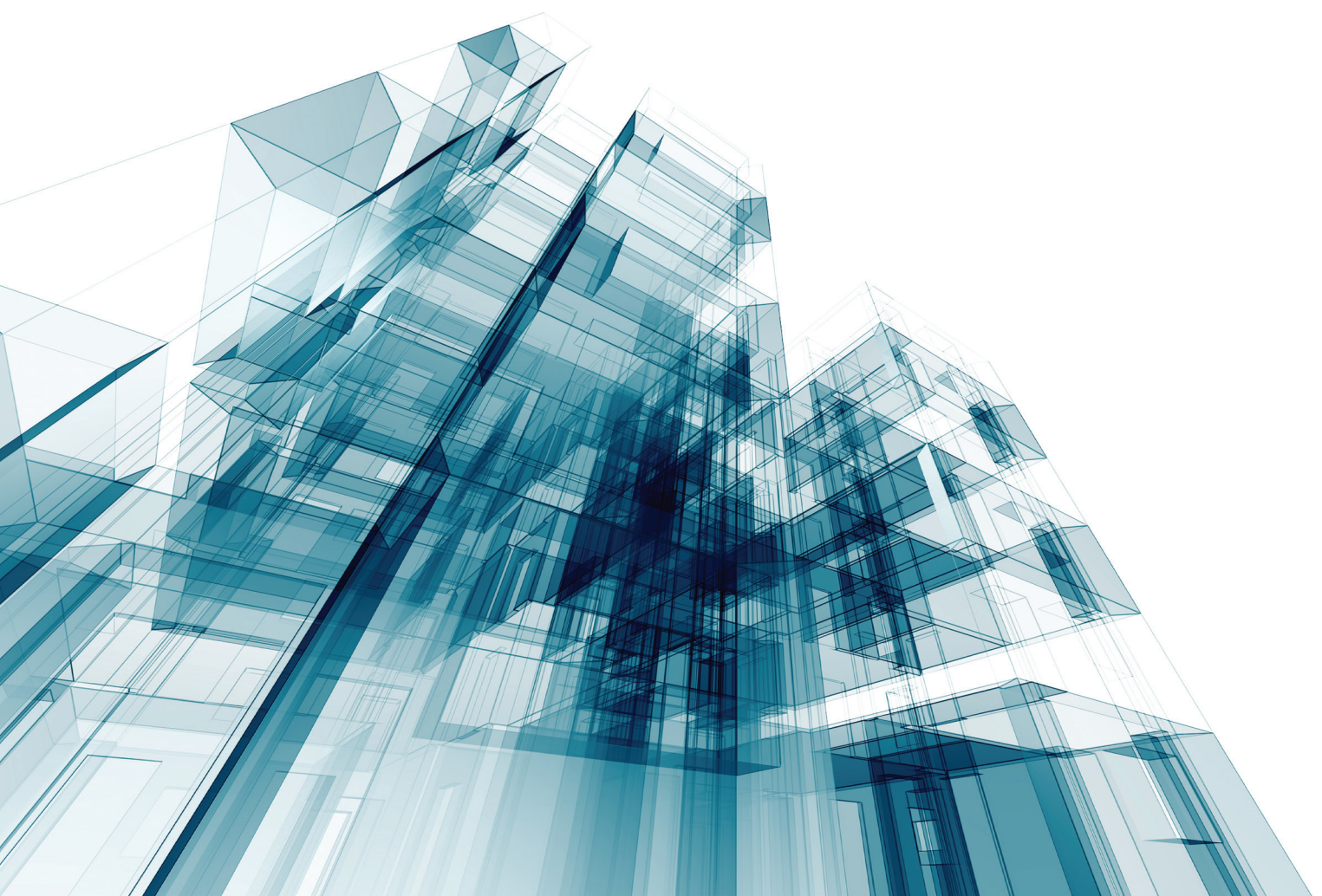




RICS professional guidance, UK

# Lender's independent monitoring surveyor

1st edition



# Lender's independent monitoring surveyor

RICS guidance note, UK

1st edition

This guidance note is endorsed by



Published by the Royal Institution of Chartered Surveyors (RICS)  
Parliament Square  
London  
SW1P 3AD  
UK

[www.rics.org](http://www.rics.org)

No responsibility for loss or damage caused to any person acting or refraining from action as a result of the material included in this publication can be accepted by the authors or RICS.

Produced by the Quantity Surveying and Construction Professional Group of the Royal Institution of Chartered Surveyors.

ISBN 978 1 78321 092 3

© Royal Institution of Chartered Surveyors (RICS) March 2015. Copyright in all or part of this publication rests with RICS. No part of this work may be reproduced or used in any form or by any means including graphic, electronic, or mechanical, including photocopying, recording, taping or web distribution, without the written permission of RICS or in line with the rules of an existing licence.

Typeset in Great Britain by Columns Design XML Ltd, Reading, Berks

# Acknowledgments

RICS would like to thank the following for their contributions to this guidance note:

**Technical author:**

Eddie Davies FRICS, MAMG Consultancy Ltd

**Author support:**

Michael Duck, Construction and Property Consultant

**Working group:**

Neil Anderson, Royal Bank of Scotland, MRICS

James Butters, Banking and Commercial Property Consultant

Nigel Chapman, Deutsche Pfandbriefbank AG, the Association of Property Lenders (APL)

James Freston, The Royal Bank of Scotland

Ken Hillen, KH Solutions

Alan Muse FRICS, RICS

Kevin Quigley MRICS, Capita Property and Infrastructure Ltd

Graham Stenning MRICS, The Royal Bank of Scotland, the Association of Property Lenders (APL)

Martin Stubbington MRICS, RICS

Michael Woolley, Rust Group L.P

**Special thanks to:** Sarah Austin, Jonathon Cuff, Simon Dekker, Rashmi Dubé, Sam Fearon, Ashley Goldblatt, Andrew Hosford, James Lockyer, Darran Muir, Duncan Pearson, Helen Pickstock, Oliver Rippier, Prof. James Sommerville, Giles Tagg, Gordon Taylor, Marcus Williams.

# Contents

<b>Acknowledgments</b> .....	<b>ii</b>
<b>RICS professional guidance</b> .....	<b>1</b>
<b>Foreword</b> .....	<b>3</b>
<b>1 Introduction</b> .....	<b>4</b>
<b>2 General principles (Level 1: Knowing)</b> .....	<b>5</b>
2.1 Overview .....	5
2.1.1 The independent monitoring surveyor.....	5
2.1.2 Project structure .....	5
2.1.3 The lender .....	6
2.1.4 The borrower .....	6
2.1.5 Conflicts of interest (the value of independence).....	6
2.1.6 Code of ethics.....	6
2.2 Commercial overview .....	7
2.2.1 Funding sources.....	7
2.2.2 Controls and limitations .....	7
2.2.3 Other commercial considerations ...	7
2.2.4 Key documentation .....	8
2.3 The process map.....	8
<b>3 Practical application (Level 2 – Doing)</b> .....	<b>10</b>
3.1 Stage 1 – Appointment.....	10
3.2 Stage 2 – Technical due diligence.....	10
3.2.1 Lines of authority and communication.....	11
3.2.2 Information and queries.....	11
3.2.3 The kick-off meeting.....	11
3.2.4 The report.....	11
3.2.5 Introduction .....	12
3.2.6 Project summary .....	12
3.2.7 Financial .....	12
3.2.8 Programme.....	14
3.2.9 Design .....	14
3.2.10 Construction.....	15
3.2.11 Contract .....	16
3.3 Stage 3 – Financial close/contract completion .....	17
3.4 Stage 4 – Construction phase .....	18
3.4.1 Commencement.....	18
3.4.2 Monthly certification.....	19
3.4.3 Monthly progress report .....	20

- 3.4.4 Financial ..... 21
- 3.4.5 Programme..... 22
- 3.4.6 Design ..... 22
- 3.4.7 Construction..... 23
- 3.4.8 Contract ..... 24
- 3.4.9 Other project scenarios ..... 24
- 3.5 Stage 5 – Practical completion ..... 24
- 3.6 Stage 6 – Exit ..... 25
  
- 4 Practical considerations (Level 3 – Advising)..... 26**
- 4.1 Risk analysis ..... 26
- 4.2 Private finance initiative ..... 26
- 4.3 Non-profit funding ..... 28

# RICS professional guidance

## International standards

RICS is at the forefront of developing international standards, working in coalitions with organisations around the world, acting in the public interest to raise standards and increase transparency within markets. International Property Measurement Standards (IPMS – ipmsc.org), International Construction Measurement Standards (ICMS), International Ethics Standards (IES) and others will be published and will be mandatory for RICS members. This guidance note links directly to these standards and underpins them. RICS members are advised to make themselves aware of the international standards (see [www.rics.org](http://www.rics.org)) and the overarching principles with which this guidance note complies. Members of RICS are uniquely placed in the market by being trained, qualified and regulated by working to international standards and complying with this guidance note.

## RICS guidance notes

This is a guidance note. Where recommendations are made for specific professional tasks, these are intended to represent 'best practice', i.e. recommendations that in the opinion of RICS meet a high standard of professional competence.

Although members are not required to follow the recommendations contained in the guidance note, they should take into account the following points.

When an allegation of professional negligence is made against a surveyor, a court or tribunal may take account of the contents of any relevant guidance notes published by RICS in deciding whether or not the member acted with reasonable competence.

In the opinion of RICS, a member conforming to the practices recommended in this guidance note should have at least a partial defence to an allegation of negligence if they have followed those practices. However, members have the responsibility of deciding when it is inappropriate to follow the guidance.

It is for each member to decide on the appropriate procedure to follow in any professional task. However, where members do not comply with the practice recommended in this guidance note, they should do so only for good reason. In the event of a legal dispute, a court or tribunal may require them to explain why they decided not to adopt the recommended practice.

Also, if members have not followed this guidance, and their actions are questioned in an RICS disciplinary case, they will be asked to explain the actions they did take and this may be taken into account by the Panel.

In some cases there may be existing national standards which may take precedence over this guidance note. National standards can be defined as professional standards that are either prescribed in law or federal/local legislation, or developed in collaboration with other relevant bodies.

In addition, guidance notes are relevant to professional competence in that each member should be up to date and should have knowledge of guidance notes within a reasonable time of their coming into effect.

This guidance note is believed to reflect case law and legislation applicable at its date of publication. It is the member's responsibility to establish if any changes in case law or legislation after the publication date have an impact on the guidance or information in this document.

## Document status defined

RICS produces a range of professional guidance and standards products. These have been defined in the table below. This document is a guidance note.

