

Best practice guidance notes for the

Technical Due Diligence

of Commercial & Industrial Property
Australia



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Foreword

As financial institutions, investors and occupiers look ever more closely at the risks of buying (or selling) property assets, Technical Due Diligence reports which detail the physical condition of a property, are increasingly important.

Having confidence in the professionals undertaking the Technical Due Diligence and the process they follow is of particular importance.

These guidance notes provide a professional approach to addressing all matters

relating to Technical Due Diligence and I am convinced that building owners and occupiers, investors and their respective advisors will benefit from the professional objectivity and guidance this document provides.

Matthew Quinn FRICS

**Managing Director
Stockland**

A Word from the Oceania Chairman

As a global professional body which seeks to set and promote professional best practice, RICS produces a wide range of guidance and standards for the property industry. These guides are both globally significant but also locally relevant.

With the publication of this new guide for Australia RICS aims to define best practice in all aspects of Technical Due Diligence of commercial and industrial property. This guide has been produced by experienced

RICS Chartered building and property professionals and property lawyers and I believe it will become accepted as the best practice standard in the Australian market.

I wish to commend the RICS Technical Due Diligence Working party for their efforts and the professional document produced.

Stephen Ellis MRICS

Chair - RICS Oceania

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Table of Contents

1. PURPOSE	3		
2. THE NEED FOR TECHNICAL DUE DILIGENCE	3		
3. TYPES OF INSPECTIONS	4		
3.1 Guidance Note	4		
3.2 Acquisition	4		
3.3 Occupation	4		
3.4 Disposal	4		
3.5 Development	4		
4. TAKING INSTRUCTIONS	5		
4.1 Client Requirements	5		
4.2 Third Party Consultants and their Appointment	6		
4.3 Engagement by Lead Consultant	6		
4.4 Engagement Directly by the Client	6		
5. MAIN COMPONENTS OF THE TECHNICAL DUE DILIGENCE REPORT	7		
5.1 General Property Description	7	5.14 Tax Depreciation/ Capital Allowances	14
5.2 Access	7	5.15 Reinstatement Cost Assessment	15
5.3 Structure	8	5.16 Capital Expenditure (CAPEX) Forecasts	15
5.4 Building Fabric	8	5.17 Operational Expenditure Assessment	16
5.5 External Areas	8	6. INTERPRETATION OF THE REPORT	17
5.6 Building Services	9	6.1 Cost Findings	17
5.7 Environmental Issues	10	6.2 Time Frame	17
5.8 Sustainability	11	6.3 Risk Ratings	17
5.9 Town Planning	11	6.4 Reasons for Defects	18
5.10 Statutory Compliance Review	12	6.5 Incorporating Costs into Investment Analysis and Strategy	18
5.11 Heritage Significance Assessment	13	7. MATTERS FOR THE LEGAL ADVISERS ATTENTION	19
5.12 Floor Space Ratio, Car Parking Ratio and Efficiency	13	7.1 Title and Tenure	19
5.13 Identification Surveys	14	7.2 Boundaries	19
		7.3 Guarantees and Warranties	19
		7.4 Leases	19
		8. INSURANCE	20
		9. ANNEXURE A	21
		Confirmation of Scope of Services	21
		10. ANNEXURE B	22
		Report Limitations	22



1. Purpose

The purpose of this document is to provide practical guidance to property professionals (being the professional providing the Technical Due Diligence services) and their Clients (being the recipient of those services) when providing, or receiving, professional advice in connection with Technical Due Diligence exercises which relate to transactions involving real estate and improvements. For convenience, when this guide refers to “property”, it will be referring to land and all structural improvements on it.

This is not intended to be an instruction manual, nor a detailed step by step process which must be followed, but rather a guide to the principles which should be adopted in a typical Technical Due Diligence process.

This is also an RICS guidance note for Australia. It provides advice to members of the RICS on a specific aspect of our profession, in this case Technical Due Diligence. Where procedures are recommended for specific professional tasks, these are intended to embody “best practice”, i.e. procedures which in the opinion of the RICS meet a high standard of professional competence. It is of course incumbent on every professional to ensure that the highest standards of service are provided at all times, and RICS guidance notes are considered to reflect the standards expected of RICS members.

2. The Need for Technical Due Diligence

Technical Due Diligence is the process of systematic review, analysis and discovery in which a prospective purchaser, occupier or financier of property gathers information about the physical characteristics of the property in order to enable them to make an informed assessment of the risks associated with the transaction.

Most physical improvements have defects or deficiencies which could impact on their short, medium, or long term performance. The defects may include the need for repairs arising from a lack of planned preventative maintenance, neglect or misuse, insufficient capacity and code non-compliances of building services.

The benefits of Technical Due Diligence include:

- (a) gaining an understanding of the condition and design of the property;
- (b) establishing the suitability of the property for its intended use;
- (c) understanding the need for and quantifying future costs and other liabilities;
- (d) providing a level of protection for institutional investors; and

- (e) providing a solid foundation for price negotiations and allocation of risk.

The majority of large property “owners” are institutional investors who manage a portfolio of property assets on behalf of their beneficial owners. They may be held in the form of listed or unlisted property trusts, property companies or syndicates. The managers of these investment vehicles have a fiduciary responsibility to the ultimate owners in making acquisitions, to ensure that all reasonable risks and liabilities are understood.

Further, the maxim of “caveat emptor” (let the buyer beware) is still a guiding legal principle in all property transactions. Unless the seller expressly promises something about the physical condition of the property, the seller does not warrant anything in relation to its condition. The party acquiring must take reasonable steps to discover as much about the acquisition as possible before committing to a commercial transaction. The process of Technical Due Diligence is therefore critical to any successful property transaction.

“ Most physical improvements have defects or deficiencies ”



3. Types of Inspections

3.1 Guidance Note

This guidance note considers four key types of Technical Due Diligence processes for commercial property, each of which will have a slightly different emphasis. These are:

- (a) Acquisition (including financing);
- (b) Occupation;
- (c) Disposal; and
- (d) Development.

