

Taking control of property due diligence

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A recent case on due diligence clauses has found that most of the widely used due diligence conditions will require a broad range of enquiries by the purchaser's lawyers. The phrase in question was "the intended use of the property" which is a commonly used phrase in such conditions. While the reasoning is sound, the last thing purchasers probably want is for their lawyers to delve into every conceivable issue at the purchaser's expense.

Due diligence is often seen as an expensive way of discovering that there are no material issues with a property. This might be true but the purpose of due diligence is to ensure that there are no issues that may cause a purchaser to lose money or suffer other loss. However, before starting any due diligence the purchaser and its lawyer should have a conversation about scope and cost.

Agreeing the scope of the due diligence is critical in keeping costs to a reasonable level. The following are some tips on areas where risk can be allocated to keep costs under control.

Most commercial property investments will involve buying buildings subject to leases. Most landlords in New Zealand use the Auckland District Law Society form of Deed of Lease, either in its standard form or with modifications. An experienced investor may be comfortable with asking its lawyer to simply provide a review of the amendments made to the standard form while a first-time investor may want a more detailed review. If the leases are custom written for the landlord then even the experienced investor may want more detail. However, the important issue is for the investor and its lawyer to have a clear conversation about what is valuable to the investor and what the investor needs to know in order to assess the lease.

The other big area where investors can reduce legal costs is in the various property reports that are available. LIM reports must be obtained as a good starting point for information but investors can read these themselves and ask for specific input on issues. Local authority property files are also very helpful but potentially even more time consuming. It can be more efficient for the investor to review these first and identify specific issues for its lawyer to consider. Building reports and earthquake reports are probably better reviewed by industry specific experts and specific issues raised with the lawyer.

All of this means there is a transfer of risk from the lawyer to the investor. If there has been a clear direction not to review documents or parts of a document, the investor assumes some risk if it transpires that an issue would have been discovered. However, a careful scoping exercise should ensure that the high risk areas are dealt with which will reduce this transfer of risk.

This article was written by Daniel Kelleher for the NBR (June 2018).

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