Type of document	Definition	Status
<b>Standard</b>		
International standard	An international high-level principle-based standard developed in collaboration with other relevant bodies.	Mandatory
<b>Professional statement</b>		
RICS professional statement	A document that provides members with mandatory requirements or a rule that a member or firm is expected to adhere to. This term encompasses practice statements, Red Book professional standards, global valuation practice statements, regulatory rules, RICS Rules of Conduct and government codes of practice	Mandatory
<b>Guidance</b>		
RICS code of practice	Document approved by RICS, and endorsed by another professional body/stakeholder, that provides users with recommendations for accepted good practice as followed by conscientious practitioners.	Mandatory or recommended good practice (will be confirmed in the document itself).
RICS guidance note (GN)	Document that provides users with recommendations or approach for accepted good practice as followed by competent and conscientious practitioners.	Recommended best practice. Usual principles apply in cases of negligence if best practice is not followed.
RICS information paper (IP)	Practice-based document that provides users with the latest technical information, knowledge or common findings from regulatory reviews.	Information and/or recommended good practice. Usual principles apply in cases of negligence if technical information is known in the market.

# Foreword

The Association of Property Lenders (APL) has been involved in the development of this guidance note and encourages chartered surveyors involved in the delivery of such services to consider its recommendations.

The role of the lender's independent monitoring surveyor should be treated as a specialist service. The role requires experienced and skilled professionals who understand the lender's perspective and requirements. This means knowledge of the scheme, structure, use of debt, equity and, if any, recycled sales. Alongside this, accurate risk assessment is paramount to how lenders will regard each funding proposal. It requires a full appreciation of all of the costs associated with an appraisal.

The skill of a chartered surveyor to accurately forecast how much a scheme will cost to complete, understanding the impact of project risks, versus available funds will be highly prized by lenders.

The guidance note should assist further establishing the principles of this profession in the industry.

**Graham Stenning, MRICS**

**Director, The Association of Property Lenders**



# 1 Introduction

This guidance note has been developed to support the work of chartered surveyors who assess risks and provide technical advice to those who provide third-party finance on real estate developments: a lender's independent monitoring surveyor (IMS). Other terms are also used for this role, such as 'bank monitor' or 'project monitoring surveyor', however, for consistency, the term independent monitoring surveyor will be utilised in this guidance note.

The provision of external finance is a fundamental component of many real estate developments. Lenders will normally actively seek to identify, quantify and mitigate risks when advancing money to a borrower to support a development. This process should start well before the transaction takes place and throughout the term of the debt facility (the model assumed in this guidance note). The lender will evaluate a borrower's business plan to verify the assumptions and undertake a sensitivity analysis. They will also, typically, initiate a due diligence process involving external professional advisers. A chartered surveyor properly articulating technical project risks and checking that such risks are and will be appropriately managed, should be a pre-eminent focus for any lender's technical due diligence. The IMS needs to understand the technical risks derived from the whole process of procurement, including the structure and delivery of a project, and to provide advice to ensure that the lender's decisions are fully informed and technical risks are understood.

The role of the IMS is not only to the benefit of those providing third-party finance (the lender), but also to the benefit of the borrower, with the shared goal of delivering a successful project on time, on budget and as specified. The technical understanding of a project's environment will assist in identifying project risks and thereby to assist the borrower to formulate strategies to mitigate those risks.

There are many organisations that invest in and lend to real estate developments, each with their own governance procedures and credit processes, which will influence their perceived need to employ an IMS. Their approach to engaging an IMS will vary depending on their risk management processes and commercial strategy.

This guidance note, while not demanding compliance, will provide a reference point for:

- **a chartered surveyor** providing a model for the delivery of real estate IMS services
- **a lender** in their appointment and use of an IMS on a real estate development; and
- **a borrower** to assist their understanding of the role and advantages of a lender's IMS in the delivery of the real estate development.

Guidance is given under the following headings that reflect the Assessment of Professional Competence (APC):

- General principles (Level 1: Knowing)
- Practical application (Level 2: Doing)
- Practical considerations (Level 3: Doing/advising).

## 2 General principles (Level 1: Knowing)

### 2.1 Overview

#### 2.1.1 The independent monitoring surveyor

The role of the independent monitoring surveyor (IMS) is an established professional service and recognised as an essential part of the wider project team, which, when properly delivered, will support the successful delivery of any real estate development. Many UK-based lenders will insist that their IMS:

- is a qualified professional (preferably an RICS chartered surveyor)
- has appropriate experience in the role (recognising the IMS role as a specialty)
- understands procurement within the wider development process and the associated risks
- is appropriately resourced and remunerated for the commission; and
- is covered by an appropriate level of professional indemnity insurance.

The lender will require the highest quality advice, tailored to their needs, established through an agreed 'scope of service'. They will expect the appointed IMS to understand technical risks from their perspective and how the IMS service should be delivered to mitigate the lender's risks.

The IMS's primary obligation relates to the independent technical due diligence of a project, assessing the initial risks and thereafter monitoring the progress of the project, assessing arising risk and approving debt drawdown from a technical perspective in accordance with the agreed lending terms. The IMS should seek to positively influence the project to ensure that the lender's interest and exposure is properly considered, providing ongoing commentary, opinion and confirming sufficient funds for the project.

An individual IMS must have a broad knowledge of real estate development delivery, i.e. what are the constituent parts that typically make up a successful project, being clear on all the risks and how they should be managed. There needs to be transparency and clarity of risk, expressed appropriately to assist the lender in the decisions they need to make and the processes they need to administer.

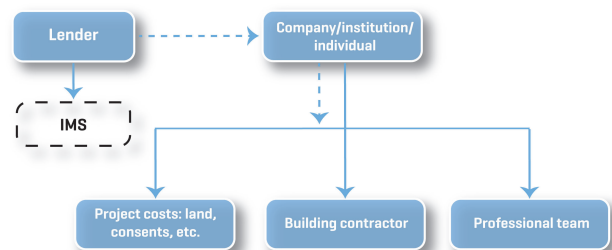
The key strategic and commercial role of the IMS is often reflected in the level of professional indemnity insurance and liability they will typically be required to provide. It is therefore important that, both for protecting the exposure of the lender and the liability of their appointed IMS, the staff delivering the services are properly qualified, experienced and skilled for the role.

#### 2.1.2 Project structure

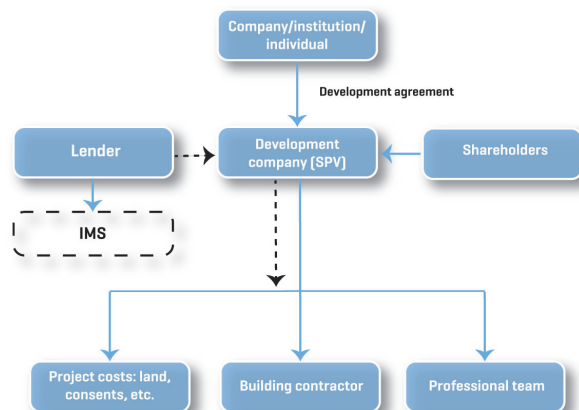
Before the IMS provides a quotation to the lender for any given project, it is important that the IMS understands how the project is to be structured, so that the likely time commitment and commercial exposure for that project can be assessed. It will also ensure that the advice the IMS provides is couched in appropriate terms, reflecting the perspective of the lender.

Below are two simple models upon which many real estate development projects are based. These are examples only, as there are many structures that may be used and often a mix of structures on major projects.

- 1 The lender will provide debt through a loan agreement directly to a company or institution or individual who will then pay project costs directly, e.g. building contract costs and professional team fees, among other things.



- 2 The lender may provide debt through a loan agreement to a development company or similar special purpose vehicle (SPV) set up to deliver the development and capture the associated liability, thus isolating the SPV from unlimited liability. The SPV will contract a builder to undertake the works and will appoint the professional team.



Irrespective of the structure of the project or how the lender may perceive the commercial risks, the IMS should ensure that each project is treated on a stand-alone basis, with a focus on the independent, unambiguous assessment of the technical risks.

### 2.1.3 The lender

Lending institutions vary considerably, for example:

- national or international clearing banks
- private banks
- specialist real estate finance providers
- mezzanine or subordinate/2nd charge debt providers
- funds (insurance, institutional, etc.); or
- on, for example, infrastructure projects, bond financing with associated insurers and rating agencies.

Each lender will have a different approach to the governance of a project and how security packages are structured to protect their interests. Each will have a different way of managing the borrower, which will influence how the IMS liaises with the borrower's own advisers.

Projects may have more than one lender. In which case, the IMS should carefully consider how this will affect the delivery of their services, for example:

- senior debt supplemented with mezzanine or 2nd charge debt
- both a fund and a senior debt provider
- senior debt may be syndicated; or
- debt providers may act in a club.

The IMS must ensure that they consider the needs of each of the lenders and understand how lines of authority function and the priority between different tranches of debt and equity. The IMS should seek clarity on how they are to be instructed and how their services should reflect the lender's processes. It is possible that a senior lender would require a different IMS to the mezzanine provider.

### 2.1.4 The borrower

The nature of the borrower may vary considerably, for example:

- a private individual
- a business or institution
- a development company, i.e. a SPV established for the project; or
- other investing stakeholders such as Housing Associations.

The IMS should always keep the duty of care they have to the lender at the forefront of their service delivery. In so far as it is possible, however, the IMS should seek to establish the trust of the borrower, without compromising or diluting the delivery of the appointed services for the lender. This will assist the project by:

- encouraging transparency of communication and the release of information

- the delivery of an accurate and suitably comprehensive technical due diligence; and
- facilitating the processes associated with drawdowns from the debt facility.

### 2.1.5 Conflicts of interest (the value of independence)

The need for clear and unbiased advice is an essential aspect of the work of an IMS. The primary duty of care, considering the interests of the lender, must be beyond doubt, both in the appointment and in the assessment and reporting of project risk. Nevertheless, clarity on inherent and potential risks should always be seen as a benefit to the borrower too.

The IMS should always be appointed by and solely responsible to the lender. This is sometimes done with the consent of the borrower, although this must not in any way dilute the duty of care to the lender, even though the IMS fees will normally be paid by the borrower as part of the development costs. It is essential that the independence of the lender's IMS cannot be perceived by any project party to have been compromised. The potential perception of a conflict of interest, should a project suffer distress or disputes arise, must be avoided.

Should the opportunity arise, the IMS should resist acting for the borrower in any manner or (as may occasionally be requested) provide a secondary duty of care to the borrower or other key stakeholders. It is essential that the duty of care to the lender is clearly expressed and apparent in the delivery of the services. Such potential scenarios should be discussed openly with the lender, being clear that the independence of the IMS advice must not be jeopardised.

Please also refer to guidance on ethics provided by the RICS, which includes further advice in relation to conflicts of interest.

### 2.1.6 Code of ethics

Below provides a proposed code of ethics in relation to the delivery of lender's IMS services. This is not mandatory, but will serve as a helpful reference point.

- The IMS shall serve the lender with honesty, integrity, candour and objectivity. The IMS will provide services with competence, using reasonable care, skill and diligence consistent with the interests of the lender and the applicable standards of the profession, and in accordance with the associated laws and regulations.
- The IMS shall only accept assignments for which they are qualified by education, training, professional experience and technical competence and shall assign staff to projects in accordance with their qualifications and commensurate with the services to be provided, and shall only make representations concerning the individual professional's qualifications and availability which are truthful and accurate.