3.2 Acquisition

The process of undertaking a Technical Due Diligence on the acquisition of commercial property is the most common of the four categories. The process of Technical Due Diligence should determine:

- (a) whether significant defects exist in the structure, fabric and building services installations of the property;
- (b) whether there are legal implications of the defects such as non compliance with statutory standards; and
- (c) whether the property is suitable for the Client's intended use.

Where there are deficiencies, estimates of the remaining life expectancy of key elements should be provided, along with information regarding the degree and costs of repairs required. The cost estimates may justify a renegotiation of the acquisition terms between the seller and the buyer.

It is important to remember that legal and investment aspects of the acquisition are also being considered by other specialists on behalf of the Client. The technical aspects should be considered in the context of this bigger picture and may require all of these advisers to liaise with each other.

3.3 Occupation

In addition to the issues outlined above for "Acquisition", if occupation by the Client is contemplated, the Technical Due Diligence process should advise on any restrictions or problems likely to be encountered in fitting out or adapting the property for the intended use. The extent of the occupier's responsibility to insure, repair and maintain the property under the lease or other occupation arrangement must be understood in the context of the physical condition of the property.

Where a Client proposes to occupy only part of a building and will share in the cost of upkeep of the whole, it is important to assess the likelihood of any major repairs necessary to the fabric of the entire building and its services, which could have a significant impact on the building outgoings.

3.4 Disposal

The primary purpose of a vendor's Technical Due Diligence before a proposed sale is to identify significant physical defects or any statutory non-compliance which may affect the value of the property on the open market, or which may allow an avenue for a purchaser to extend negotiations regarding certain technical issues.

Vendor's Technical Due Diligence normally precedes a valuation. The valuation can then provide an opinion on the value of the property having regard to its condition.

However, a vendor may undertake a Technical Due Diligence as a standalone process so that information on the physical condition of a property can be made available to prospective purchasers in an attempt to expedite the sale process.

3.5 Development

The role of a Technical Due Diligence process as part of a development feasibility is to establish the potential value and viability of development projects.

Input from specialists will be required to provide comprehensive advice to a Client, and this advice must be reviewed, analysed, and compiled into a report providing the Client with a summary of the key issues to be considered through the development process.

Clients may subsequently instruct the professional to review the design, specification and plans and monitor the works as they proceed. This is common where a Client enters into an agreement to fund, purchase or lease a development that has yet to be built. This is the role of "Project Monitoring", for which a separate RICS guidance note exists.



“The technical aspects should be considered in the context of this bigger picture”



4. Taking Instructions

4.1 Client Requirements

A clear understanding of the Client's requirements is essential to the successful completion of a Technical Due Diligence report. A "one size fits all" approach cannot be taken. However, as a guide it is recommended that the following items are established before providing an offer of service:

- (a) the identity of the Client/other party;
 - (b) the identity of the property professional/company;
 - (c) what service(s) is/are to be provided (refer to Annexure A);
 - (d) the address and extent of the premises to be inspected;
 - (e) the existing or intended use of the property and any timeframes affecting a change of use;
 - (f) the extent of any information being made available for review by the property professional, and how reliable it is;
 - (g) whether sub-consultants are to be engaged direct by the Client or through the property professional;
 - (h) any particular OH&S issues which would affect the nature of the inspection;
 - (i) the report format;
 - (j) any limitations on the extent of the inspection and report;
 - (k) the timeframe for completing the inspection and report; and
 - (l) the commercial terms of the instruction (such as professional fees).
- In determining the scope of the instructions, the property professional should:
- (m) not assume that they know what the Client wants to achieve from the inspection and report;
 - (n) establish what the Client considers to be important before providing an offer of service;
 - (o) establish why the Client requires the information; and
 - (p) guide the Client if it appears that the Client is not fully aware of all of the services available. (This may include specialist advice from other disciplines. A checklist of potential services is provided in Annexure A - Scope of Service.)

In the written offer, the Property Professional should:

- (q) make it clear whether they are willing to assume liability to a third party if the report is assigned;
- (r) clarify the extent of their liability for specialist sub-consultant reports. (If sub-consultants are engaged by the Property Professional the level of detail included in the agreement with the Client should be replicated in any agreement with the specialist sub-consultant or contractor); and
- (s) notify the Client of any limitations of the report (sample report limitations are noted at Annexure B, however these will be unique to each instruction).

Irrespective of how often the property professional has been engaged by a particular Client, the property professional should ensure that a clear scope of works is established and that a contract exists before starting each Technical Due Diligence process. Disputes can be minimised by establishing a clear understanding of the terms of engagement at the outset and confirming all of the Client's instructions in writing.

“ A clear understanding of the Client's requirements is essential ”

4.2 Third party Consultants and their Appointment

Undertaking a Technical Due Diligence investigation, particularly on a large commercial, retail or industrial property can involve a number of individual consultants, each covering their specific area of expertise. It is unlikely that a single consultancy will be able to provide all disciplines required with exclusive in-house personnel. Therefore, it is standard practice in the market to engage third party specialist consultants from time to time to assist with the Technical Due Diligence process and the preparation of a Technical Due Diligence report.

These specialist consultants are engaged primarily by one of two methods;

- (a) by the main or 'lead' consultant; and
- (b) directly by the Client.

4.3 Engagement by Lead Consultant

Where a specialist consultant is to be engaged by a lead consultant via a sub-consultancy agreement, the lead consultant should advise the Client which aspects of the report will be undertaken by third party companies or individuals.

The lead consultant will:

- (a) provide the sub-consultant with a comprehensive brief of the services required;
- (b) check the sub-consultant's professional indemnity insurance cover (mandatory for RICS members); and
- (c) meet the cost of the third party involvement.

If a lead consultant is required to enter into a confidentiality agreement with a Client, the sub-consultant must accept the same conditions and enter into a separate confidentiality agreement with the lead consultant.

The major benefit of having a "lead consultant" is that there is only one point of contact for the Client. With a complex project involving up to 10 or more individuals, this will be important.

