

Falconbury Facilities Management

Module 1 Acquisition of a Property and Types of Contract

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provide the basic knowledge that will at least enable those
seeking further knowledge to ask informed questions.

ACQUISITION OF A PROPERTY AND TYPES OF CONTRACT

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1. INTRODUCTION

Property is often the most valuable of an organization's fixed assets. This course, however, is not concerned so much with property as an investment (other than as a one-off) but with its use and administration for the purpose of an organization's own business.

Duties

The obligations of those responsible for the administration of their organization's property assets are three fold:

- 1) Facilities administration, which the British Institute of Facilities Management defines as:
 - the integration of multi-disciplinary activities within the built environment and the management of their impact on people and the workplace
 - (combining) resources and activities (which) are vital to the success of any organization, by contributing to the delivery of strategic and operational objectives
 - providing a safe and efficient working environment which is essential to business performance whatever its size and scope
 - the provision, maintenance and development of myriad facility services which range from developing a strategy, managing space and putting in a communications infrastructure to building maintenance, administration and contract management.
- 2) Budgetary and expenditure control. In many organizations there is an apparent 'cost blindness' to property expenditure, so much so that facility costs are regarded as fixed and immutable as taxation. Indeed in some instances costs are passed for payment with hardly any examination as to correct calculation and/ or appropriateness. Property costs could be among the most expensive in the budget.
- 3) Property administration, which could include:
 - long-term planning of requirements
 - compiling and administration of records
 - interfacing with regulatory bodies involved in building, fitting out and occupying properties, and those having access to them
 - interfacing with landlords and/or agents
 - administration of cleaning, security, reception, housekeeping and safety, waste disposal, gardening etc services
 - ensuring compliance with covenants under leases
 - interfacing with, providing information to, and making claims on insurers
 - interfacing with utility and other bought in service providers
 - preparing and updating contingency and/or disaster recovery plans

- interfacing with neighbours and trespassers
- assisting with planning and implementation of relocation
- overseeing the renegotiation of leases, agreeing rent reviews and renewals
- and so on

With this range of obligations it is obvious that in any organization (particularly if property is leased) this should not be a job to be added to the duties to be undertaken by someone who already has enough to do. It poses specific problems and challenges which, if not dealt with properly, could involve (and often does) considerable cost, waste and inconvenience.

2. ACQUISITION

Introduction

Rights to property occupation, other than under licence, often entail a long-term commitment. Failing to appreciate the implications of such a commitment can come as an expensive surprise. The aspects and implications of the various types of occupation, covered in the Freehold, Leashold and Licence sections later in this Module should be referred to. Whilst the choice between the accommodation types may be predominantly a financial one there are a number of other considerations which need to be borne in mind.

Types of occupation

a) Freehold

The acquisition of freehold property entails a capital outlay which must be sourced and financed. However, investing in a freehold property may strengthen the organization's balance sheet since, in the long-term, property values tend to rise at around the level of inflation. Thus suppliers or creditors inspecting the balance sheet may derive some comfort from seeing such assets which, unlike most others, should appreciate. A freehold acquisition retains flexibility since:

- the business could raise capital on the property by means of a 'sale and lease-back' arrangement whereby, owning the freehold, the business sells that interest to a third party subject to the simultaneous grant of a lease to them of the premises (so that they retain occupation rights),
- subject to planning restrictions and any restrictive covenants in the conveyance the owner can do with the property what it wishes,
- businesses operating an occupational pension scheme can reduce their levy to the Pension Protection Fund if they pledge property/ies to that scheme.

All aspects of the investment need to be identified and costed.

ACQUISITION JUSTIFICATION FORM – FREEHOLD

ORGANIZATION _____

FREEHOLD ACQUISITION ASSESSMENT

Property address _____

Purpose _____

A. RATIONALE

Is acquisition in plan? YES/NO* _____

If NO provide complete rationale and explain effect on plan _____

_____If YES – is timing in accordance with plan? YES/NO* If not provide explanation

_____**B. COST**

Purchase price £ _____

Purchase costs £ (fees for agents, surveyors, solicitors; stamp duty) _____

Fitting out costs £ (confirmed estimate) _____

Total acquisition costs £ _____
=====

Estimated annual charge £ per square metre/yard (so that an occupation cost per department can be calculated (see INTERNAL RENTS)

C. LOCATIONExplain rationale for selecting this site. _____
_____What is the planning authority's designated use for the area? _____

What are prospects for disposal in long-term? _____

Any capital growth anticipated? YES/NO _____

If YES explain type of growth/period etc. _____

D. USAGE

Is whole property to be used YES/NO _____

If Yes – state annual income from purpose of occupation _____

If No – explain approach regarding surplus _____

Subletting – expected income (etc) _____

E. RUNNING COSTS

Annual operating costs _____

(Provide analysis for duration of plan span of [specify]) _____

(Note: This could include the 'annual charge' (see B above), internal rent, cost of money or depreciation, statutory imposition reserve, etc.)