- The IMS shall endeavour to avoid conflicts of interest; and shall disclose conflicts that may be perceived to impair objectivity or integrity.
- The IMS shall negotiate fairly and openly with the lender in establishing a basis for compensation and shall charge fees and expenses that are reasonable and commensurate with the services to be provided and the responsibilities and risks to be assumed.
- The IMS shall only make statements that are truthful and shall keep information and records confidential when appropriate and protect the proprietary interests of the lender, borrower, members of the professional team and other project stakeholders.
- The IMS shall continue to develop their professional knowledge and competency as an IMS and shall contribute to the advancement of the independent monitoring surveyor profession by fostering research and education and through the encouragement of fellow professional practitioners.
- The IMS shall avoid actions which promote their own self-interest at the expense of the profession and shall uphold the standards of the IMS profession with honour and dignity.

## 2.2 Commercial overview

### 2.2.1 Funding structures

It is important that the IMS understands the context of their work and the intended approach to financing the proposed development. Every project is unique and there are many models, as financing can be from a variety of sources with complex arrangements, varying hierarchies and governance procedures. The IMS should be properly informed by their lender about how the project is intended to be funded, timings, sources, priorities and how different sources of funds are allocated to project costs. As an example, as it is impossible to be prescriptive, a project may be funded from the following three sources:

- 55% of project costs\* may be funded through senior debt provided by the lender
- 20% by mezzanine debt from another debt provider; and
- 25% by the borrower's equity.

\*Project costs may include land and 'soft costs' such as professional fees, however, each project is different and the IMS should ensure that they understand this from the lender.

The sources of funding may change as a project progresses. The IMS should understand from the lender how this may change during the project and how key funding project milestones are to be treated. Sometimes, the borrower would be required to fund the project initially with their equity or mezzanine debt, before the debt facility can be utilised. The borrower may need to top up with their own equity should there be any overspend. However, every project is different and depending on the arising

scenarios and the views of those with a commercial interest in the development, how funding is managed may change.

### 2.2.2 Controls and limitations

Those providing senior debt will have various controls and limits on how debt is released into a project. It is important that the IMS understands those requirements relevant to their role and properly considers them in the delivery of their services. These are normally made clear in the loan or facility agreement signed between the lender and the borrower. Noted below are three common examples. The types, mix and levels of such limitations and controls may change project by project.

#### *Loan to value [LTV]*

LTV, or loan to gross development value, establishes a limit to the debt facility by way of a percentage of the value of the completed development, usually certified by the lender's own valuation adviser (valuer). The LTV may, for example, require that the debt facility be less than 55% of the gross development value. The IMS will often be required to track the cumulative debt drawn against the established value confirming it is within the agreed LTV.

#### *Loan to cost [LTC]*

LTC, or loan to total costs, establishes a limit to the debt facility based on the total estimated development costs as agreed between the lender and the borrower. What is included in the total costs may vary project to project. The LTC may, for example, require that the debt facility be less than 60% of the agreed total costs. It is important that the lender's IMS understands in detail what comprises the agreed total development costs and will often be required to track the spend against the total costs and confirm that it is within the agreed LTC, and that there are sufficient funds to complete the project.

#### *Peak spend*

Peak spend limits can also be used, for example, on a private house building project where construction spend is offset by revenue from unit sales. A cash limit of peak net spend may be used against what may be drawn at any time, i.e. maximum amount does not exceed the 'commitment'. The IMS may be required to track net spend against such limits month to month.

### 2.2.3 Other commercial considerations

#### *VAT*

VAT is a matter that requires careful attention. It must be clear how VAT is to be funded and, where VAT is reclaimable, who is responsible for reclaiming and how any

VAT receipts are to be used. In some instances, VAT will be funded through a separate revolving account.

### *Exit*

It may be helpful for the IMS to be aware of the lender's 'exit', i.e. what is the term of the loan and how is the debt to be serviced and repaid, e.g. through house sales with revenue deposited into a lender controlled account. While this is an area for the lender to establish with the borrower, it is helpful for the IMS to have an understanding of this to support their general discussions with the project parties during the project.

### *Project costs*

The project will have an agreed cost plan or budget (and associated cash flows) with allowances for each element of the development (costs) against which spend must be apportioned and tracked with ongoing reconciliation of actual costs to forecasts. It is important to note that the lender may only fund some of the costs up to practical completion.

### *Contingency*

It is important to understand how contingency is structured into the total development costs and how spend of such contingency is authorised. This contingency may exist at different levels and under the management of different parties, e.g. identified in the development appraisal and managed by the borrower or identified within the building contract and managed by the building contractor or a separate allowance within the debt facility itself. Normally, specific contingency can only be utilised with the lender and IMS approval.

### *Cost overrun guarantee*

On some projects the level of risk on a project may prompt the lender to secure a 'guarantee' from the borrower, providing an additional security that can be called upon in the event the total development cost is exceeded. The IMS may be required to provide their view as to what financial level of guarantee would be reasonable.

### *Project accounts*

A project may have accounts arranged that ensure various monies are properly ring-fenced for different purposes (particularly on 'mixed used' developments), with the governance of each account clearly defined, including the identity of who has authority to release monies. It is important that the IMS seeks to understand from the

lender how the accounts operate and interact with drawdowns, the IMS may need to certify from the debt facility, for example:

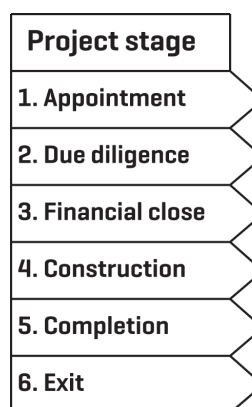
- project/proceeds account
- sales account
- VAT facility; and
- retentions account.

## 2.2.4 Key documentation

The IMS needs to be particularly aware that the competency of the development documentation is an essential component for the lender, e.g. development agreements, building contracts, professional team appointments, collateral warranties, parent company guarantees and performance bonds. The lender will often appoint a separate legal due diligence and the IMS must not replicate that work, but they should consider the documentation in detail from a technical and commercial perspective and work closely with any separate legal due diligence.

## 2.3 The process map

At each stage and milestone of a commission the lender's IMS has different issues that must be carefully addressed. Different projects will vary on the timings and sometimes at what stage the lender's IMS is to be appointed, however, the general process is illustrated below. The map is based on a simple single phase project. For each stage or milestone, a high level overview of the key components is given. Further detail on some key technical aspects is provided in section 3.



### *Stage 1 – Appointment*

In this stage, the IMS is approached to act for a lender on a real estate development. The following needs to be considered:

- general project details
- scope of service
- appointment particulars
- timescales



- likely resourcing
- fee quotation; and
- conflicts of interest

#### *Stage 2 – Technical due diligence*

This stage requires the appointed lender's IMS to review all the technical risks of the project (following the structure and focus of the agreed scope of service), with a view to potentially signing off the project often as a condition precedent to the lender's debt facility agreement.

This will require that the lender's IMS undertakes some or all of the following:

- establish lines of authority and communication routes
- issue to the borrower a required list of information (tailored to the scope of service)
- meet the borrower and chair a kick-off meeting
- visit site and consider the development in context
- prepare an interim report with preliminary observations
- review, comment on and cross-reference incoming information, raising queries as required
- liaise with the borrower on any actual or perceived risks; and/or
- liaise with other lender advisers, e.g. legal, financial, valuation and/or insurance advisers.

#### *Stage 3 – Financial close/contract completion*

At financial close the technical due diligence is completed in report form (initial report) in accordance with the appointment, to fulfil the loan or facility agreement condition precedent requirements. While this is not always an identifiable milestone on a project, to establish a working model for IMS services, it is helpful to recognise this point. To achieve the milestone the IMS needs to:

- close out queries
- complete the technical due diligence
- prepare a technical risk register or summary
- review the report with the lender
- finalise the report with internal peer review; and
- deliver the final report.

#### *Stage 4 – Construction phase*

The construction phase has two key activities for the lender's IMS: certifying drawdown from the facility; and considering, advising and reporting on previously identified and arising technical risks.

##### **Commencement**

- agree timelines and diary with the borrower and lender for the drawdown process and site visits

- agree with the borrower monthly pre-visit and general information requirements; and
- agree with the lender the report and certification format.

##### **Construction phase (monthly)**

- review pre-visit information received from the borrower (typically in the form of a contractor's report and borrower drawdown application)
- attend site (and progress meeting), review and discuss project matters
- walk site, take photographs and agree programme progress and drawdown amount with borrower
- review actual net and cumulative spend in the month against agreed budget forecast, and assess costs to complete
- prepare drawdown certificate and issue to lender
- prepare monthly progress report and issue to lender – highlighting key issues and risks; and
- discuss the project with the lender.

#### *Stage 5 – Completion*

At the end of the construction phase various aspects of the project require to be considered. Key issues are:

- completion properly certified
- variations properly finalised
- status of claims (cost and time) and disputes
- final account agreement status
- defects established
- handover documentation provided
- contractual matters addressed, including collateral warranties and other third-party matters such as those relating to planning, party walls, rights of light and agreements for lease
- insurance arrangements in place; and
- statutory compliance demonstrated.

#### *Stage 6 – Exit*

Often the work of the IMS has concluded by the time of the lender's exit. For example, sales of residential units, lease rental or purchase of the completed development may provide the revenue that permits the debt to be fully repaid. The IMS is often not involved, however, circumstances may occur which require their involvement, such as:

- defects or latent defects arising and not being remedied
- the built facility not compliant with project requirements
- insolvency events; and
- release of retention monies.

## 3 Practical application (Level 2 – Doing)

### 3.1 Stage 1 – Appointment

In this stage, the independent monitoring surveyor (IMS) is approached to act on the lender's behalf on a project development. It is essential that the lender's IMS understands the broad project requirements, including any potential complexities, so that these are reflected in their proposal and quotation. Information such as the following should be clarified:

- general project and professional team details
- scope of service
- appointment particulars, including any confidentiality or non-disclosure agreements\*
- timescales; and
- anticipated lending structure.

\*It is important that the IMS fully respects obligations relating to confidentiality. Any information arising from the project must only be used for delivering their IMS services for the project. Such information must not be made available to others nor should the IMS provide information on the project to others without prior permission from the lender and the borrower.

The information should be sufficient to allow the IMS to establish:

- who will be reliant on their advice
- whether there are any conflicts of interest with the borrower and/or their team
- resource availability and suitability; and
- price (quotation) and any areas of pricing uncertainty.

#### *Scope of Service*

Most lenders will have a standard scope of service for their IMS appointment. The IMS should consider the scope in detail to assess that they have the capability to address every aspect competently. The IMS should be careful where:

- a part of the scope of service does not appear relevant to the details of the project; or
- there are elements of the scope of service that impose or implies a liability that an IMS would not normally accept, e.g. design or construction compliance.

#### *Appointment*

If an IMS is already on a panel established by the lender, then the required appointment terms are likely to already be established. It is important that the IMS considers the

specific appointment terms in detail, in the context of the project and the scope of service, and confirms to the lender that they are acceptable. In particular, the IMS should check:

- professional indemnity insurance levels, limitations and requirements
- liability levels, limitations and requirements
- duties of care
- payment processes
- termination rights
- intellectual property and third party use of information; and
- project timescales and treatment of delay.