Once the Client has provided the lead consultant written instructions to proceed, it is the responsibility of the lead consultant to;

- (d) assemble the consultant team and brief them on the project;
- (e) make arrangements for site access for the whole team;
- (f) obtain all documentation necessary for the investigation and channel requests for further information via one point of contact;
- (g) implement OH&S policy for all personnel under its control while on site;
- (h) liaise with all consultants during and after the site inspection(s);
- (i) identify and advise the Client of any "deal breakers" from a technical perspective as soon as they are identified by the lead consultant or a sub-consultant;
- (j) review progress of each consultant and provide input during all stages of the appointment; and
- (k) review draft and final reports.

If a sub-consultant is engaged, their report should be included as a stand alone report, annexed to the lead consultant's Technical Due Diligence report. Altering or providing a misleading synopsis of a sub-consultant's report can expose the lead consultant to direct legal liability. Where any summary of the sub-contractor's report is included in the Technical Due Diligence report, there should be a note that it refers to the annexed report of the sub consultant.



“ unlikely that a single consultancy will be able to provide all disciplines required ”

4.4 Engagement directly by the Client

A Client may wish to appoint a specialist consultant directly. There could be a number of reasons for this: a Client may have a pre existing nationwide contract, for example, with a particular engineering or environmental practice for the delivery of services, or the purchase may be a joint venture where one of the purchasing entities has nominated a particular consultant.

In this instance, the Client will issue a brief direct to the third party consultant, and meet the cost of their involvement. In this case the Contract is between the Client and the specialist consultant. Despite this direct relationship between the Client and the specialist consultant, normally the property professional as the lead consultant will still treat the specialist consultant, and the reports produced, in the same manner as they would a sub consultant (i.e will comply with paragraphs 4.3 (d) to (k) above), in order to provide a holistic service.

5. Main Components of the Technical Due Diligence Report

5.1 General Property Description

This part of the report should give a concise overview of the property under consideration including:

- (a) the name and address of the property and the building(s);
- (b) the orientation of the building(s);
- (c) an overview of surrounding areas including zoning/building usage and infrastructure;
- (d) a description of the buildings and structures on the property;
- (e) the age of the building(s) and details of any extensions and/or refurbishments; and
- (f) the area of each building.

Where information is not available or an item above has not been reported on this must be stated in the report.

5.2 Access

Sufficient physical access to undertake the property inspection is vital to get the most meaningful information for the Technical Due Diligence report. A report that consistently refers to “lack of access” will be inadequate to meet a Client’s requirements.

The property professional should undertake research on the property before attending

the property, and also confirm with the Client in advance whether access will be available to the following areas during the inspection;

- (a) occupied areas;
- (b) common areas;
- (c) roof areas;
- (d) building facades;
- (e) lift motor rooms;
- (f) plant rooms;
- (g) service cupboards;
- (h) switch rooms; and
- (i) basement areas.

Depending on the age and type of property being inspected, advance notice regarding lack of access, (eg. roof and façade) will allow the property professional time (if approved by the Client) to arrange alternative access and to organise any equipment that may be necessary. The property professional can also discuss any associated additional costs with the Client.

Each property professional will have its own specific Occupational Health & Safety (OH&S) policy to ensure the health, safety and welfare of its employees, sub-consultants and the general public, and each property professional should advise its Client if they will not be able to access portion(s) of the property due to OH&S concerns.

“ The property professional should undertake research on the property before attending ”





5.3 Structure

This section of the report should identify the primary structural components of the property. Potential shortcomings of the design and its condition should be identified.

A visual inspection of structural elements may reveal deterioration or other defects which may warrant further investigation or monitoring. Typical issues may include:

- (a) spalling of concrete;
- (b) subsidence;
- (c) overloading; and
- (d) other structural distress.

Intrusive investigations with the assistance of a structural engineer may be required in any of these circumstances, and the property professional may recommend that a specialist structural engineer should be engaged.

Comment should be made on the suitability of the structural elements to perform their intended purpose. This may range from general suitability to a detailed design review by a structural engineer depending on the scope of the instruction.

5.4 Building Fabric

This section of the report will include:

- (a) a description of the elements of the building fabric;
- (b) the location of each element of the building;
- (c) an opinion on the fitness of the property for its intended purpose having regard to factors such as design, workmanship and condition;

- (d) recommendations for repair or replacement of items due to maintenance shortfalls, damage/misuse;
- (e) lifecycle expectations of each element of the building fabric. (Such recommendations should be aligned with the Client's intentions for the property e.g. refurbishment, remodelling, partial demolition etc).

The building fabric encompasses a broad range of elements which may include:

- (f) Roofs;
 - (i) roof coverings
 - (ii) terraces / balconies
 - (iii) awnings
 - (iv) rainwater goods
 - (v) maintenance access
- (g) Façades;
 - (i) walls
 - (ii) windows
 - (iii) canopies/sun screens
 - (iv) doors
 - (v) maintenance access
- (h) Interior;
 - (i) ceilings
 - (ii) walls / partitions / doors
 - (iii) floors / staircases
 - (iv) finishes
 - (v) fixtures and fittings

5.5 External Areas

The external areas comprise:

- (a) the hard and soft landscaped surfaces;
- (b) vegetation; and
- (c) boundary treatments

within the curtilage of the property, and may include smaller outbuildings and structures which, due to their limited size and/or material relevance, do not necessarily warrant specific reporting within the main structure and building fabric sections of the Technical Due Diligence report.

This section of the Technical Due Diligence Report should describe:

- (d) the condition of hard landscaped surfaces and their suitability for current or intended use. The suitability for intended use may warrant additional investigations and/or testing where an increased load is anticipated (eg where heavy vehicle movements are proposed).
- (e) the condition of retaining walls including any evidence of structural distress and whether further investigations are recommended (such as the assistance of a structural engineer);
- (f) the size and relative proximity of mature trees to buildings, structures and infrastructure and any evidence of distress to improvements which appears to have been caused by the trees; and
- (g) evidence of mature trees which appear to have been recently cut down, and are relatively close to improvements, (particularly in areas with reactive clay soil due to potential soil heave).

“ building fabric encompasses a broad range of elements ”



5.6 Building Services

Building services, or services engineering, as a proportion of the initial capital costs of a property are significant. Building services also account for a major proportion of the ongoing or property life cycle costs, as they will be required to periodically be upgraded or replaced a number of times during the life of the building.

