



ISSUES REGARDING THE PURCHASE OF COMMERCIAL, INDUSTRIAL OR RETAIL PROPERTY

by
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When purchasing commercial, industrial or retail property consideration is required of many issues which do not arise when purchasing residential property. The following is intended as a service to alert potential purchasers of matters of concern and interest at the time of considering a purchase of non-residential property but is not intended to be a comprehensive guide nor does it contemplate or include the usual conveyancing practices common to all conveyances such as investigation of title, encumbrances, ownership, boundaries of the property, normal conveyancing enquiries and settlement procedures.

1. PURCHASE STRUCTURE

Prior to entering into the purchase agreement consideration should be given to the appropriate purchase vehicle.

Thought needs to be given to protection of the purchaser's assets from creditors and any potential legal actions which may be initiated. Clearly, this involves the purchaser undertaking an analysis of the level of risk having regard to their particular personal or business circumstances.

Thought should also be given to income or capital gains arising in respect of the property and how best to deal with these from a tax perspective. The choice of purchase vehicle can make a significant difference to the amount of tax paid in respect of income or capital gains arising in respect of the property. Importantly, however, where the purchase of property is part of a taxpayer's business it will be important to ensure that the choice of purchase vehicle is consistent with the purchaser's commercial needs.

Broadly, the purchase vehicles available to a purchaser of property are a company structure, a partnership arrangement, a trust arrangement (discretionary trust, unit trust or a specially tailored hybrid form of trust) or simply to purchase the property in their own name.

The common issue which must be considered when determining the appropriate form of vehicle are:

- business liabilities - what they are and how to minimise them;
- tax, cash flow and tax planning;
- obtaining finance;
- control;
- dispute resolution; and
- distribution of income and assets.

2. COMMERCIAL PROPERTY

A full investigation of the building should be undertaken.

We would expect pre-purchase investigations to include the retaining of a structural engineer amongst others. Current building standards are set out in the Building Code of Australia ("BCA").

After the pre-purchase investigations have been undertaken, an assessment of the following should be considered.

2.1 Structural Adequacy, Equipment & Services

- (1) Structural adequacy of the building.
- (2) Whether the building was constructed in accord with BCA specifications.
- (3) What work would be required to upgrade the building to meet BCA specifications and what would be the estimated cost of compliance.
- (4) Whether approved drawings of the buildings are available.

These questions equally apply to lifts/escalators, electrical services, hydraulic services, air conditioning and fire protection services and equipment.

2.2 Maintenance Contracts

Are the following services and systems contractually maintained fully to the BCA and other appropriate codes and appropriately certified and if not what is the estimated cost of compliance.

- (1) Fire Services - Code AS.1851
- (2) Building Automation Systems
- (3) Cooling Towers and Evaporative Condensers Code AS.3666
- (4) Water Treatment -Code AS.3666
- (5) Air Conditioning - Code AS.3666/AS.1668
- (6) Plumbing Services - Code AS.3500
- (7) Lifts/Escalators - Code AS.1735
- (8) Electrical Services -Code AS.3000
- (9) Energy Management - Code AS.3598
- (10) Telecommunications - Code AS.3260

2.3 Zoning and Use

When considering the zoning and use of the property, the following should be considered.

- (1) What is the zoning of the property? Details of the conditions applying to the zoning. Are there any outstanding conditions of zoning approval? Is there a written contract in relation to the zoning of the property? Is that document to be assigned? Is the purchaser to provide any bonds?
- (2) Have any development approvals been issued in relation to the property? If so, have the conditions been fully complied with? When does the development approval expire?
- (3) Details of current building approvals. Location of building plans as approved by the local authority. If work is not complete, when does the building approval expire? Have all improvements/alterations to the property been made with the approval of the local authority? Does any certificate need to be issued from a local authority to allow the property to be occupied? Does any relevant certificate allow the property to be used for its current use?
- (4) For what purpose is the property currently being used? Is any consent required for the current use? Is the use permitted under the current zoning?
- (5) When were the current improvements constructed? Were the improvements constructed in accordance with plans and specifications approved by all relevant authorities?
- (6) Are any structures on the property in question listed with heritage authorities that have jurisdiction over the site? What is the estimated future cost to maintain the listed item?
- (7) Have any notices been issued by Council or other authority?

Prudence would dictate that a copy of the development consent and a building certificate be obtained.

In the event that you intend to change the use of the property you will likely need to lodge a development application with the local council and will likely be required to make a contribution to Council for local facilities.

2.4 Cost of operating the property

In reviewing the operating costs for the property, consideration should also be given to security, fuel supply, telecommunications, pest control, cleaning, public address, energy management, fire protection, trade waste disposal and toxic waste. Are there current contracts in place? What is its current cost? What date do they expire? When were they last reviewed? Are they assignable?

2.5 Leased property

In purchasing a leased property, there are various issues which need to be considered, including:

- (1) the terms of the registered (or unregistered) leases;
- (2) the terms of any collateral agreements;
- (3) the terms of any undisclosed arrangements which may include rent free periods, free fit outs, incentives to related parties and the like;
- (4) the terms of any licensing arrangements, including licences for car parking and signage;
- (5) the enforceability and assignability of relevant documents (including guarantees offered as security of the arrangements);
- (6) the financial arrangements including the calibre of the tenant and the terms of any offered security;
- (7) an audit of the payment history of the tenant. Confirm lease obligations against actual payments (including rent, outgoing, insurance etc);
- (8) any rent review or valuation disputes;
- (9) whether any option has been properly exercised;
- (10) Council approvals to the tenant use and fit-out of the premises;
- (11) clarification as to what are tenant and what are landlord fixtures and fittings and the make good terms of the tenant lease;
- (12) the tenant make good obligations; and
- (13) the tenant refurbishment or repaint obligations.