#### *Anticipated resourcing*

An experienced IMS will recognise that various factors can influence the level of resourcing they may need to give to any particular project at each stage, depending on how the project is structured. While an IMS will need to weigh up the competitive situation when providing a quotation, they must carefully consider their ability to commercially support the likely time input of the allocated staff. Resourcing may be influenced by a number of factors, for example:

- scale and location of the project
- project programme
- borrower experience
- procurement routes
- tendering process; and
- timing of the IMS appointment.

### 3.2 Stage 2 – Technical due diligence

Technical due diligence is the core discipline of the appointed IMS and will establish the perceived character and risk profile of the project. The results of the technical due diligence must be clearly articulated in a report (usually referred to as an 'initial report'), which is usually a condition precedent of the debt facility. The typical key elements of stage 2 are outlined below:

- 1 establish the lines of authority and communication routes

- 2 issue the borrower with the required list of information (tailored to the scope of service)
- 3 meet the borrower and chair a kick-off meeting
- 4 visit the site and consider the development in the context of the site and surrounding areas
- 5 give a preliminary review of the project for the lender
- 6 review, comment on and cross-reference incoming information, raising queries as required
- 7 liaise with the borrower on any actual or perceived risks; and
- 8 liaise with any other lender advisers, e.g. legal, financial, valuation or insurance advisers.

### 3.2.1 Lines of authority and communication

Lines of communication and authority may change during the project, however, from the outset the following should be established:

- The structure of the proposed IMS team at each stage should be made clear to the lender.
- The lender will often have a team and a lead within that team to whom the IMS should report.
- The borrower should identify the main point of contact for the IMS, who should be appropriately senior within the borrower's team, which would preferably include their own chartered quantity surveyor.
- The lender will often have other advisors such as a valuer and a legal adviser.

### 3.2.2 Information and queries

At the start of the technical due diligence, it is important that the IMS establishes dialogue with the borrower as soon as possible. The lender's IMS should give to the borrower a preliminary list of information required to support the technical due diligence.

The borrower will normally be obliged through the terms of the proposed debt facility agreement to provide all information reasonably requested by the lender and their IMS. The lender's IMS should then:

- record and track the information received
- systematically read and review the information; and
- raise any follow on requests for information (RFIs) and queries.

### 3.2.3 The kick-off meeting

At the commencement of the technical due diligence, a kick-off meeting should be arranged where the lender's IMS will meet with the borrower and appropriate members of their team. In advance, the IMS should have issued the list of information required and, with the lender's permission, a copy of the scope of service to which they have been appointed. The meeting may take the following agenda:

- introductions
- overview and status of the project by the borrower
- lines of communication

- project timescales
- scope of service review
- information requirements
- known problems/risks; and
- site visit.

The kick-off meeting, and the initial review of project information, should allow the IMS, if necessary, the opportunity to provide an early warning to the lender of any particular areas of risk that need to be addressed during the technical due diligence, and to liaise with the borrower at the earliest occasion on such matters.

### 3.2.4 The report

The report should be structured to ensure that each aspect of the scope of service is clearly addressed. Most scopes of service also carry a requirement that the IMS consider any other relevant technical aspects. Using their experience, such issues should be included and highlighted in appropriate sections.

The report's executive summary should comprise a clear general assessment of the perceived risk of each element of the project.

The main body of the report should clearly identify conclusions and opinions throughout, highlighting whether such potential risks have been properly considered and what residual risk may be present. This should differentiate between what is factual, what are the opinions of others and what is the opinion of the IMS.

A clear and concise conclusion should be provided where the opinion of the IMS is offered based on the information provided.

Different lenders may have their own specific requirements for the structure of the report, sometimes with a template of how commercial aspects of the project should be laid out. For this guidance note we use the following report structure, which is also used for headings against which guidance on key areas of technical due diligence is given:

- 1 introduction
- 2 executive summary (risk register)
- 3 project summary
- 4 finance
- 5 programme
- 6 design
- 7 construction
- 8 contract; and
- 9 conclusion

RICS produces professional guidance on many of the key aspects and it is important that a chartered surveyor appointed in this role has a familiarity with such guidance. The technical observations given in this guidance note should not be considered exhaustive, but an indication of the typical key matters. An IMS should have a breadth of experience which will permit them to understand how and



where project risks occur and develop throughout the life cycle of a project as it is conceived, structured, managed and delivered.

### 3.2.5 Introduction

It is important at the start of the report to have an introduction that clearly sets out the purpose and limitations of the report. The introduction should cover aspects such as:

- the purpose of the report
- the reference of the report within the loan or debt facility agreement, the IMS appointment and associated scope of service
- confirming who the recipients of the report are
- limitations relating to whom the advice is provided should be clear, noting no duty of care to others, nor can reliance be placed by others
- should the report require to be made available to other lenders, who at the time of instruction are not identified, this should be carefully considered
- the use of all or any part of the report to third parties must only be by full permission of both the IMS and the lender
- limitations of the advice given and any conclusions considering the nature of the information received during the technical due diligence; and
- any specific wording required by the lender.

### 3.2.6 Project summary

A project summary at the start of the report is often considered helpful as a reference point, which may within one or two pages summarise the key features of the project. This may include the following:

- project description
- key project parties
- project timescales
- procurement route(s)
- capital expenditure
- statutory approvals and consents; and
- funding limits and controls.

### 3.2.7 Financial

A primary consideration of any technical due diligence relates to the sufficiency of the construction and related development costs proposed by the borrower. This will need to carefully consider elements of cost which are identified as either not fixed, e.g. provisional sums and contingency, or will be subject to change depending on progress.

It is also important to consider the contractual structure of the project; the pass down of risks from the borrower to other parties; and where other development costs may arise in consideration of the wider project.

### Construction costs

The primary cost component on any real estate development will be the construction costs. The lender needs to be satisfied that the construction costs are sufficient should the project properly progress as anticipated. The IMS must provide an opinion on cost sufficiency. This is usually done by benchmarking the construction costs, whereby the estimated construction costs are expressed as a £/m<sup>2</sup> rate and compared to appropriate historical data from similar projects, which may be taken from in-house data that the IMS may have or external industry data sources such as the Building Cost Information Service (BCIS).

It is important to adjust the project figures to ensure a like for like comparison with the benchmark data considering, for example:

- base date, e.g. using the BCIS Tender Price Index
- location, e.g. by reference to BCIS Location Adjustment Factors
- ground conditions – informed by the various site investigations; and
- external works – depending on the site wide requirements.

Consider the basis of the construction cost at the time, including the type and stage of procurement, for example:

- Have the costs been prepared by a chartered quantity surveyor on planning status drawings?
- Is it a pre-tender estimate based on detailed design, possibly with supporting bills of quantities? or
- Is it fully priced under an agreed building contract?

Other factors may also influence cost and should be commented on as required, such as:

- design concept and materials
- site access and space
- terrain
- economic conditions
- phasing and sequence; and
- procurement route (and stage of procurement).

The costs should be presented by the borrower in a contract sum analysis or cost plan, which will often follow the standard structure provided by BCIS.

In addition to the benchmarking exercise, the proportion of the construction costs allocated to preliminaries and contractor's overhead and profit (OHP) should be assessed and commented on.

The level of cost certainty should carefully consider where costs are not fixed; the potential risk of cost increases of such project elements should be identified. These may include:

- budgeted allowances
- provisional sums
- prime cost sums; or
- general contingency.

It is also common to consider the sufficiency of costs associated with, for example:

- enabling works
- utilities connections; and
- miscellaneous site preparation.

The IMS should consider whether the costs are front loaded, i.e. increasing the level of the budgetary allowances or prices for works that are early in the programme. This is occasionally done by contractors to assist with liquidity early in the works however, it is important that cash flow is controlled to ensure that there is sufficient monies available to complete the project at any point in time.

#### *Development appraisal*

The IMS will normally be provided with a development appraisal, which provides a forecast of the month to month spend for the entire duration of the project against all the various project cost headings. This will be used as the reference point throughout the project to track actual spend against forecast. The IMS should provide an opinion on the adequacy, appropriateness and any risks relating to the identified costs. In addition to the construction cash flow, other elements will be considered, such as:

- land costs
- enabling works, demolition and site clearance
- planning and consents (including arising financial commitments)
- professional team fees
- development management fees
- site and project investigations and surveys
- crane oversail rights, rights of light, party wall awards and other third party costs
- legal fees
- marketing and sales administration fees
- fees arising from the lender; and
- insurance premia.

The loan agreement may identify which elements of the project will be funded by the borrower and which will be funded by the lender. A loan agreement may also identify separate cost headings which will identify anticipated

spend against different aspects of the development. The IMS should cross-refer to such reference points as required.

The development appraisal should also identify the anticipated cash flows associated with:

- recoverable and non-recoverable VAT
- revenue, e.g. sales of residential units or housing association milestone payments.
- interest and fees arising from the lender; and
- construction retention.

The month-to-month cash flow profile should be considered against the proposed programme, including any possible front-loading. On larger projects, drawdowns may be capped against the agreed cash flow, whereby the borrower cannot exceed the amount shown in a particular month.

#### *Other commercial considerations*

##### **Procurement routes**

Different procurement routes will have an effect on the shape of the cash flow throughout the project. The construction works may be delivered by one of or a mix/hybrid of the following classic forms of procurement, whether using standard or bespoke contract drafting. It is important that the IMS understands the nuances of different procurement routes and the associated risk profile and risk allocation, and appropriately reflects this in their advice:

- traditional building contracts
- design and build [possibly with a novated design team]
- management contracting
- construction management.

Other aspects of how projects are procured may affect how cost risk is considered, for example:

- Were the contracts negotiated or tendered?
- Is the contract another phase of a repeating programme of projects or is it a one off?
- Is the borrower experienced in administering such contracts or is this one of their first or largest projects?
- Is the project delivered by a builder developer?

##### **Building contractor payment**

The IMS should note and comment on how payment to the building contractor is to be administered under the construction contract.

##### **Liquidated and ascertained damages (LADs)**

LADs should be established early on with the chosen building contractor based on a genuine pre-estimate of actual loss to the borrower should a completion date not

be achieved. Without LADs there may be limited commercial leverage on the building contractor to complete on time.

### Performance bonds

There may be a requirement for the building contractor to procure a performance bond, under which an insurance company or bank will release a cash sum to the borrower should certain pre-specified events occur. Such arrangements provide helpful further protection for the lender. The details of performance bond arrangements will vary and such negotiations will be led by the legal advisers. The IMS may be asked to provide an opinion on technical aspects of such agreements and on the amount of cover.

### Parent company guarantees (PCG)

There may be an obligation, where appropriate, for the building contractor to procure a parent company guarantee. This often takes the form of a contract between the building contractor's parent (e.g. a holding company) and a third party (e.g. the borrower and/or lender), which guarantees the performance of the subsidiary. The details of how a PCG operates will vary. The IMS may be asked to provide an opinion on technical aspects of such agreements and the perceived financial stability of the contractor.