F. ALTERNATIVE RATIONALE

(That is provide an explanation of how the situation will be addressed if this purchase does not happen.)

NOTES

- i) Unless the proposal has been previously addressed within the planning process the whole rationale needs to be examined.
- ii) The means by which the operating department/unit etc is charged for the occupation needs to be determined either by means of a proportion of the original cost price, or by an internal rent or depreciation charge etc.
- iii) The question of ultimate use or disposal should be addressed.

iv) The 'statutory imposition' reserve addresses the fact that increasingly commercial occupiers of property are required under legislation to carry out alterations etc., to their properties. For example:

- since October 2004, occupiers have been required to make reasonable adjustments to their premises to allow disabled access to members of the public;
- since November 2005, occupiers have been required to carry out an 'asbestos containing materials' survey of their premises and to protect any asbestos discovered from being disturbed;
- since April 2006 occupiers have been required to be pro-active regarding assessing FIRE risks in their premises.

All such requirements could, depending on the state of the building, be expensive.

b) Leasehold

A lease grants a right of occupation in return for which the occupier must pay rent and other outgoings for the premises and keep them in a state of good repair and decoration for the lease term. A lease is a binding contract with many clauses including a number of covenants (see Module 2) which can be onerous and restrictive. The implications of all covenants should be fully appreciated, particularly as failure to comply may mean that the lessee can be in breach of the lease which could lead to loss of occupation, and the payment of compensation in respect of the unexpired term. A lease usually also grants a right to the lessee to a new lease when the old expires unless:

- the landlord wishes to occupy the premises himself or to redevelop them, or
- the lessee has failed to comply with the covenants, or
- the lease is agreed (with Court approval) to be outside the Landlord and Tenant Act (the legislation which protects the interests of lessees).

Subject to some provisions a lease may be able to be sold (assigned).

ACQUISITION JUSTIFICATION FORM – LEASEHOLD

ORGANIZATION _____

LEASEHOLD ACQUISITION ASSESSMENT _____

Property address _____

Purpose _____

A. COMMITMENT RATIONALE

Is commitment in plan? YES/NO* _____

If NO provide complete rationale and explain effect on plan _____

If YES is timing in accordance with plan? YES/NO* _____

If NO – provide an explanation _____
_____**B. TOTAL EXPENDITURE COMMITMENT**Expenditure: multiply commencing annual rent plus service charge (if any)
by term of lease or term to option date (if any) _____
_____Projected additional rent and service charge from reviews _____

Total commitment (i.e. figure to be justified) _____

What alternatives are there to the lease commitment? _____
_____Can lease term be shortened and is this appropriate? _____
_____If there is no option to break, can one be introduced? _____
_____Possibilities of assignment (i.e. is lease marketable)? _____

Any possibility of acquiring freehold? YES/NO

If YES, what price?

C. ANNUAL RUNNING COSTS

(Total annual expenditure inc. rent, rates, heating, lighting, statutory imposition reserve, maintenance, redecoration, dilapidation reserve.)

D. USAGE

Is whole property to be used? YES/NO _____

If NO, can surplus be sublet? YES/NO _____

If YES what is expected income to offset annual costs? _____

If NO – explain rationale re. surplus _____

NOTES

- i) The requirement for prospective occupiers to state alternatives should approval for occupation not be granted is used widely in the USA. Such alternatives could, for example, include:
 - a) a bought-in service
 - b) short-term licensing
 - c) outsourcing
 - d) outworking, and so on.
- ii) The requirement to consider the implications of commitment to a long-term lease is mainly to underline that very point, i.e. it is a long term commitment and any method of achieving flexibility should be considered.
- iii) See the notes to the Freehold acquisition form for other guidance to the questions asked above.

c) Licence

This is simply a ‘right to occupy’, usually only for a short period. Similar covenants to those in a lease may be contained but without any right to renewal of occupation at the end of the term. Occupying premises under licence provides little security, although usually it does have the advantage of low cost. It is very unlikely that the rights under a licence could be transferred.

Pre-commitment checklist

1. **Location:** Ideal locations are rare, but unless the required parameters are identified it will certainly be unlikely to find the ideal (see Relocation in Module 4).

