'd):

- Results of searches – environmental, local authority, water and drainage, etc
- Rights, covenants, obligation and liabilities affecting the property
- Existing and required insurances
- Leases – any existing leases (see below)
- Legislation affecting the property – eg. Landlord and Tenant Act security of tenure
- Defects, omissions and the implications and recommendations for remedy or mitigation
- Required consents for purchase or charging
- Replies to enquiries and any issues arising
- Existing planning consents and conditions
- Material unusual issues – eg. Breaches of restrictions, defective title insurance

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9. Leases

Responsibility – Solicitor

Leases can have a direct effect on the value and ongoing management of the property.

The principal terms of any leases should be reported, particularly those that have a direct financial impact on the value of the property, including:

- termination dates
- break clauses
- rents/rent reviews
- transfer or charging restrictions
- insurance and repairing obligations
- security of tenure/contracted out
- any limitations on service charge recovery

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10. Covenant Strength

Responsibility – Solicitor

The following enquiries should be made in respect of any tenants:

- financial status and credit quality
- length of lease, number of break clauses
- rental and service charge payment history
- review of filed accounts, financial assessments and payment record
- guarantor arrangements – AGAs
- financial status of any guarantors or sureties and credit quality
- up to date insurances

11. Rental Value

Responsibility – Valuer & Surveyor

- The rental value must be assessed in order to determine whether there is scope for rental growth
- Study rental growth over previous 10 years and make prediction as to growth potential over next 10 years
- Calculate earnings after tax and insurance

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12. Tax

Responsibility – Accountant

- Assessment of tax liabilities
- Is VAT payable
- Is the sale a transfer of a going concern
- Assessment of balance sheet
- Assessment of income, risks, relationships with other entities
- How will the ownership be structured – company, trust, personally
- What capital allowances apply
- What is the most tax efficient ownership structure for your overall strategy

13. Legislation and Regulations

Responsibility – Solicitor & Team

You must ensure that all relevant legislation and regulations are complied with:

- Landlord and Tenant Acts – security of tenure, etc
- Law of Property Act 1925
- Climate Change Act
- Energy Act – EPC rating

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13. Legislation and Regulations (cont'd)

Responsibility – Solicitor & Team

You must ensure that all relevant legislation and regulations are complied with:

- Health and Safety legislation
- Building Regulations
- Fire and Asbestos Regulations

14. Exposure to Risk

Responsibility – Financial Advisor, Solicitor & Buyer

- Calculate the risk you are willing to take and balance this with the risk a lender is likely to be willing to take
- Finance and legal costs likely to be higher than residential costs
- Is the property a close fit with your investment strategy
- Have a “Plan B” – be prepared in case there is a prolonged void period

Your Commercial Property Due Diligence Checklist

15. Documentation

Responsibility – Entire Team

It's important to read all documents associated with the property, including:

- loan documents
- trust deeds
- bank statements
- business licenses
- payroll
- planning and environmental reports

Conclusion

If you undertake the above steps before purchasing a commercial property, you should have enough quality information to understand the costs, benefits and risks of purchasing the property and whether it is valued correctly.

This will give you the best chance of great returns!