

# From wetsuit to watertight deal

**Paul Spaven on the development of vendor survey reports and how, after overcoming the concerns of the market, they have benefited clients**

The story starts on the Greek island of Lefkas in August 2001... I was determined to qualify as a PADI Scuba-Diver and so enrolled on an intensive course with other Jacques Cousteau hopefuls and spent two weeks 'immersed' in the subject. Only during our final dive boat journey did we chat about our jobs back in the UK. It turned out that my 'dive buddy', Mark Witham, was also a chartered surveyor and we agreed to meet up to explore mutual business opportunities (or perhaps we just agreed to share a few beers...).

Fast forward a few months and Mark, in the estates team of Chartwell Land, needed to get its assets into good shape ready for the confidential disposal of its retail parks. He wanted to use commercial vendor survey reports as a means of keeping the sale under wraps for as long as possible and he invited me to help create a model, which we then 'test drove' to fine tune. At that time, vendor surveys were in their infancy and many property professionals and investors were suspicious of them. We had to acknowledge the concerns of the market – primarily that vendor survey reports weren't to be trusted – and then address them within the model.

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The project team consisted of the property owner, lawyers, an environmental consultant and a building surveyor (with access to the managing agents and facilities managers) and we developed and rolled out vendor due diligence reports for the disposal of 19 UK retail parks, all within a very short timescale. We were instructed on a Friday lunchtime and had to have sample surveys under way the following week while developing, in tandem, a reporting structure and format for both the first- and second-stage reports. At the first stage, we were identifying potential issues and 'deal breakers', which, once eliminated, lead to the second-stage final reports.

From the day of receiving instructions to the publication of final reports to the bidders was around six weeks. Quite a task, given the amount of construction information, leases, pre-planned maintenance schedules and historic data to be reviewed, coupled with the logistics of completing the building inspections on these multi-tenanted sites.

Perhaps as a result of the honest 'warts and all' approach necessary to overcome purchaser scepticism of vendor surveys, coupled with the two-stage approach, the asset disposals hit the critical target date and achieved around a 20% improvement on the expected pre-sale valuation. We had developed a successful formula.

In the meantime, the residential property market debated the looming spectre of vendor surveys, while they quietly gained favour in some quarters of the commercial property world. The advantages,

particularly of the two-stage process, include improved purchaser/investor confidence, faster transaction times and maximum purchase prices achieved.

## Breathing under water

Which brings us almost up to date. Mark had subsequently joined Spen Hill, the development arm of Tesco. In 2008, and using his previous experience from the Chartwell Land transaction, Mark and Tesco began to roll out Project Reservoir, based broadly on a sale and leaseback of its freehold stock.

This project model created the trading arm of Tesco as the retail tenant and its property company as the freeholder but with a structure allowing investment into the asset through a JV partnership or through investment within securitised assets by commercial mortgage-backed securities (CMBS). Tesco could have reaped cash from the sale of its freehold investments, but it decided this would inevitably devolve control to the investor and so was not an option.

Earlier this year, Tesco successfully achieved the UK's biggest CMBS, raising around £750m through a single transaction.

It is this type of deal that has allowed Tesco to consistently create value in its freehold estate through site purchase, planning permission, and retail store and logistics facilities development. 'Tesco' as a retail brand is well recognised, but it is also a top-rated international investment target.

Asset disposals into complex investment vehicles are ideally suited to a vendor survey approach. All of the investor parties can benefit from the vendor due diligence, obviating the need for an army of surveyors disrupting the trading business. The cash required to be generated by this vehicle and the strict timescales for deal completion were driven by Tesco's Corporate Finance function. These strictures needed careful orchestration by the client project team and a flexible but rapid response from the Project Reservoir technical due diligence (TDD) team.

## Snorkelling before diving

The initial TDD consultants performed well in terms of the investment levels achieved, but the timetable for deal completion was being stretched, e.g. a number of investors commissioned their own TDD, which added weeks to the deal programme as well as disrupting the trading arm.

At that time, the TDD of the buildings was procured as a 'structural' survey performed by consulting structural engineers. Their reports inevitably addressed the condition of the structural elements, but this didn't suit the investment market requirements for a comprehensive building survey that also required coverage of the fabric and finishes. We were brought in to develop a model and provide reports with a more acceptable investment market appeal.

The property investment market demands robust, clear TDD reports and so the discovery of potential 'deal breakers' or other bad news needs careful but honest management. Anodyne reports or watered-down instructions and liability are unacceptable when producing vendor reports, which only destroys the trust between the surveyor, client and investor.

But none of this would work without a close-knit team. The Project Reservoir team instructs legal title due diligence preparation and investment transaction support through their solicitors, Berwin Leighton



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Vendor surveys were used on 220 Tesco stores as part of a 'sale and leaseback' arrangement of its freehold stock

Paisner. Environ UK (the environmental consultants employed on the Chartwell Land vendor surveys) has a track record of delivering to market demands and are part of the team. We provide the buildings' TDD and have 'call-off' support from Tesco's structural engineers, project managers and development team.

To avoid disputes over net lettable areas, GL Hearn, an independent firm of consultant surveyors, provides warranted area measurements. This aspect is often missing from vendor survey teams, but in this case significantly reduced the transaction timescales.

Input from these experts means the legal title pack, the assignable reports dealing with environmentals, the net lettable areas and the building TDD reports are available to the investor from the outset. The report format is regularly updated, documents are held on a secure extranet, and the sequencing for the interim reporting reduces the timescales from instruction to publication.

For the building surveying component of the due diligence team, it was essential to have:

- dedicated project partners (we have two partners enabling 24/7 cover for client contact)
- a comprehensive, intranet-accessible briefing pack and regular training for all surveyors and admin support
- a consistent QA process
- an experienced team of surveyors with the enthusiasm and motivation to move swiftly and act professionally
- a dedicated, flexible administrative and logistics team
- the essential ingredient, 'team spirit'.

There have of course been challenges in meeting Tesco's expectations – the main one being the demands of the tight timescales. This was achieved by having an open and continuing dialogue with the client, and by having the number of people to react to the scale of the brief. The benefits of a dedicated team vastly outweigh any temptation to bring all hands to the pump.

**Coming up for air**

This could have been a simple TDD exercise. But the desire to innovate has resulted in a dynamic, comprehensive and responsive due diligence model for the Project Reservoir team. Tesco's Estates team now also uses the model and employs the same dedicated TDD team to deal with internal asset transfers.

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The project and team enthusiasm have also generated some wider benefits, e.g. building pathology research, face to face and electronic knowledge-transfer briefings, improved reporting formats and even online project systems, procurement and invoicing.

**All aboard?**

Like diving, this type of project is exciting but not for everyone. The task demands a high level of expertise and dedication. To follow the diving analogy, success is dependent on:

- emergency checks – planning for all eventualities
- not running out of air – working within tight deadlines
- 'buddying up' – everyone working as part of a team.

In total, over 220 Tesco vendor surveys were carried out in two years – perhaps not the outcome I had anticipated when I learned to scuba dive almost 10 years ago.

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