There are a number of initiatives operated either by the State (DTI Enterprise initiative, Urban Regeneration), by local authorities (Enterprise Zones) and the European Union (Special Assistance Areas) giving financial assistance to businesses prepared to move to certain areas where employment is required. The Department of the Environment has issued over 20 guides giving information about development policies in various areas.

2. **Area:** Before making a decision, the long-term future of the area should be considered. Is it likely that, should the organization wish to dispose of the premises in the medium future, that there will be a market for such premises in such a location? If not, the possibility that disposal may be costly (or at a discount) needs to be borne in mind as part of the acquisition cost assessment. The position regarding Registration of Land on which the building stands should also be investigated. Although an increasing proportion of land in the UK is now registered (i.e. details of position, history, ownership, restrictive covenants etc., are on record with the Land Registry and allocated a Title Number) sizable areas (including much of London) are not yet registered which may make the investigation of title more difficult.
3. **Type of property:** Whilst using a property that fits the exact requirements of the organization is ideal, if such requirements are very unusual and the property is customized it may be difficult to dispose of it. Using a listed building may add to an organization’s image, but there are severe restrictions regarding use and alteration of such a property – and its value on disposal may be reduced accordingly.
4. **Pre-acquisition survey:** Since failing to establish the true state of the property could prove costly, a full structural survey should be commissioned, despite the cost. This is especially the case with property subject to a full repairing lease. Under the terms of such a lease the landlord can force the lessee to rectify repairs etc, but if the clause states ‘put and keep repaired’, the lessee’s obligation is extended, and requires the lessee to bring the property to a fair state of repair no matter how dilapidated it may have been initially (and how blameless the current lessee is for its state). Establishing the state of the building enables the purchaser to take a commercial decision in recognition of such potential obligations. Indeed, the existence (and results!) of a professionally compiled and costed survey may be a valuable negotiating factor in arriving at the determination of price, rent and/or premium.
5. **Inherent defects.** Another advantage of the survey is that it may disclose any inherent defects in the building which, through negotiation, may be taken out of any commitment as far as rectification and/or repair.

6. **Condition Schedule:** Such a schedule may also be negotiated to minimize onerous repairing/rectification obligations in a lease. An agreed schedule of the state of the property should minimize the lessee's obligations to repair to that state (and no better). (Also see Condition Survey later in this Module.)
7. **Covenants:** The full effect of all the covenants required to be included in the lease should be explained to those who will actually operate in the building in case any (for example, unduly restrictive opening hours) would inhibit the required use of the building. Someone fully aware of the effect of covenants on the practical aspects of operating in the premises should review ALL covenants before commitment. (Also see Covenants in Module 2.)
8. **Privity of contract:** If these requirements or their equivalent are included in the lease, permission for the lessee to sublet or underlet as an option to assignment should be insisted upon. In this way, should the premises become surplus to requirements, and an alternative occupier be found, the lessee can sublet or underlet (rather than assign), knowing that should the new occupier fail, they retain rights (usually lost in the event of assignment) to re-occupy and/or to re-let. (Also see Privity of contract in Module 3.)
9. **Planning:** Any restrictions placed on occupation by planning consents and/or conditions, and/or covenants contained in the conveyance need to be fully appreciated (and costed). (Also see Planning in Module 4.)
10. **Acquisition costs:** As well as the actual purchase price, all solicitors' and agents' costs, stamp duty, land tax, insurance etc. should be built into the budget. For leasehold premises, some organizations require justification of the total rental exposure for the term of the lease (ignoring or including reviews) because this is the total commitment being entered into.
11. **Acquisition concerns:** When an organization acquires land or buildings, enquiry regarding pollution should be made. Land may previously have been used by organizations that contaminated the land and under the Environment Protection legislation if the polluter cannot be found then the occupier is responsible for an expensive cleansing of the land. Since knowledge that the land is polluted may not be realized for some time it may be advisable to insure against this risk. Alternatively it may be possible to obtain an undertaking from the vendor to hold the purchaser harmless from such costs.
12. **Occupation costs:** The full costs of occupying and running the facility need to be assessed and justified. In a relocation, the current costs of heating and lighting may be extrapolated (to take account of buildings of different sizes and/or configurations). If an existing building is being acquired, enquiry of the previous occupier may also provide a guide to these costs. Obviously the effect of building costs as well as the investment, depreciation etc must also be taken into account. If the use of the building – or its configuration in terms of occupation – is to be changed, the question of the rating valuation (also see Module 8) – and any appeal – should also be considered. It may also be necessary to check whether there is any breach of user or planning requirements (also see Module 4).
13. **Access,** car parking and relationships with neighbours should be investigated: Where access could be denied, e.g. because of fire of a neighbouring building, insurance against 'denial of access' (a particular consideration if a unit is, for example, in shared facilities such as a tower block, retail centre or park) should be considered and costed.
14. **Personnel:** Staffing costs and employees' travelling conditions may need consideration.