The status of building services can have a major impact on the perception of building quality, life cycle cost levels, facilities management and sustainability performance.

The assessment of building services commonly covers, but is not limited to:

- (a) mechanical (heating, ventilation, air conditioning cooling towers and controls);
- (b) electrical (power supply and reticulation, lighting, signage and lightning protection);
- (c) communications (telephones, mobile phones, intercoms, data cables and wireless, and internet connections);
- (d) security (access, control and intruder detection);
- (e) building management control systems (BMCS);
- (f) hydraulics (water supply and reticulation, sewer, storm water and trade waste treatment);

- (g) fire protection (hydrant, hose reels, sprinklers and extinguishers);
- (h) emergency services (power, water and communications contingencies); and
- (i) vertical transportation (lifts, elevators, escalators and travelators).

The scope of building services can extend to include;

- (j) fire engineered solutions;
- (k) indoor environmental quality (air, water, lighting and acoustic conditions); and
- (l) specialist equipment (power generation, refrigeration, computers and swimming pools).

In all cases the assessment of building services should be undertaken by consultants with appropriate experience. Common criteria used to evaluate building services include:

- (a) design intent, capacity and redundancy;
- (b) age, condition and life expectancy;
- (c) compliance with current codes, standards and practices;
- (d) standard of maintenance;
- (e) apparent defects and deficiencies; and
- (f) operational efficiency.

High level assessments may deal with services and systems holistically. However, a more detailed assessment should be expected to comment on sub-systems and items of plant and equipment.

A number of building services require specific compliance with the provisions of applicable Building Codes. These services are considered to be essential and typically include services relating to fire safety. These essential services are generally required to be maintained and re-certified annually throughout the life of the building. There may be legal penalties for non-compliance with approvals and consents under the relevant planning acts and applicable standard codes.

“ In all cases the assessment of building services should be undertaken by consultants with appropriate experience ”

5.7 Environmental Issues

The evaluation of environmental risk pertaining to real estate is an important element of the Technical Due Diligence process. Ongoing changes to environmental legislation places a significant duty of care on the property owner.

The nature and extent of any environmental assessment must be clearly discussed with the Client at the time of taking instructions. The Client is likely to require expert opinion as to what type of report is required. The types of reports include:

(a) Preliminary Site Investigation – PSI (or Phase 1 site audit)

The PSI involves a desktop review of available documentation and site “walk over” to identify potential areas of risk (contamination) associated with past development/usage of the property. Investigations should include, but not be limited to, the following:

- (i) review of historical aerial photographs for the site;
- (ii) historical property title review;
- (iii) review of available Council Development Application(s); and
- (iv) site inspection to view likelihood for imported fill, underground storage tanks (USTs) and other operations that could result in land contamination.

(b) Detailed Site Investigation – DSI (or Phase 2 site audit)

A detailed site investigation may be recommended if a PSI deems contamination likely to be present on site. The DSI includes drilling boreholes to allow the collection of soil samples and installation of groundwater monitoring wells where groundwater is likely to be an issue. Soil and groundwater samples once collected are sent to a laboratory for analysis for chemicals of concern. The results are then checked against relevant state and national regulatory criteria and the suitability of the property for its planned use is determined.

When undertaking a DSI, due to required laboratory analysis, equipment utilisation (such as drill rigs) and OH&S access constraints, time delays can occur and assessments may take over a month from inception to completion. Furthermore, in many cases initial works may identify environmental issues which require further clarification and in turn additional time delays and costs. The Client should be made aware of the possibility of these delays so that the expectations of the parties as to when the transaction can complete are realistic.

(c) Hazardous Materials Audit

This is an inspection and testing regime to identify and advise upon common hazardous materials (or “deleterious” or “prohibited” materials), such as:

- (i) asbestos;
- (ii) polychlorinated biphenyls (PCBs);
- (iii) synthetic mineral fibres (SMF) and chlorofluorocarbons (CFCs); and
- (iv) lead based paint.

If the property professional determines that a material identified on the property is suspect, a sample is usually taken and sent for analysis at an approved laboratory. Any additional costs for such tests should be first approved by the Client.

(d) Geotechnical Report

Ground conditions should be reviewed and compared to the existing and/or proposed building so that the suitability of current or planned structures can be confirmed. Geotechnical investigations will involve taking soil samples for laboratory analysis.

(e) Acoustics

Building acoustics consists of two parts, room acoustics which deals with sound propagation in a room and building acoustics which deals with sound propagation between rooms and external sources. Building acoustics would typically be focused on by undertaking testing of impact sound insulation of floors or assessing airborne sound insulation testing of walls and floors. All results of testing are then cross referenced to technical guidance from relevant Building Codes or Client requirements.

(f) Air Quality

The aim of air quality assessments is to determine airborne concentrations of dust or concentrations of carbon dioxide, carbon monoxide, temperature and humidity within the office environment. These components are typically measured on a real time basis using hand held electrical meters. Results are then compared to relevant Indoor Air Quality (IAQ) guidelines.



“ The Client is likely to require expert opinion as to what type of report is required ”

“ The property professional should be aware of the various environmental/sustainability rating tools which exist ”



5.8 Sustainability

Increasingly, both building owners and occupiers are seeking to enhance their corporate social responsibility performance and mitigate potential future investment risks by purchasing or developing buildings which offer greater energy efficiency and a reduced environmental impact, or indeed to upgrade assets which do not meet their criteria in this regard.

The property professional should be aware of the various environmental/sustainability rating tools which exist in the current market and should provide advice to the Client in line with the agreed brief on the overall sustainability of the building. In some circumstances, this may involve the engagement of specialist consultants should a detailed appraisal or rating estimation be required.

5.9 Town Planning

The property professional should consult with the Client and determine whether a specialist town planning adviser should be engaged.

The town planning review should involve a visual inspection of the property and surrounding area, together with the following research activities:

- (a) Review Planning Controls - a thorough review of existing planning controls affecting the site, including local, regional and state controls;
- (b) Review of Council Files – this will involve lodging a request and reviewing Council’s files relating to the property in order to establish a history of the planning consents and to ascertain whether the current uses of the property conform to the approved use or uses.

Consent from the building owner may be required in which case the property professional may need to be advised of the time to acquire this.