### Insurance

There are two key areas of insurance that should be checked by the lender's IMS. The first is the required levels of professional indemnity insurance provided by various parties, especially the professional team, and the design and engineering companies (or building subcontractors) involved. The second is the insurances to be procured under the terms of the building contract itself. The IMS will usually be required to provide an opinion on the levels of such insurance. Such insurances may include:

- contractor's all risk
- public liability; and
- non-negligence.

Other insurances may also need to be considered, for example:

- property owners insurance
- defective title indemnity
- delayed start up cover; and
- latent defects insurance.

The debt facility agreement may make reference to insurance terms, e.g. noting the lender's interest. The IMS should be aware of such reference, however, should the

lender require any further comment on the various policies, a separate insurance adviser would be needed and the lender's IMS may then also have to respond to any technical queries that may be raised by such advisers.

### 3.2.8 Programme

The borrower should provide the IMS with detailed project programmes, for example:

- a master programme
- a detailed construction programme; and
- a design programme and 'information release schedule'.

The IMS should review and provide an opinion on the programmes, for example:

- completion, sectional completion and key milestones
- the sufficiency of time allowances overall and for each task
- the allowance for float (programme contingency)
- that each construction and development task follows a logical order; and
- that a critical path has been properly considered.

A key date schedule or table should be established by the IMS, identifying, for example, start and end dates of key elements of work, especially those that lie on the critical path. Any key milestones (and associated dates) where time is of the essence (or is specifically identified in the lender's debt facility agreement with the borrower or in a third-party agreement such as a pre-let or pre-sale agreement), should be identified. The key date schedule may then be used during the construction phase to record progress each month.

### 3.2.9 Design

In this section design aspects are considered. The IMS will not normally take any design liability and such liability should be explicitly excluded in their appointment.

#### *The design team*

The project will have a design team typically comprising the following plus a range of other specialist consultants:

- architect
- building services engineer; and
- civil and structural engineer.

The IMS should receive a copy of the appointment terms of each of the key members of the design team, providing an opinion upon the adequacy of the form of appointment, liability levels, professional indemnity insurance (PII) offered, fee levels and scopes of service. Where possible, the IMS should also provide an opinion on the experience of the staff being used for the project, as well as the company itself.

When considering the scope of service the IMS should consider, for example

- the description and list of packages
- pre- and post-contract arrangements; and
- obligations of the consultant to visit the works as they progress to assess compliance with the design.

#### *Design information*

Design information will be developed appropriate for the procurement route. The general adequacy of the design and engineering information pack should be considered by the IMS, considering how far the design has progressed across the different elements of the project. The IMS should have sufficient experience to generally understand how a typical design and engineering pack should be brought together, considering specifications and drawings from different parts of the design team.

The design will be further developed during the construction phase and some indication of how this will be programmed and managed should be explained, and at what stages the borrower is to approve arising design. This will also allow the IMS to observe progress during construction.

Most projects will have elements of design liability not taken directly by the design team, but by specific subcontractors to the building contractor, typically, for example, steelwork, lifts, cladding or roofing. The documentation should be clear where such liability exists. The IMS should make recommendations on the need for collateral warranties executed in favour of the lender with such parties. Where a design and build contract is used, the building contractor should also execute a collateral warranty in favour of the lender, because they will be taking the primary design liability. Many projects will have portions of the design which will be left to the contractor to finalise – often called the ‘contractor’s design portion’. Some projects may have specifications or design requirements provided by third parties that should be considered in the borrower’s design, e.g. where a future tenant has a ‘warm specification’, or similar, which identifies their requirements for the space that they are to occupy in the completed building. The IMS should request confirmation from the design team of compliance with relevant industry standards associated with the sector, for example, British Council of Offices Standards, with any non-compliance being appropriately justified. It is also important to ensure that aspects relating to equality, sustainability and energy are properly considered in the design, such as the achievement of BREEAM ratings, the required Energy Performance Certificates (EPCs) and any other requirements relevant at the time.

#### *Reports, surveys and investigations*

The design review will also consider the various site reports, site investigations and surveys that have been undertaken to inform the design and to permit the project to properly progress. The range of surveys can be extensive, informing the development of the design itself, depending on the nature of the pre-existing site and buildings and requirements for planning and other consents. The IMS should consider the sufficiency of the range of surveys and investigations undertaken and how risk has been apportioned. Reliance must be taken on the contents and conclusions of any surveys and investigations.

Arising technical issues can be extensive. Key issues will often include ground conditions, contamination, adequacy of utilities servicing the site and site access/highways. Should existing buildings be present, key issues often relate to structural integrity, asbestos, water ingress and rot.

Some lenders may require that key surveys, such as the primary site investigation, are undertaken by a verified competent engineer, sometimes from their own supplier list. It may also be appropriate for some key surveys to have the benefit extended or assigned or have a collateral warranty executed in favour of the lender by the company delivering the survey itself. The IMS may be required to give an opinion on this.

#### *Planning, consents and statutory approvals*

The borrower should provide the IMS with a copy of all the planning permission documentation and any other necessary approvals (such as those relating to Building Regulations and statutory approvals) and/or a confirmed status of the dialogue with the relevant authorities. It is important that the IMS liaises with the borrower on these matters and clearly identifies such issues for the lender, considering the ability of the borrower to procure all the necessary consents (particularly any pre-commencement conditions) and statutory approvals, including utilities agreements and associated wayleaves and easements, as failure to do so may jeopardise progress of the project.

Third-party consents need to be properly considered by the borrower such as, latent defect warranties, party wall awards, rights of light, crane oversail or wayleaves and easements.

### **3.2.10 Construction**

Under the general construction heading, the IMS should consider the competency of the construction solution,

considering the ability of those delivering the building works and the general arrangements proposed for managing and delivering the project.

### **Capability and capacity**

The IMS should seek details from the borrower of those delivering the building works to assess their capability and capacity, for example:

- the relevant experience of the building contractor considering project type and complexity
- the building contractor's assurance of their capacity to deliver the project
- the structure of the proposed team and, if possible, identifying named individuals for key roles with their CVs; and
- subcontracting arrangements and the relevant experience of such parties.

### **Client brief and contractor method statements**

Under a traditionally procured project, the borrower should have a clear and professionally developed brief including design (or employer's requirements in a design and build procurement) to which the proposed building contractor will respond with their own detailed proposals and method statements (contractor's proposals in a design and build procurement). The IMS should consider the competency of the contractor's proposed method statement. Some aspects of a typical method statement are considered below. Should the borrower be directly building through a construction management procurement route, then it will be the borrower who has to provide such 'method statement' information.

### **Site logistics**

The building contractor (approved by the borrower) should be able to present a commentary, with the site plans, for each phase of the project, explaining how the site and the construction works will be managed and delivered, considering any site constraints and traffic.

### **Site management**

The building contractor's method statement should also properly consider matters relating to the general management of the site, for example:

- site arrangements and security
- protection of the public
- management of waste; and
- management of boundaries.

### **Subcontractor management**

The borrower should provide information to the IMS on how the building contractor will manage the procurement, appointment and supervision of subcontractors. Often a building contract will have an obligation on the building contractor to seek the approval of the employer or client of the building contract for any subcontractors they intend to appoint.

Where the procurement route is construction management, the borrower should evidence their own management

arrangements and competency to manage such direct trade contractor appointments.

It is also important that the approach taken by the building contractor and the borrower to ensure good quality and compliant build is outlined. The site management arrangements involving the building contractor's staff to supervise the works is important, along with any professional team engagement during the construction works.

Such arrangements should recognise that typically, under the debt facility agreement, the borrower and the IMS have the right to visit the site during the works to consider quality and compliance matters, and that any observations are reasonably considered by those who carry the liability for quality and compliance.

### **Information flow**

The building contractor should be obliged to provide information on the works to the employer or client of the building contract. Similarly, under the debt facility agreement, the borrower should be obliged to provide the lender's IMS, with information reasonably requested at any point in time.

During the construction phase, preferably as a condition precedent to any drawdown from the debt facility, the building contractor should provide a report in agreed form, with supporting information. While delivering the technical due diligence, the lender's IMS should seek to agree with the borrower and the building contractor what information would comprise a competent report.

### **Completion**

A key component of any method statement is the management of the works up to completion prior to the occupation of the building. The building contract may impose various obligations on the building contractor relating to the management of and criteria for completion, depending on the scale and complexity of the project.

The need for competent operation and maintenance (O&M) manuals at completion is important, especially on larger more complex projects.

### **Health and safety**

It is essential that health and safety matters are clearly and explicitly considered by the building contractor in their method statements. The IMS should specifically outline in their technical due diligence the various health and safety considerations, especially relating to legislative obligations and notifications to the Health and Safety Executive.

### **3.2.11 Contract**

The IMS will need to consider the technical aspects of the contract documentation. Depending on the structure of the development there may be a range of documentation, for example:

- development agreement
- building contract(s)
- subcontract terms



- collateral warranties; and
- agreements to lease (or other similar back-to-back agreements).

The IMS should outline the structure of the contracts with a synopsis of the nature of the procurement route and the associated risks. The IMS should undertake a careful review of all the documentation, abstracting out into the initial report all the key technical components, commenting on how the technical risks have been considered. Many of the technical aspects of the contracts will reflect issues considered elsewhere in the technical due diligence.

It is important that, while it is not a legal comment, the IMS reads the documentation in detail and is sure that their understanding of how the project is to be delivered reflects the drafting. The lender will normally have appointed a legal advisor. The lender's IMS should make sure that they address the arising technical issues identified by the legal adviser in the legal documentation.

Building contracts will often be amended to reflect project-specific aspects and how the liability and management of risks have been allocated between the various parties. These amendments will often be a distinct set of additional clauses. The nature of the project specific technical risks, that have been analysed elsewhere in the technical due diligence, should be seen to be properly reflected in the documentation and the IMS should be satisfied that this is the case.

It is suggested that the IMS prepares a brief commentary of the building contract (including subcontracts), following the order of the documentation, providing observations and comment on technical aspects as considered appropriate.

Under traditional forms of procurement, the building contractor will usually require to enter into subcontracts for the delivery of various work packages. Draft terms should be made available and preferably will be based on a standard form reflecting the terms of the building contract itself.

Where the building contract is a construction management or management contract, then the contract terms entered into with each contractor for each works package will need to be considered, as the terms will have a direct impact on the borrower.

Often, commercial developments will involve contracts with third parties that are essential to the commercial success of the project, for example, agreements for lease may have been entered into with a potential tenant, such that the tenant is obliged to occupy and pay a rental upon the building being delivered to the required specification by an agreed date. It is essential that the IMS considers such documentation and that the requirements have been reflected in the timescales, project requirements of the building contract and any development agreements. The impact of a failure of the building contractor to achieve the requirements of such third party agreements should be made clear in the technical due diligence.

### 3.3 Stage 3 – Financial close/contract completion

Financial close/contract completion is not always a specific milestone on a project, however to establish a working model for IMS services, it is helpful to consider how the technical due diligence has to be competently completed as a condition precedent to the signing of a debt facility.

