



The cost of negligence

Such was the rush to place capital during the boom that due diligence was in some cases too superficial or even disregarded altogether. Some investors now wishing to sell are finding costly defects in their portfolios. **Paul Spaven** reports

It is probably fair to say that this recession has taught those involved in commercial property a few harsh lessons.

Perhaps the biggest lesson learned is that return on investment is not guaranteed, that commercial property prices do not just rise and rise and that due diligence is not just an additional cost that slows down a deal. To add to their woes, investors are increasingly discovering defects that they were previously unaware of when attempting to dispose of their property assets and these are having a further negative impact on already declining values.

The big question is, who is culpable in these situations and what can be done to prevent them from happening in the future?

While I have heard claims from a number of sources that the quality of building reports delivered during the peak of the property boom by surveyors was not as stringent as it should have been, I do not believe that this is the case.

As with any profession, there are always going to be some service deliverers who do not provide the



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right level of quality, but the vast majority of surveyors will deliver a high quality of report no matter what the circumstances. Surveyors understand property and construction and are tasked with delivering the intelligence needed for investors to make commercial decisions concerning a physical asset. This information is not designed to please, but rather to inform risk analysis. It is dangerous to ignore it.

I think one of the most significant contributing factors to our current situation was the number of fund managers out there who saw commercial property investment as a sure thing and a way to achieve rising high returns in a very short time frame.

There was a belief from some investors that property prices only go one way – up – and this led to a gung-ho attitude towards buyer due diligence, often

cutting it out from the purchasing process altogether.

Our due diligence team was asked on a number of occasions to carry out quick inspections and to provide a bullet-point report of the main issues. While we declined these instructions, the ensuing situation with property owners not knowing the true extent of the condition of their assets would suggest that other less scrupulous surveyors were found. The desired result of due diligence from the client in these instances was not risk management, but box ticking. This is a naïve strategy in a traditionally complex, challenging and dynamic business environment.

What we are seeing now is that the market has collapsed, and is still in decline, and those investors who threw caution to the wind are not able to shift their assets. At least certainly not for the price they would like. Not only are they unable to achieve the sales but the problem is further compounded with the responsibility for maintaining the building and repairing the defects also becoming their problem.

The concern for these funds is that with bank covenants in danger of being breached and capital needing to be raised quickly, they are struggling to offload properties. Buyers who do have the cash to spend currently have the pick of the bunch and are shying away from taking on an asset that already has defects that will need addressing.

Due diligence is not something that should be taken lightly and we are already seeing signs that the way it is approached is changing as a result of the shifting needs of the market.

During a recession, anyone spending money is naturally cautious and will have the time and inclination to carefully manage transactions and avoid unnecessary risks on their investment choices. I expect that once the market has picked up we will see that fund managers have realised that they must continue to be diligent in their approach. They will make sure that, when investing in built assets, a thorough and holistic due diligence is performed and the results considered carefully in order to safeguard the investment and to remain competitive.

It is not only being aware of the true condition of a building's fabric that is important. Buyers should also be carrying out environmental assessments, mechanical and electrical service checks and lettable area measurements, as well as checking energy performance certificates and title information. They need to think ahead to how they can maintain or increase the value of their built asset. This recession has driven home the fact that the market factors may change radically but the fundamental principles of property do not. Due diligence in property transactions is an essential part of a professional approach to the market in good times or bad.

The good news for due diligence-shy fund managers is that there is a growing trend towards the vendor carrying out the checks and surveys and providing the buyers with a comprehensive pack of information. Two-stage vendor surveys, where the vendor assesses the property, addresses defects and comes to market with a solid proposal, can help make the best out of a bad situation, removing the opportunity for downward negotiation on price or the stalling of the deal because of unforeseen issues.

At the moment much of the selling is being done by investment funds looking to shift assets quickly in order to balance their books and aid cash flow. They are turning to vendor due diligence because of the way it can remove unforeseen delays and allow the transaction to progress smoothly. For them it is a way of ensuring that not only do they reach a quick sale, but that they also can be assured that they are working their asset to its full potential to achieve the best price.

Risk management has long been a favoured catch phrase of fund managers. Now they are finding out just how real those risks are. For these to be minimised in the future, the lessons of the past decade have to be learned.