- (c) Discussions with Council Officers – this will involve holding discussions to gain information on any strategic planning studies being undertaken in the local area and the views on future development opportunities and constraints relevant to the property.
- (d) Assessment of Future Development Opportunities – this will involve providing an assessment of potential future development opportunities and constraints for the property.



5.10 Statutory Compliance Review

(a) Building Code Compliance

This part of the Technical Due Diligence report should include:

- (i) an explanation of the role of the applicable building code in relation to the property;
- (ii) a statement about the need for, or exemption from, retrospective compliance. Some guidance on the triggers for retrospective compliance should also be provided (such as a requirement to bring an older building in line with current codes where the building is being substantially refurbished);
- (iii) any applicable annual or periodic certifications which are required;
- (iv) whether evidence of approval to occupy is available such as the following certifications:
 - essential services;
 - sprinkler system annual flow test;
 - cooling tower registration;
 - backflow prevention testing certification;
 - lift registration;
 - trade waste agreement; and
 - thermostatic mixing valve certification.

Having regard to the Client's brief, the purpose of the Technical Due Diligence Report and the proposed use of the property, an opinion should be provided about the commercial implications of non-compliances and the limitations that any non-compliance may have on current and future occupancy.

By way of example, the category and volume of product that can be stored in a warehouse can be largely dependent on the type of sprinkler system despite both high and low capacity systems meeting 'base building open plan' standards. A Client would be left ill-informed if the report confirms that the base building complies with appropriate standards without referring to the limitations on the type and volume of product that can be stored in a building with that type of sprinkler system.

It is recommended that the report makes clear whether a review or detailed audit has been carried out.

In summary, this part of the report should include an opinion on:

- (v) the risks arising from any compliance issues;
- (vi) a quantification of the costs to rectify the non-compliances; and
- (vii) the timeframe within which non-compliances should be rectified and the various priorities for the rectification or upgrade works.

(b) Accessibility

The property professional should comment generally on the property's compliance with applicable access legislation. Depending upon factors such as the building's age,

current or proposed use and location, the property professional may recommend to the Client that an access audit is undertaken.

An access audit should determine the property's compliance with relevant legislation, such as the Disability Discrimination Act. The audit should include a review of:

- (i) external and internal paths of travel;
- (ii) parking;
- (iii) building entry points;
- (iv) disabled toilets; and
- (v) lifts, stairs and ramps;

to define the level of compliance achieved and the prioritisation of any non-compliances.

The types of disability to be considered within the audit should include:

- (vi) people using a wheelchair;
- (vii) ambulant persons with a mobility impairment;
- (viii) people with a hearing disability; and
- (ix) people with a sight disability.

The audit should include comment on the presence of any accessibility action plans previously prepared for the property and a review of the strategy adopted for the building and site under review. Accessibility action plans are a strategy for changing business practices in order to mitigate or eliminate the risk of a complaint being made against a building owner.



“ the report makes clear whether a review or detailed audit has been carried out ”



5.11 Heritage Significance Assessment

Whether or not a heritage significance/conservation assessment on a property is required would be determined by the current or potential listing of a property (or neighbouring properties) on the local, state/territory or national heritage register. A property may be listed due to historical, aesthetic, scientific or social attributes and therefore subject to specific approval prior to undertaking any works.

The heritage significance assessment should:

- (a) comprise a visual inspection of the property and surrounds;

- (b) research the property's status (on a statutory heritage register) and any statutory controls affecting it;
- (c) be undertaken by a consultant with relevant expertise in the type of property under assessment and its location;
- (d) provide a review of the heritage attributes of the building and property and the level of cultural significance;
- (e) address the implications for the future use and occupancy, and redevelopment potential of the property; and
- (f) form the basis for policies and management structures implemented by the owner to enable conformity with the applicable statutory controls.

5.12 Floor Space Ratio, Car Parking Ratio and Efficiency

The floor space ratio and car parking ratio of a property are determined by the local authority and implemented through local planning controls. These factors determine the maximum amount of usable floor space which can be constructed on a property, along with the number of car parking bays which are permitted. This information will be important to a Client in assessing the "highest and best use" of a property, and information regarding current controls should be included within the Technical Due Diligence Report.

Building efficiency, in the context of floor space, is a comparison of the Gross floor area (all floor space within a building) with the net lettable floor area (the area of the building available to be leased for a commercial rent). This provides an indication of the ability of the building to provide maximum commercial value from the area of building constructed.



“ This information will be important to a Client in assessing the “highest and best use” of a property ”

5.13 Identification Surveys

Site Identification Surveys are prepared by registered land surveyors and their purpose is twofold:

- (a) to identify/verify the position of the building(s) and other improvements on the property; and
- (b) to identify easements, rights of way, encroachments and other issues that either burden or favour the property.

The information gained from this section of the Technical Due Diligence report is usually shared with the Legal Due Diligence team as there are “cross-overs” of information that will assist both teams during the investigation process.

In undertaking an identification survey, the surveyor will access records from the appropriate land title’s office that contain specific details of the property title. The review will identify site boundary information and will note the existence of easements, rights of way, covenants and other legally enforceable issues that either favour or burden the property.

The location of easements, for example, may affect the potential for future development of the property as costs to build over water or sewer easements can be prohibitive. A right of way may exist on the property that gives an adjoining owner the right to use part of the property for access; therefore the land affected by this right of way cannot be built upon in the future.

A site survey will then be conducted to verify:

- (c) boundary dimensions;
- (d) whether the building(s) or other improvements constructed have been

built entirely on the property. (In some instances, boundary walls may have been constructed over the boundary which can have serious implications for the property owner, particularly if the Client is contemplating strata subdivision); and

- (e) whether neighbouring buildings, fences etc. encroach onto the property.

5.14 Tax Depreciation/ Capital Allowances

These allowances are generally available to property owners as a deduction or adjustment to assessable income attributed to property assets and their effective lives.

Generally, the effective life of a depreciating asset is how long it can be used by any entity for a taxable or income producing purpose as set out in the relevant legislation. A depreciating asset is one that’s effective life is limited, and that can reasonably be expected to decrease in value over its useful life. Understanding both the legislation and its application to various property assets, depending on age, condition, cost or classification is the key to realising the maximum benefit available.