Commitment checklist

- 1. Customizing:** Rarely will any building be ideal for immediate occupation and most will require some customizing. Such works need to be approved under building regulations and comply with the requirements issued in accordance with the latest fire precautions regulations. Where the occupation is leasehold the approval of the landlord must also be sought prior to any works being effected whilst the obligations under any reinstatement requirements should be assessed (also see Module 2).
- 2. Works approval:** Landlord's approval can be obtained either formally (under a licence to carry out works or a Deed of Variation) or informally (by the landlord signing copies of the plans and specification setting out the work to be conducted). Usually the formal route is required which will not only require a deed to be drawn up, but will also set out conditions regarding the works and an obligation on the lessee to reinstate the premises on lease termination. This requirement can have a triple cost: payment for the works, payment for them to be removed at lease termination and, since the premises must be left in a good state of repair, payment to make good.
- 3. Funding the works:** Such costs can be met by either party. If the landlord pays, the costs could be recovered by the rent being increased. Although this makes the relationship somewhat 'tidier' since the lessee is simply occupying a facility, the entire cost of which has been met by the landlord, if the rent itself is increased it may have repercussions at times of rent review when the occupier needs to relate its rent to rents commanded by similar properties in the immediate area. The 'rentalised' costs may be better dealt with as a charge entirely separate to the rent (even if collected at the same time). If the lessee funds the works, then not only should the triple cost effect referred to above be borne in mind but also the lease should stipulate that the effect of the works should be ignored when the rent is reviewed. If not, the lessee, having paid for works which have increased the value of the premises, be asked to pay rent enhanced by the value of the same works. If the landlord resists this 'ignore the effect of the works at rent review' argument and requires the full value to be reflected at review either the landlord should fund the works, or some dilution of other covenants (e.g. repairing and/or reinstatement obligations) should be negotiated.
- 4. Accountability:** Ideally completion of the acquisition phase should take place in sufficient time for customizing and setting up work to be completed before occupation. Rarely does this occur and usually there needs to be some compromise – often with employees trying to commence working whilst builders are still finishing. Usually the terms of a building contract will require the builder to take responsibility for the property during the works (and to effect insurance related to this). If staff from the employing organization occupy the premises before the builder has 'handed over', responsibility, in the event of any loss or damage, may be blurred. In addition, the builder may be able to disclaim any attempt to enforce any penalties for late completion by virtue of his staff being 'hampered' by the occupation.

3. VALUATION

Introduction

Property can, for many organizations, be among their most valuable assets. If so, the current value of such assets should be known at all times. This should be a continuous process since property values are constantly changing, simply due to supply and demand – as well as to a variety of other factors. If the true value is not known, appropriate decisions concerning the assets cannot (or should not) be made.

Staged valuation

Many property owners adopt as a policy the concept of revaluing (say) a third of their portfolio every year meaning that over a period of three years the value of their whole portfolio will have been updated. Not only does this mean that at any time the value of no property should be more than three years out of date but also it spreads the valuation cost over the same period (indeed it can become a regular annual charge). If a system of recharging an internal rent (see Module 8) against those parts of the business that occupy the premises, the valuations themselves can serve as a base for the calculation.

As an alternative, staged revaluations over a five year period can be used, although property values tend to be somewhat dynamic and to leave a valuation of part of the portfolio for five years may mean that the value of some properties are seriously out of date. In addition, the valuation itself could be a major addition to costs in that year.

Instruction

For valuations to be reliable and of use, particularly as part of the financial accounts of the organization, it will be necessary for qualified surveyors or valuers to conduct the work – and to provide written confirmation of their assessments. If such advisers regularly carry out work for the organization, and/or a commitment to repeat the process regularly is given, it may be possible to negotiate a reduced fee. If the same valuer is used repeatedly, a reduced fee may be negotiated at the time of the second or subsequent valuation, as a certain amount of information and knowledge of the property should have already been assimilated by the valuer with records compiled and a history of the organization's occupation being available.

Other matters

As part of a valuation, particularly one required for a proposed purchase, checks can also be made on floor loading, security and the exact position of boundaries etc. Some firms can also provide valuations of plant and machinery. For the purposes of insurance cover it may also be necessary to obtain valuations although here it is normally the cost of rebuilding that may be required. The valuation figures could be incorporated in the (keeping) property records and also in the yearly projections to assist in the taking of informed decisions (also see Module 8).