At financial close/contract completion the technical due diligence is completed in report form (initial report) in accordance with the appointment, to fulfil the loan or facility agreement condition precedent requirements. This will require the IMS to:

- Close out queries that have been raised and advise on the associated risks should it not have been possible to satisfactorily address any queries.
- Complete the technical due diligence and be satisfied that the requirements of the scope of service have been addressed.
- Prepare a technical risk register or summary that will be incorporated in the initial report. The IMS should seek to be satisfied that every area of technical risk has been appropriately addressed, however, should a technical aspect represent a concern then this should be clearly identified.
- Review a draft report with the lender (preferably a 'page turn') to make sure that they understand what has been articulated in the report and can be satisfied that they can also present internally for their own governance, often to those who manage the credit function.
- Finalise the initial report, ensuring the observations and requirements of the lender have been properly considered, with a detailed internal quality assurance and peer review by the IMS.
- Deliver a signed and dated report as required under the appointment terms and scope of service to fulfil the required condition precedent defined in the debt facility agreement.

The initial report should:

- Be finalised and signed to meet the project timescales, considering the lender's credit process, in advance of the first drawdown.
- Confirm costs incurred at the time of the report and, if appropriate, sign off a drawdown.
- Provide confirmation to the lender that the required equity amount has been injected into the scheme.
- Give clear conclusions, drawn from the technical due diligence, that the project has been properly considered from a technical perspective, in accordance with the scope of service.
- Be clear on the residual risks that will need to be monitored during the construction phase.

- Be coherent, with a concise and well-drafted executive summary, risk register and project summary.
- Be drafted with simple, clear sentences; each section starting with the findings, i.e. the situation is acceptable or not, with high level summary of residual risk; explanation and analysis below.

### 3.4 Stage 4 – Construction phase

The construction phase has two key activities for the lender's IMS: certifying drawdown from the debt facility and the consideration of arising technical risk recorded through a monthly report. There are two elements to this stage. The first is establishing and agreeing the requirements and procedures at the outset with the lender and the borrower. The second is the monthly procedure for drawdown approvals and reporting.

#### Commencement

- 1 Establish the monthly drawdown timescales and a diary identifying progress meeting and drawdown dates throughout the project lifecycle with the borrower and the lender.
- 2 Agree with the borrower the monthly pre-visit information they are to forward.
- 3 Agree with the lender the format of the monthly progress report and drawdown certificate.

#### Construction phase (monthly)

- 1 Review the pre-visit information received from the borrower.
- 2 Visit the site to review and discuss project matters.
- 3 Walk the site, take photographs and agree progress and the drawdown amount with the borrower.
- 4 Review the actual net and cumulative spend against agreed budget forecast, and assess costs to complete.
- 5 Prepare the drawdown certificate and issue to the lender.
- 6 Prepare the monthly progress report and issue to the lender – highlighting key issues and risks.
- 7 Discuss the arising and potential project risks with the lender.

#### 3.4.1 Commencement

The debt facility agreement documentation is likely to have conditions precedent in relation to the drawdown of monies throughout the construction phase. The IMS must ensure services are delivered to support and inform such conditions precedent.

#### Diary

At the outset it is advisable to agree with the borrower (checking that it works for the lender) a month-to-month diary for the whole construction phase. This will assist with

managing the impact of holidays (both general public holidays and any leave taken by key personnel), any key project milestones and the general smooth management of the monthly process. The diary should consider the following:

- drawdown certification dates (tying into the borrower valuation and payment requirements under the building contract)
- monthly IMS site visit (it is preferable that this ties in to the timing of the borrower valuation of the building contract payment to avoid the risk of subsequent disagreement)
- monthly progress meetings – if different to the valuation date (it is preferable that this occurs on the same day as the borrower valuation and drawdown progress assessment); and
- lender's IMS progress report (the lender will either want this report within, for example, 5 business days of the drawdown date or at the same time as the certificate – the latter will require careful planning and preparation for each month by the IMS).

#### Information

As considered in the technical due diligence stage, the borrower should be required to release certain project information to support the assessment of the drawdown (including a 'contractor's report'), and to inform the IMS progress report and assessment of any arising risks. The IMS should also request other relevant information reasonably required and the borrower will normally be obliged to cooperate under the terms of the debt facility agreement.

#### Drawdown certificate template

A template of the drawdown certificate should be agreed with the lender. Some projects will provide a template for the certificate in the debt facility documentation itself. This certificate is typically a single side of A4 with the gross and net drawdown amounts clearly expressed (the latter both in numbers and written), with an area for the IMS to sign on behalf of their company. It is important that the certificate is clear on the sums of money relating to different project components as agreed between the lender and the borrower, for example, split to different parts of the project, use of equity, contingency, VAT positions, etc.

The certificate should have a backup page that shows how the cumulative drawdown amount has been calculated, considering in detail all the costs of the project, identifying any required separate cost headings.

#### Reporting format

The monthly report required of the IMS should follow the structure of the agreed scope of service within the appointment or other specific structure preferred by the lender. The IMS should include anything the lender may specifically require, including, for example, how commercial data is to be presented. A typical monthly report to support the drawdown approval may comprise the following elements:

- Title page.
- Contents page.
- Introduction – a brief description of the project including the purpose of the report, who the recipients of the report are, i.e. to whom the report is addressed, limitations relating to whom the advice is given and to whom there is not a duty of care should be clear – the report should be solely for the benefit of the lender(s) and associated parties. The use of all or any part of the report to third parties must only be by full permission of both the IMS and the lender.
- Project summary – prior to getting into the detail of the project status, a project summary may be useful, which summarises the key features of the project. This may include the following:
  - project description
  - key project parties
  - project timescales, including key dates
  - procurement route(s)
  - capital expenditure estimate split to key headings; and/or
  - funding limits and controls, e.g. LTV or LTC.
- Executive summary/risk analysis – all the key observations should be summarised at the start of the report. The IMS should endeavour to keep this as succinct as possible to allow the lender to quickly identify current issues and risks. The use of a red, amber or green (RAG) analysis within the executive summary is often preferred, to help the lender understand the status of current project matters. The executive summary should be qualified as being a summary of the technical points, recommending that the lender also read the body of the report to ensure that they fully understand the issues.
- Finance – all the key commercial aspects, including cost to complete and insurance matters.
- Programme – a commentary of the progress of the project and key risks to the ongoing programme and the likelihood of achieving key dates.
- Design – the ongoing development of the design, including the status of planning, consents and statutory approvals.
- Construction – the technical delivery of the project on-site, including sign-offs/confirmation of compliance by others (site engineer or building control officer for example), and health and safety matters.
- Contract – key contractual elements of the project, claims, disputes, etc.
- Appendices – used to provide further detail to elements within the main body of the report and reproduce any key documentation, for example:
  - a copy of the drawdown certificate and drawdown tracker

- development appraisal marked up with actual expenditure
- marked up master programme; and
- any certificates, reports, commentaries, correspondence, etc considered appropriate.

The use of appendices is important to ensure the main body of the report is not unnecessarily cluttered with reference material or text relating to historical observations.

### 3.4.2 Monthly certification

There are a number of important matters to consider when agreeing what has been properly spent on the project and approving the drawdown amount from the debt facility.

#### Drawdown assessment preparation

In advance of the site visit and drawdown assessment, information should have been forwarded to the IMS to inform them of progress and the status of all commercial matters. The IMS should speak to the lender to assess if there are any salient issues that may have arisen out of direct discussion between the borrower and the lender.

#### Assessment of drawdown amount

The IMS should seek to attend site on the same day that the borrower is seeking to assess what payment is properly due for the construction works under the building contract. This would provide the IMS with visibility of the interim payment valuation rationale (including how identified non-compliant or defective works have been treated) and the agreed amount of monies due in relation to the direct construction and development activities identifiable in the agreed budget, which will facilitate the approval of the drawdown amount.

The IMS should ensure that they are not (nor potentially seen to be) certifying the value of the works to be paid to the borrower's contractor(s). The borrower may have an externally appointed chartered quantity surveyor formally assessing the payment for works completed in accordance with the contract, certifying such valuations. The IMS may then provide an assurance to the lender that they have undertaken reasonable checks of the borrower's assessment of works properly completed in accordance with the contract.

For the IMS to value the construction works, this would place them in a role that is a direct liability and duty of care to the borrower, and would dilute their independence and duty of care to the lender, presenting a conflict of interest.



In relation to construction spend it is also helpful, where the procurement route does not provide the necessary visibility, such as that found in construction management or management contracting, that the IMS is provided with evidence that subcontractors and any professional fees have been paid from the monies certified in the previous month, and, where relevant, that any building contract retention monies have been properly set aside by the borrower. Similarly, the IMS should review invoices to substantiate expenditure considering whether they are appropriate for the stage and properly addressed to the project. This will provide assurance that the drawn monies are being properly spent on the project, supporting project liquidity, and that there is sufficient monies to complete the project at any point in time. Consider carefully issues relating to materials on and off site. If possible, the drawdown should only relate to the value of completed works, however, in some instances the borrower may certify costs for such materials. The IMS needs to carefully consider retention of title, and materials ordering and invoicing. This issue is highlighted in situations where the borrower or the building contractor, experiences an insolvency event.

### Debt facility requirements

The debt facility agreement between the borrower and the lender will normally have requirements or conditions precedent that need to be considered for each drawdown, for example:

- receipt of a drawdown request in an appropriate form from the borrower
- understanding the flow of money relating to any project accounts if applicable
- confirmation that the balance of the facility is sufficient to complete the works
- receipt of information that may be specifically required from the borrower by the agreements
- LTV requirements have been met
- LTC requirements have been met
- equity contributions (or other sources of funds) have been properly considered; and
- VAT has been suitably considered.

### 3.4.3 Monthly progress report

The progress report (issued either at the same time as the lender's IMS drawdown certificate or shortly thereafter as agreed with the lender) should clearly and succinctly capture the key issues and arising risks of the project at the time of the assessment of the drawdown amount.

#### Information review and site visit

Insofar as information is made available, the IMS should review all the information forwarded by the borrower, raising queries and discussing matters where appropriate, and in sufficient detail so that the IMS can competently comment and provide an opinion on the various technical matters.

The IMS should discuss the technical matters arising with the borrower and members of their team where appropriate, and, preferably, have the opportunity to listen to discussion and become involved during progress meetings. The information previously reviewed should inform and prompt such discussions. Sometimes, should information be limited, such discussions are key to understanding what the present risks on a project are.

The IMS should walk around the site, accompanied by the borrower and/or appropriate members of their team. Key elements of the works should be inspected to assist with the agreement of progress and to consider aspects that might be presenting a particular technical issue.

Photographs should be taken that are reproduced in the report issued to the lender to illustrate progress (if possible taken from the same visual perspectives each month) and any particular technical issues that are important at the time, e.g. an arising defect.

It is important that issues relating to health and safety are properly considered by the borrower. The IMS should be satisfied that the borrower has sought to address their health and safety obligations, e.g. inspections from a safety officer, and site set up and management. Should the IMS observe anything that they may consider to present a health and safety risk, they should raise such matters immediately with site staff.