The Australian Taxation Office (ATO) recognises depreciation by the:

- (a) Prime Cost method – the decline in value is calculated as a percentage of the initial cost of the asset by equal amounts per annum on a straight line basis; and
- (b) Diminishing Value method – the decline in value is calculated on the reducing balance of the asset’s initial cost that remains after the previous years has been taken into account.

When a commercial property is acquired, depending on clauses that may be included in the contract of sale and the applicable tax legislation, there are often substantial depreciation deductions that are available to a purchaser. The purpose of a tax depreciation schedule is to capture these deductions. The elements considered by a report are typically divided into two main deduction categories: depreciating assets (plant and equipment) and the building structure (capital works).

Common tax depreciation schedules include: initial desktop estimates which are typically prepared during the due diligence period; and detailed estimates are usually prepared upon settlement. A tax depreciation report should be prepared by a suitably qualified professional with a robust knowledge of the applicable tax legislation.



“ there are often substantial depreciation deductions that are available to a purchaser ”

“the more simplistic the approach the greater the potential margin of inaccuracy”

5.15 Reinstatement Cost Assessment

A reinstatement cost assessment is an estimate of the total cost to rebuild a property which has been subject to a major incident of damage eg. fire or explosion. The assessments are prepared for the purpose of ascertaining a rebuild cost to be factored into insurance cover for a particular building.

The accuracy of the assessment is dictated by the scope of the instruction and can vary from a simple square metre rate for a particular building type to an area measure of drawings supplemented by a site inspection. In broad terms, the more simplistic the approach the greater the potential margin of inaccuracy.

The cost assessment should take into account:

- (a) demolition;
- (b) rebuilding the improvements to the same/similar specification as the existing building (where there has been a change in building code requirements since the original building was approved, the rebuild cost should allow for current code requirements);
- (c) re-documentation;
- (d) consultants;
- (e) statutory approvals and cost escalation; and
- (f) loss of rent incurred during the reinstatement process based on rental information provided by the Client.

5.16 Capital Expenditure (CAPEX) Forecasts

Cost estimates associated with due diligence are generally concerned with capital expenditure (CAPEX) forecasts, normally reflecting a 5 or 10 year planning period. Hence, these estimates are typically indicative only and are provided as an “order of magnitude cost allowance” for specifically identified works. Items of work are often not fully described or detailed reflecting the high level nature of the assessment, the amount of information available and the purpose for which they are prepared.

Consideration should be given to any pre-existing CAPEX records or budgets, where available.

On occasions CAPEX forecasts may be estimated on the basis of being undertaken as part of a major upgrade or refurbishment. Under such circumstances more details should be prepared or sought regarding the scope of works, design, specifications and programme.

Further, any assumptions or exclusions material to the CAPEX forecasts should be stated. These could include but are not limited to details of:

- (a) preliminaries, builders margins, overheads or contingencies;
- (b) negotiated, staged or other special forms of contract;
- (c) approval, consents or compliance orders;
- (d) costs associated with the further investigations;
- (e) professional/consultant fees for further investigation and testing, the design, documentation and the management of rectification works, or any resulting change in the scope of rectification works;



- (f) costs associated with the relocation, temporary accommodation, disruption to business or loss of profit of the building owner or tenants;
- (g) work outside site boundaries;
- (h) goods and services tax (GST); and
- (i) future escalation.

The Client may also have specific requirements for proposed expenditure which may include:

- (a) refurbishment of the property to reposition it in the market;
- (b) sustainability improvements such as replacement of building services equipment with more energy efficient equipment; and
- (c) remodelling or extensions/additions to a building.

Estimating the costs involved in the scope of proposed capital works of this nature can be involved, and the Client's brief and reporting expectations should therefore be accurately defined.

The presentation of capital expenditure forecasts varies subject to specific reporting requirements. A common format is a tabular report. Typically this would include a series of line items detailing the element under consideration, the proposed scope of works and the associated costs. A suggested rectification timeframe and risk rating are also commonly specified for each item which aids in framing the context of the suggested expenditure.

5.17 Operational Expenditure Assessment

Operational Expenditure (OPEX) is different from CAPEX in that it can ordinarily be recovered in part from the tenants of a building (in an investment transaction), or can be offset as a deduction against rental income for taxation purposes.

OPEX typically includes both statutory charges (such as municipal rates, water and sewerage rates, land taxes and other miscellaneous charges), and operating costs (such as insurance premiums, cleaning, energy costs associated with operating the base building services installations, repairs and maintenance, management, administration, security and other miscellaneous expenses). These costs, together, are commonly known as "Outgoings".

Information should be obtained from the Client or vendor regarding the level of outgoings for a building and an assessment undertaken against industry benchmarks for such costs in order to provide the Client with an indication of the operating costs for the building.



“ Operational Expenditure (OPEX) is different from CAPEX in that it can ordinarily be recovered in part from the tenants of a building ”



6. Interpretation of the Report

6.1 Cost Findings

An assessment of costs associated with the issues identified in the report is critical to the Technical Due Diligence process. This is particularly the case in a highly competitive market when the viability of a proposed transaction is based on achieving a certain yield or rate of return generally within a short period of time.

The cost implications of the various defects, anomalies and shortcomings are therefore a significant component in the Technical Due Diligence report.

6.2 Time Frame

It is not sufficient to only identify the cost of the various defects. It is important to establish when the cost is likely to be incurred. It is generally accepted in the property industry that time periods are identified as follows:

- (a) Immediate: within one year
- (b) Short term: one to two years
- (c) Medium term: three to five years
- (d) Long term: five to ten years

Definitions of the time frames used in the report need to be identified for the avoidance of any doubt.

When providing advice as to costs and their anticipated period of expenditure, account must be taken of the purchaser's intention for the property, as established at the brief stage.

6.3 Risk Ratings

Risk ratings involve balancing liabilities and opportunities, both in terms of capital and life costs, and hence are an integral part of Technical Due Diligence. A risk can be defined as the chance of something happening that will have an impact upon the objectives. Using the Australian and New Zealand Risk Management Standard risks are measured in terms of combining the magnitude of a potential consequence with the likelihood of an event occurrence with regard to any activity, function, project, product or asset.