Of course the abovementioned matters must be considered having regard to the specific terms of any relevant legislation such as the Retail Leases Act and compliance with such legislation.

Further, it may be prudent to prepare a sensitivity analysis (including yield, internal rate of return and say 10 year discounted cash flow).

Should you require, we can provide you with further information concerning:

- pre-lease negotiations;
- rent and outgoing;
- rent review provisions;
- lease security;
- enforceability and enforcement of leases;
- estoppel and waiver and their impact on leases;
- property insurance cover;
- environmental issues; and
- representations and conduct of Agents.

2.6 Insurance

The law is unequivocal - the property is at the vendor's risk until completion of contracts (unless qualified by contractual arrangement). However, the purchaser should insure against its risk of loss from exchange.

Importantly, full reinstatement and replacement insurance may oblige you to insure the improvements for substantially more than the purchase price of the property.

2.7 Depreciation

As there are many tax concessions available in respect of commercial property, the availability of proper documentation in relation to building allowance deduction, depreciation, and the

ownership of partitioning in leased premises is essential to ensure that the return on the property is maximised.

3. INDUSTRIAL PROPERTY

3.1 Contamination & other Environmental Issues

A contaminated site is a site at which hazardous substances occur at concentrations above levels in the local area and assessment indicates that it poses or is likely to pose an immediate or long term hazard to human health or the environment.

In general terms, most environmental issues relating to a property will need to be addressed by the occupier of the land or the user of machinery or the like on the premises. There are exceptions to this general position of which the owner needs to be aware. These include liability for leakages, spills or escapes of substances which harm or are likely to harm the environment pursuant to the Environmental Offences and Penalties Act.

The other major environmental issue impacting on owners is the ability of the Environmental Protection Authority to declare land as unhealthy land pursuant to the Unhealthy Building Land Act. This will be noted on the zoning certificate to the land and once noted will not be removed until satisfactory remediation has been carried out. If the land is stated to be unhealthy building land, it is prohibited to erect a structure on such land except with the approval of the Environmental Protection Authority. This may significantly impact on the value of collateral being provided by an owner to its mortgagee for financial accommodation which may include finance for construction of a new building on the land.

It is desirable that provisions be made in a lease, particularly of industrial premises, for the tenant to covenant to comply with all environmental laws and, if necessary at the end of the lease, to conduct an environmental site audit to determine whether any environmental hazard has resulted from the tenant's activities at the premises. A bond can be held by the landlord to protect itself from such liability or in the alternate, insurance may be effected to protect the owner or its mortgagee from such liability.

Where an owner is involved actively in the leasing of industrial premises or land which is proposed for such purpose, it is ordinarily a requirement prior to such development to conduct an environmental impact study. The taxation legislation provides deductions for environmental impact expenditure for such studies which are generally deductible over 10 years or the life of the project to which it relates, whichever is the lesser.

In addition, where the land being used is for income producing purposes, expenditure incurred on or after 19 August 1992 for the sole or dominant purpose of carrying on an eligible environment protection activity is generally deductible.

Accordingly, environment protection activities to minimise the owner's risks of breaching the various environmental laws can not only minimise the owner's liability for offences under such legislation but can in addition attract tax deductibility benefits.

It is imperative that potential purchasers of land which is known to be or suspected to be contaminated make full enquiries regarding the extent of potential contamination which would usually involve a full environmental audit by an accredited auditor. Council may have additional requirements which should be fully investigated depending upon the use to which the property is to be put.

A building report should disclose whether asbestos has been used in the construction and the condition of such material. Damaged asbestos material may require removal under rigorous safety conditions and may prove expensive.

3.2 Strata title

Strata industrial developments where each strata lot is a separate building should be considered carefully if the buildings comprise common property which must be maintained by all the owners in the strata plan rather than each lot. For example the roof of one lot may require replacement but

the costs would be borne by all of the owners. Consideration should be given to the condition of all the buildings rather than just the building relating to the lot being purchased.

4. RETAIL PROPERTY

4.1 Location

The tenancy mix of the surrounding area has an important bearing upon the customer flow and potential income which can be derived from the property. Investigations should be conducted by talking to estate agents in the area, other tenants and making enquiries with Council to ascertain whether there is any proposed or new development in the area which will affect the property, the customer or traffic flow to, past or near the property.

4.2 Leases

Premises that form part of a retail shopping centre, whether used as a retail shop or not will be covered by the Retail Leases Act. This Act requires the lease to comply with certain mandatory provisions, implies certain terms into leases, places restrictions on the ability of the landlord to recover outgoings and limits the circumstances in which the landlord may terminate the lease. As some leases still have not been brought within the provisions of the Act as they were in existence prior to its commencement, it is important that the lease provisions be checked carefully as future leases terms may not be as favourable to the owner.

Our comments earlier regarding leases also apply to retail premises.

This broad summary has been provided for your general information. Clearly there are many more issues that may be relevant to your individual circumstances. Should you require any particular advice please do not hesitate to contact any member of the Property Team at The Argyle Partnership on (02) 8263 6600.