During the site walk, the IMS should also generally consider quality and compliance of the works. As part of the review of quality and compliance the IMS should also consider the sign off or reporting provided by those parties with a clear duty to inspect and confirm compliance, for example, resident engineers, building control officer, clerk of works, etc. The IMS will not take any design or construction works compliance liability and should use language carefully to reflect this, however, they should raise any matters that their experience may suggest is an issue, which should then be considered by the borrower and their team.

#### Report quality assurance

It is essential for the proper delivery of the IMS service that each progress report is properly checked by a professional member of the IMS team (a peer review). Such checks should consider the following aspects:

- Computation check (comp check): a full check of the arithmetic to reach the drawdown amount is essential, including how it is presented in the report. Drafting slips, data input or formula errors can occur. It is important that each written monetary amount is checked.
- Risk identification: risk has been considered and properly expressed in the report.
- Technical comment: the report has appropriately provided technical comment and opinion.

- Comprehension: the report can be easily read, for example, keeping sentences short and clear, avoiding duplication, avoiding over-elaboration and proper use of grammar.

The IMS should seek to discuss the project regularly with the lender. This should be done to suit their individual preferences, potentially before the site visit, after the site visit and/or after the issue of their report (possibly by exception only). This will assist with:

- the satisfactory delivery of the IMS services
- the lender's understanding of the project at any point in time and any issues that need to be discussed with the borrower; and
- the proper consideration of arising project issues, i.e. an early warning, especially in relation to any risk relating to delay or overspend.

### 3.4.4 Financial

#### Overall status of development budgets

At the start of the report, the IMS should summarise the status of the overall project budgets, comparing the actual current spend in the month against the overall budgets and spend for the previous month, considering each element of the debt commitments and key phases of the project. Spend relating to contingency and VAT should also be summarised where appropriate, including the current status of LTV and LTC, and any other limitations.

#### Construction costs

The IMS should provide a comment on the status of construction costs and the construction contract budget. A summary of variations and anticipated variations leading to an estimated final account should be provided, indicating how they are to be funded.

Preferably, the borrower will provide a full construction contract cost report identifying actual and potential additional cost movements, prepared by their own chartered quantity surveyor. It is important that every instruction and/or change is properly recorded and formally signed off.

The IMS should outline how the costs have moved from the previous month, with a comment on the cost movement trend, e.g. are costs likely to increase or are cost savings being successfully applied? A table should be completed that summarises areas of cost movement. Sometimes the lender will require the IMS to use their own preferred format for how such project cost status should be presented.

Areas where potential costs may occur, putting pressure on the construction budget, may be drawn from the information provided by the borrower and from discussions from the site visit and attendance at the progress meeting.

Depending on the scale of variations instructed on the construction contract, they can be detailed within the body

of the report, otherwise they may be summarised with a detailed breakdown of all the variations in an appendix.

#### Construction cash flow

The IMS should report and provide an opinion on the speed of spend against the forecast cash flow. A table should be provided showing the month-to-month construction contract payments and the associated actual drawdowns from the debt facility, compared to the forecast month-to-month cash flow. This should be illustrated in a cash flow chart, showing the cumulative and stage construction payments against the forecast cash flow.

The forecast cash flow may be adjusted in agreement with the borrower to reflect the likely completion date (considering any delays) and the projected building contract final account. The report should always show the original forecast.

#### Loss and expense claims

The IMS should comment on any likely or actual claims made by the construction contractor under the building contract. To provide a detailed comment, other than the highest level opinion, may be treated as an extra service under the IMS appointment, however, the borrower should provide sufficient information from their perspective to allow the IMS to provide a comment on the potential outcomes.

#### Development costs

The actual cumulative development costs spent up to the month of the drawdown should be identified against the forecast cumulative spend by that month taken from the original development appraisal agreed by the borrower with the lender. The actual cumulative spend may also be summarised in a table against each cost heading of the development appraisal, which may also be reproduced in the executive summary.

The rate of overall project spend should also be illustrated in a graph showing the actual and originally forecast cumulative and stage spend per month. The data table supporting the graphs (preferably drawn from a coded development appraisal) should also be provided.

The IMS should provide an opinion on the rate of spend, e.g. ahead, behind, slowing, speeding up, etc., by comparison to the original cashflows. Any risks to the sufficiency of the budget (costs to complete) and potential need for additional equity support by the borrower should be considered and highlighted.

Other elements of cash flow where relevant, for example, sales revenue or VAT reclamation, should also be tracked and the IMS should comment on the potential impact on project liquidity and cash flow projections, and how this is being managed.

There may also be financing costs, such as rolled-up interest, however, this will not normally be for the IMS to assess, but they should enquire of the lender and the

borrower to confirm that appropriate allowances have been made in the drawdown approval and the cash flow projections.

### **Development contingency and cost to complete**

At financial close an appropriate level of contingency monies should be identified, both in the construction costs [a separate line in construction budgets and/or within a building contract cost profile] and the wider project cash flows, e.g. coded line(s) in the development appraisal. The IMS should comment on expenditure against contingency amounts [considering the borrower's rights to expend or instruct expenditure against identified contingency] and provide an opinion on the possible sufficiency of such sums to support further arising costs both forecasted and potential.

At any time, should it be apparent that there is pressure on the levels of contingency and thereby potentially a risk that the presently identified funding is insufficient [based upon the originally agreed funding parameters], this should be highlighted and immediately brought to the attention of the both the borrower and the lender. This will inform the dialogue required to consider the funding and the management of the project to a successful outcome.

Most lenders will require [and it is recommended] that each month the IMS gives an opinion on the ability to fund the remaining project activities, including the construction works, with the current debt and equity provisions agreed, i.e. 'costs to complete'. This is only insofar as the information presented to the IMS can inform such an opinion and does not allow for unforeseen events such as an insolvency event.

### **Insurance**

The IMS should record the ongoing maintenance and proper renewal of the required project insurances by the borrower. The borrower should provide confirmation that the necessary insurance cover is in place, including cover notes from the insurers and/or insurance broker. This will include all the relevant construction phase insurances as identified in the initial report, including those required relating to the building contract/works and professional team professional indemnity insurance.

### **3.4.5 Programme**

#### **General progress**

The borrower should have provided the IMS with a mark-up of the construction programme and any overall development programme, showing a timeline for that month dropped down the programme adjusted to their understanding of the actual progress achieved for each activity. The IMS should review this in detail and discuss the progress of each activity with the borrower. Such discussion should consider critical path items and the logic of the technical sequence of activities.

Should significant delay be apparent, that cannot be recovered through improved progress across the currently programmed activities, or absorbed in programme float,

the borrower may propose action plans and/or re-programme the remaining works to seek to achieve the original completion date(s) or to mitigate the impact of the delay.

Should a revised programme be provided by the borrower, the IMS should continue to report progress against the original programme and provide an opinion on any revised programmes, including a copy of the programme in the report.

The IMS should provide their own opinion on progress against each element of the agreed programme and on the ability of the construction works to be completed by the currently identified completion date(s).

Should delay be observed in the current activities, which make it likely that a delay to the anticipated completion date(s) will occur, this should also be reflected both in the cash flow review and the likely outturn budget assessment in the previous section.

#### **Key dates**

The IMS and the lender may consider it helpful to provide a table of key dates in the report, in which the originally anticipated milestones and progress dates are listed, with an opinion given on progress towards those key dates, especially in relation to dates for completion or other key contractual dates such as those required for tenant access. If delay is a risk, then comment and provide an opinion on the likely date and repercussions of such delay. Should certificates in relation to practical completion or non-completion (or other formal notices) have been issued, then this should be noted and a copy included in an appendix.

#### **Extension of time claims**

Should an extension of time claim be raised (or likely to be raised) by the building contractor that would affect the contracted dates for completion (or other key dates), the IMS should briefly observe this in their report and draw to the lender's attention the potential impact on the project. The IMS may provide a general opinion on the validity of such claims, however, the liability for managing and agreeing such claims should always rest with the borrower. To provide a detailed comment, other than the highest level opinion, may be treated as an extra service under the IMS appointment, however, the borrower should provide sufficient information from their perspective to allow the IMS to provide a comment on the potential outcomes.

#### **Construction works**

The IMS may briefly note what specific works have been delivered during the reporting period against the main elements of the building and what works will be anticipated in the following month. If necessary, areas of concern should be highlighted.

### **3.4.6 Design**

#### **Design progress**

Most projects will require significant levels of design to be finalised after works have commenced on site. Such

residual design work will depend on the procurement route selected and may be captured in an information release schedule (IRS) or design programme. The progress of such design development is essential to supporting the delivery of competent construction works.

Each month, progress of such design development should be considered and the IMS should discuss this with the borrower. Should an IRS or design programme be available then the lender's IMS should request that the borrower reports progress against such documentation each month.

Should delay have occurred on an element of design then the reasons for such delay must be explained, along with the potential impact on the programme and the proposed remedial actions.

Major projects will often have a diary of technical and design meetings in addition to the general monthly progress meetings. The IMS should be permitted the right to attend if appropriate and/or request copies of the associated minutes. This will assist the identification and interpretation of arising issues.

Often, members of the borrower's design team may be required to produce their own monthly reports, considering design progress and construction compliance. Again, the IMS should request a copy of such reports to ensure that their comment is fully informed.

### Planning

In addition to generally considering compliance of the development with the planning consent, the IMS should summarise the status of the discharge of planning conditions, with a comment against each reserved matter, considering those matters that need to be signed off at different stages of the development life cycle. Any particular areas of concern should be highlighted.

Preferably, the design team lead, often the architect, should produce a tracker that provides a progress statement for that month against each matter they are trying to resolve with the planning authority. The IMS may refer to this in their comment and reproduce the tracker in an appendix.

### Building Regulations, statutory approvals and other consents

The IMS should receive information each month from the borrower on the progress being achieved in relation to Building Regulations and statutory approvals, including plans, technical appraisal and site inspections. Similarly, for any other consents essential to the project such as (where relevant) party wall awards, rights of light, crane oversail and wayleaves or easements.

## 3.4.7 Construction

### Quality and workmanship

Any comment made in relation to quality and workmanship will be dependent on the scope of services that the IMS is appointed under. Usually, the lender's IMS will not be required to do more than a general consideration of quality and workmanship during the monthly site visit. It is

important that the liability for the delivery and compliance of the construction works rests clearly with the borrower and their team and contractors.

The IMS may still give a general opinion on the perceived quality and workmanship of the works and should raise any observations directly with the borrower, who should reasonably consider such representations and potentially provide a response or plan for remedial action. Should the IMS have a specific quality, workmanship or compliance 'sign-off' obligation, then they must be careful to ensure that they use appropriately qualified staff for that role, and that the fee reflects the time commitments such services require and that they are properly insured for that liability.

It is always preferable that the borrower has some form of quality and compliance regime in place with identified staff inspecting the works. This may be a mix of work done by the borrower's in-house staff, external appointments and the building contractor's own staff. The IMS should seek visibility of such activities and be able to inspect quality and compliance observations and reports, e.g. a clerk of works producing field observation reports. Should there be any specific third-party sign-off of the works, the IMS should receive a copy of such authorisation or certification for the record.