“ the viability of a proposed transaction is based on achieving a certain yield or rate of return ”

The Standard sets out a seven-step process for managing risk and classifies risks as follows with corresponding responses;

- (a) Extreme: immediate action required
- (b) High: senior management attention needed
- (c) Moderate: management responsibility must be specified
- (d) Low: manage by routine procedures.

Risk management can be qualitative and/or quantitative, enabling the Client to better identify, analyse, respond to, monitor and report on risks. For Technical Due Diligence this can assist in determining what responses are recommended to the Client and which risks to avoid, transfer, mitigate or accept. Such decisions are linked to the corresponding design, construction and facilities management issues and the associated capital and operational expenditure (CAPEX and OPEX) forecasts.

6.4 Reasons for Defects

When identifying a defect, an assessment is required of its cause, effect and importantly recommendations for remedial action/further investigations.

Defects generally fall into one of the following categories:

- (a) capital expenditure;
- (b) repairs and maintenance;
- (c) statutory compliance issues – this is not simply an assessment by the building code consultant, but needs to include comment on any essential fire services certificate, fire precautions, workplace issues, etc; and
- (d) lease obligations.

6.5 Incorporating Costs into Investment Analysis and Strategy

There is an essential relationship between Technical Due Diligence and commercial due diligence, and it is important that costs as with all advice given in a Technical Due Diligence report are placed in a commercial context. It is rare for no issues to arise during the Technical Due Diligence process, but it is also important that the process is used as a proactive tool in a property transaction.

The challenge is for the Client to identify those aspects of the property that will impact in a materially negative way on the transaction and to put in place a strategy to negate or limit their impact. As the reasons for a property transaction will vary from Client to Client, it is essential to identify those aspects that can be turned to an advantage. Hence the importance of gaining a clear understanding at briefing stage as to the goals of your Client.

A correctly structured Technical Due Diligence report should assist the Client's decision-making process and be easy to understand so that relevant information can be extracted.



“ There is an essential relationship between Technical Due Diligence and commercial due diligence ”



“ the outcome of the Technical Due Diligence serves to inform the scope of the legal due diligence ”

7. Matters for the Legal Advisors Attention

There is an important relationship between Technical Due Diligence and the legal due diligence which is undertaken by legal advisors, and often there is an overlap. Often the same tasks can be performed by the property professional and the legal advisors, but Clients are of course best served by the 2 advisors working together to minimise duplication. It should be noted that the Client would normally appoint the legal advisor directly.

Typically the Technical Due Diligence is undertaken before the legal due diligence. The outcome of the Technical Due Diligence serves to inform the scope of the legal due diligence, and the drafting and negotiation of the relevant contract, be it a sale agreement or lease.

Specifically (but not exhaustively), the outcome of the technical due diligence may affect the following legal aspects of a transaction:

- (a) the extent of Vendor/Lessor warranties;
- (b) disclosure;
- (c) the extent to which statutory records need to be searched;
- (d) the management and assumption of risk;
- (e) the negotiation of indemnities; and
- (f) the conditions of completion/seller/lessor obligations.

The property professional is advised to alert the Client's legal advisor (if known, and to the Client if not) to physical or other issues that could affect the property and that may need legal investigation or clarification. Some of these issues may include;

7.1 Title and tenure

- (a) tenure;
- (b) title – Torrens, Crown land, Strata or other statutory instrument;
- (c) evidence of occupation, tenancies, licences or sublettings, or vacant possession;
- (d) evidence of possible trespass;

- (e) evidence that suggests possible rights of way adversely affecting the property;
- (f) evidence of the need for rights of way or easements to access the property;
- (g) evidence that an authority may have an interest in the resumption of an abutting roads or footpaths;
- (h) inventory of inclusions and exclusions (particularly in leased premises);

7.2 Boundaries

- (a) evidence of poorly defined site boundaries;
- (b) riparian rights (relating to banks of rivers or waterways);
- (c) evidence of the conduct of the business being outside the boundaries of the subject property (whether as to core operations or ancillary facilities);
- (d) evidence of encroachments;

7.3 Guarantees and warranties

The availability and transferability of guarantees with respect to the construction of the building;

7.4 Leases

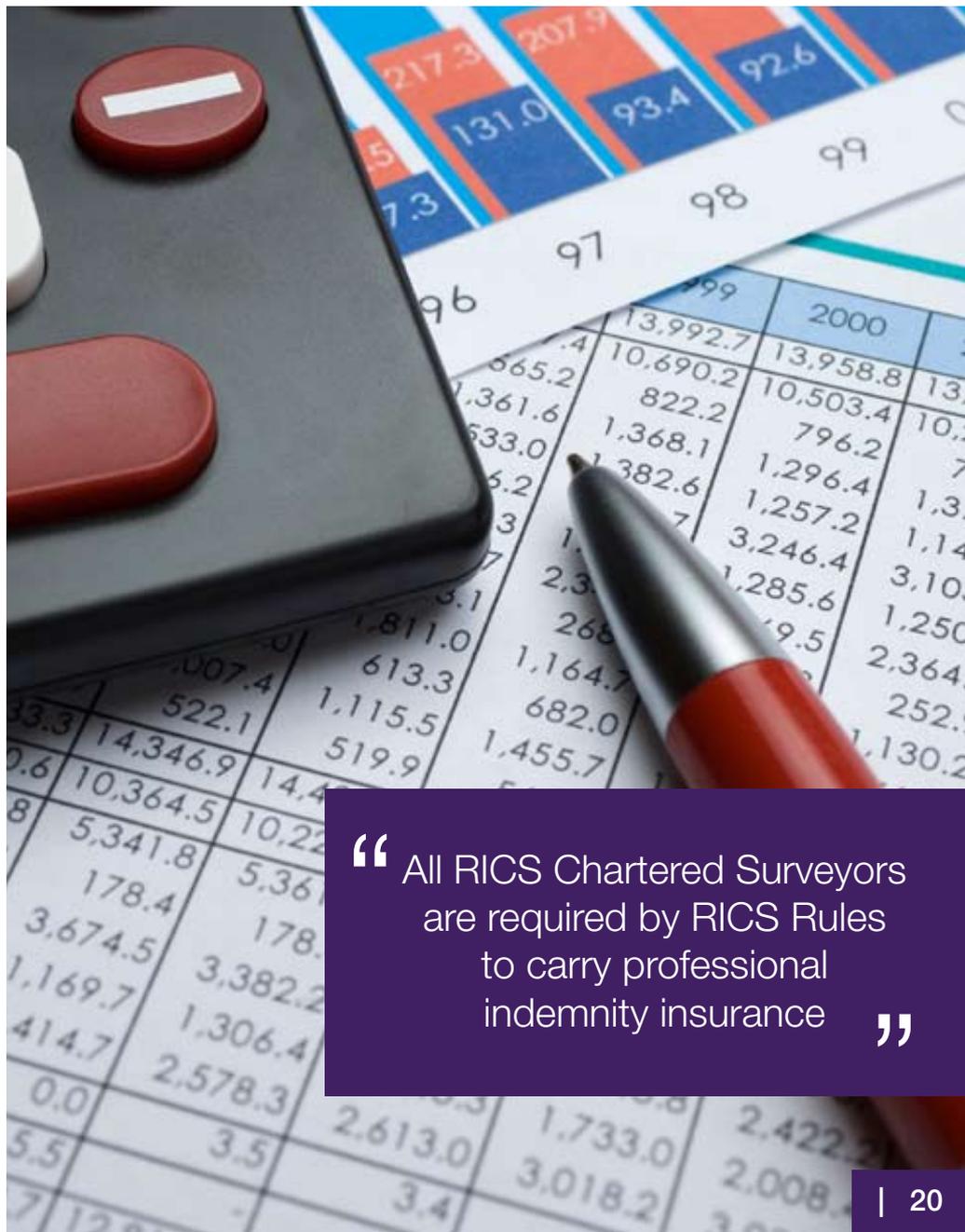
- (a) evident breaches of repair covenants in leases;
- (b) evident breaches of permitted use covenants; and
- (c) details of vacancies.



8. Insurance

The property professional must carry professional indemnity insurance commensurate with the tasks being undertaken and services being provided.

All RICS Chartered Surveyors are required by RICS Rules to carry professional indemnity insurance. RICS members should also be protected with insurance for personal injury and third party claims. RICS members must ensure they comply with any stipulations of their insurance company.



“ All RICS Chartered Surveyors are required by RICS Rules to carry professional indemnity insurance ”



9. ANNEXURE A Confirmation of Scope of Services

The template below is intended for use in conjunction with a detailed form of appointment which makes explicit reference to this guidance note, and should be used for confirming which elements of the Technical Due Diligence services are included, excluded, or recognised to be undertaken by other third parties on behalf of the Client direct.

Elements of Service	Included	Excluded	By Others	Comment
Brief	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Limitations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
General Property Description	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Access	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Structure	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Concrete Testing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Building Fabric	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
External Areas	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Building services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Mechanical	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Electrical	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Communications	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Security	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Building Management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Hydraulics	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Fire Services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Emergency Services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Vertical Transportation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Fire Engineering	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Indoor Environment Quality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Specialist Systems (please specify)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Other (please specify)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Environmental Assessment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Preliminary Site Investigation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Detailed Site Investigation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Hazardous Materials Audit	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Geotechnical Report	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Acoustics	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Air Quality	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Sustainability	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Town Planning	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Statutory Compliance Review	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Building Codes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Accessibility Audit	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Heritage Significance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Floor Space Ratio / Car Parking Ratio	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Site Identification Survey	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Measured/Building Area Survey	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Tax Depreciation/Capital Allowance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Reinstatement Cost Assessment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
CAPEX Forecasts	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
OPEX Review	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Legal Document Review	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Title and Tenure	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Boundaries	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Guarantees and Warranties	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
• Leases	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

10. ANNEXURE B Report Limitations

- Parts of the building built in, covered up or otherwise made inaccessible during construction, alteration or fitting out, have not been inspected. This generally relates to ceiling voids, wall cavities and service risers. Therefore we are unable to comment as to whether such elements are free from defect or infestation.
- We have not undertaken any work of a specific engineering nature, such as engineering calculations, structural analysis, testing or measurements as the report reflects our interpretation of the condition of the building as apparent from the inspection.
- Building services have been visually inspected where exposed to view only. No internal inspections have been undertaken of plant, equipment and machinery or where services are covered up or hidden by the building structural element or finishes. Building services have not been tested and no design calculations have been undertaken.
- The property has not been inspected specifically for termite infestation and we would only report on such if termite evidence was apparent during our inspection.
- Where a variety of multiple units are inspected, a random selection of each type of unit was inspected and used for the basis for this report.
- This report is not a certification, a warranty or guarantee and has been scoped in accordance with the instructions given and the time allowed.
- The scope of the report is described in [refer to appointment documentation] and disciplines not specifically mentioned are excluded from this report.
- The report has been prepared for the benefit of [insert Client name]. This report is not to be reproduced, in whole or in part, without the express written authorisation of [insert name of property professional].



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RICS Best Practice guidance notes for the Technical Due Diligence of Commercial & Industrial Property: Australia

This best practice guide is written for any property professional, owner, investor, occupier, manager, or lawyer involved in the purchase, sale, lease or management of commercial and industrial property. It deals with every aspect of the Technical Due Diligence process including;

- Defining the nature and benefits of Technical Due Diligence
- Taking instructions and clarifying terms of engagement
- Understanding the relationship between various consultants
- Detailing the main components of a Technical Due Diligence report
- Identifying matters for the legal advisor's attention
- A simple summary checklist for confirming the scope of the Technical Due Diligence required

Written by experienced Australian RICS building and property professionals and property lawyers the intent of the guidance note is to:

- Clarify the nature and benefits of the Technical Due Diligence process
- Encourage property owners and occupiers to understand how risk can be minimised
- Reinforce the need for professional objectivity
- Encourage property professionals to act in accordance with 'best practice' procedures

This edition has been written to apply to the Australian property market.

RICS Australia 2009

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