### Subcontractor procurement

Based on information provided by the borrower, a record of the status of appointment of construction works packages, contractors and/or subcontractors should be maintained and reproduced in the IMS report. This may indicate where packages have not been appointed and estimates of the likely date of appointment.

Some projects may require that the lender and/or their IMS will need to approve such appointments, which should not be unreasonably withheld.

It is particularly important that any construction works packages that require the appointed contractor or subcontractor to execute a collateral warranty in agreed form in favour of the lender is clearly identified and the status of such execution clearly highlighted each month. This is a key element of security for any lender.

### Health and safety

It is important that the IMS carefully records matters associated with health and safety in their report. They should ask the borrower about any incidents and whether any are reportable. This should be clearly recorded in the report.

Most projects will have a party appointed to consider health and safety under existing legislation. The borrower and/or building contractor may also have their own safety officer undertaking regular inspections and reporting. The IMS should enquire as to the involvement of such parties on the project and should seek permission to inspect any arising reports.



Any construction professional when they visit a site has an obligation to report any potential health and safety risk or contravention that they observe. Observations should be raised with site staff and the borrower, who will have the liability to respond appropriately.

### Other site issues

There may be a wide range of construction related issues that would be appropriate for the IMS to provide an opinion in their report at their discretion, for example:

- boundary and neighbour liaison issues
- crane oversail or party wall matters
- site management and set-up
- security and break-ins; and
- utilities and connections.

### 3.4.8 Contract

In this section the IMS should go through any particular elements of progress that relate to contractual documentation or legal points that may have arisen or need to be identified, using appropriate headings. These may have been touched on already in the report, however, may be mentioned again and referred back to the earlier section of the report where the issue is discussed. This section may cover issues such as:

- execution of collateral warranties (professional team and subcontractors)
- completion, non-completion, partial possession, completion of making good defects, etc.
- highway agreements, agreements to lease or other ancillary agreements
- contract procedure difficulties
- issues relating to liability and potential claims
- insurance renewals, including annual renewals of professional indemnity insurances of design and engineering parties with collateral warranties executed in favour of the lender.

Should there be any matters relating to legal interpretation, then the IMS must recommend the lender seeks comment from their legal advisers.

### 3.4.9 Other project scenarios

Some projects may lead the lender to feel that only a relatively high-level approach from their IMS is appropriate. In such a situation, the IMS needs to check that this reflects the agreed scope of service, the expectation for sign off of drawdowns from the debt facility and the depth of reporting and dialogue that may be required with the borrower and the lender, considering the project dynamics.

Sometimes, an IMS may be appointed by the lender late on in a project, where perhaps construction works have already commenced, occasionally when the lender has already decided to provide a debt facility. In such scenarios the IMS should be careful about their preliminary technical due diligence of the project, considering the inherent risks of the project presented and likely success of the project

at the time. This will also affect the nature of the IMS role going forward. The lender and the borrower need to be clear on what to expect from the involvement of an IMS at such a late stage.

A project that involves an inexperienced borrower may need to be carefully considered, because it will often require additional time for the IMS in dialogue with the borrower by comparison to a project where the borrower has extensive experience of the development process. Such borrowers may not have anticipated the involvement of an IMS or understand how they may contribute to a project's success. Such borrowers will need to have the perspective of risk from a technical and financial perspective clearly and regularly explained.

Projects that involve, for example, the lender providing a debt facility directly to a borrower to support their development, who is a high net worth individual, will affect how the IMS may approach the delivery of their services. The IMS may need to reflect the nuances of the relationship existing between the lender and the borrower. The borrower may be experienced or inexperienced, however, personal as well as professional levels of confidentiality and a focus on maintaining positive relationships will be key considerations.

## 3.5 Stage 5 – Practical completion

The IMS may continue with monthly visits, project dialogue and certification of drawdowns until the point in time that the all project costs as anticipated by the original development appraisal have been expended. Lenders may also still require the IMS to attend site, agree progress and actual spend even if the debt facility has been fully drawn and the project is being funded through the borrower's equity. This may go beyond completion (or practical completion under the building contract) or phased completions through the project. For the guidance note, to establish a model of service delivery, it is assumed that practical completion has been achieved concurrently with the conclusion of all the technical and commercial matters relating to project delivery.

At this stage appointments will often require a completion or closeout report prepared by the IMS with a separately identified fee. This report will explain the consolidated position for all of the various technical aspects of the project.

### 3.5.1 Completion properly certified

It should be clear that completions have been achieved for the building works that permits proper use of the facility or appropriate access for third parties. Should practical completion have been certified under a building contract, then a copy of the certificate should be made available and the IMS should include a copy in their report.

The IMS should be satisfied that technical issues supporting completion have been properly considered, for example:

- design drawings and as-built drawings have been organised and are available
- operation and maintenance manuals have been developed
- sign off in relation to planning, Building Regulations and other consents have been achieved; and
- testing and commissioning of the facility has been properly addressed.

### 3.5.2 Instructions and variations properly finalised

The commercial impact of all instructions and changes on the project should have been fully recorded and formally incorporated, with the funding sources identified. Variations often involve, directly or indirectly, a third party who may also have a right to approve such variations. Such approvals, the final cost of the works and the rationale for cost movement should be clearly and specifically recorded.

### 3.5.3 Status of claims (cost and time) and disputes

Claims or compensation events made under a building contract associated with delay and extra costs should be clearly explained. As previously noted, it is not the IMS who would normally review and approve or reject claims, but they should seek to be clear in their report on the possible outcomes and the impacts on the project. The completion report should provide an overview of any claims made, the status of agreement of those claims between the various parties, the range of positions for each claim, the potential outcomes and any residual risk.

### 3.5.4 Final account agreement status

The final account normally relates to the quantum agreed between the employer and the building contractor as the full and final amount properly due under the building contract, including variations, claims and any other commercial matters, such as any liquidated and ascertained damages that may have been set off.

Similarly, issues relating to retention monies, VAT and any set off amounts should all be clear to ensure the final account represents the actual or anticipated final position. At completion (or practical completion) the final account is often not finalised, with a number of residual commercial matters remaining. The IMS should liaise with the borrower and be satisfied that all commercial matters have a clear position established, highlighting anything that still requires to be finalised or has some residual risk. The completion/close-out report should clearly note what the final account position may be if it has not been finalised at the time.

### 3.5.5 Defects established

At completion there will often be a list of 'defects' (works that have not been delivered in accordance with the building contract which require to be addressed by the

building contractor), which are not considered to be sufficiently significant to materially prevent occupation or use of the facility. These defects, however, will still require to be put right by the building contractor during the defects liability period, often a 12-month period after the completion date.

The lender's IMS should provide a comment on the defects, the scale of them, how they are being managed and the potential impact on the project thereafter.

### 3.5.6 Contractual matters addressed

A wide range of contractual matters may need to be summarised and captured in the IMS completion/close-out report, for example:

- the execution of collateral warranties in favour of the lender
- the issue of certificates, e.g. completion certificates
- the status of performance bonds and guarantees; and
- the completion of works on time and to satisfy the requirements of ancillary contracts and arrangements.

### 3.5.7 Insurance arrangements

Any insurance arrangements should be in place with evidence provided by the borrower that the necessary policies have been procured and premia paid.

### 3.5.8 Statutory compliance and consents

The IMS should be satisfied that the borrower has undertaken all reasonable actions to ensure compliance of the works with the project and legislative obligations, including planning regulations, Building Regulations and any warranty requirements, such as home warranties where relevant for residential projects. Confirmatory documentation should be provided by the borrower as evidence that all necessary consents have been achieved.

## 3.6 Stage 6 – Exit

The lender's exit, i.e. the point in time that the debt facility has been fully serviced by the borrower, will often be after the lender's IMS involvement has normally ceased. For example, with final sales of residential units, accrued lease rental or purchase of the completed development. The IMS is often not involved, however, circumstances may occur that require their involvement. Such input would often be instructed by the lender as an additional service under the original appointment. Such events where the IMS is to provide an opinion or advice are wide ranging, however, may include scenarios such as:

- defects not being properly remedied
- the built facility not being compliant preventing lease or sale
- issues relating to a later fit-out or other subsequent works
- an insolvency event occurring with a key party; or
- release of retention monies.

## 4 Practical considerations (Level 3 – Advising)

### 4.1 Risk analysis

In the technical due diligence section it is noted that the lender will normally expect some form of tabulated risk analysis in their reports, either in or supplementary to the executive summary, and similarly in the monthly progress and drawdown reports.

The primary requirements of the technical due diligence analysis and the resultant initial report is to clearly present and articulate the project environment and the technical project risks, so that the lender's decisions can be fully informed. It is with this in mind that the preparation and clear presentation of the risk analysis is an essential component of a competent initial report.

The IMS would typically summarise the technical observations from the body of their report (whether the initial report or monthly progress/drawdown report), categorise the risks and take a view on how such risks may impact on the successful progression and completion of the project. The technical components of the project would be tabulated, summarising the potential impact on the project and any mitigants that are in place. A graphical 'red, amber or green' risk allocation (RAG analysis) is often used to provide a visual indication of the IMS opinion on the level of risk for each technical matter at the time of the assessment. An example of how 'red, amber or green' risks are defined is given below.

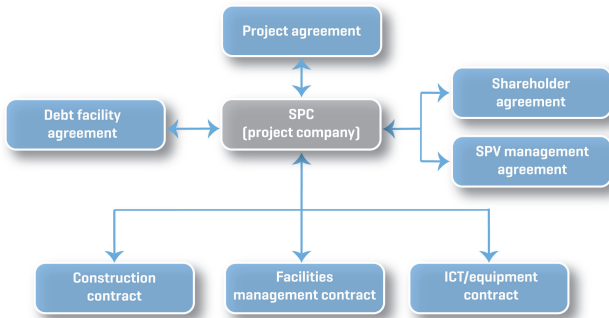
- 'Green' – the technical matter has no or low risk which is a typical or accepted situation for such a project, with suitable mitigation in place, with minimal impact on the project from a technical perspective.
- 'Amber' – the technical matter has a medium or higher risk profile than preferred and will require monitoring, but should not have a significant impact on the project from a technical perspective if properly managed, with clear mitigation in place.
- 'Red' – the technical matter has, in the opinion of the IMS, a high risk profile that could negatively impact on the delivery of the project from a technical perspective and needs to be addressed.

Should the IMS be of the opinion that risks are clearly apparent on the project, whether they are 'amber' or 'red', it is important to make this clear to the borrower. While it is essential and incumbent on the IMS to give their independent view on project risk from their own analysis, the borrower should be given the opportunity to give their opinion and to discuss how the risk may be treated to minimise the potential impacts and to encourage the successful delivery of the project. This will support any dialogue that the lender may then have with the borrower, with both parties aware of the IMS opinion on such matters.

### 4.2 Private finance initiative

Over recent years, UK governments have procured social infrastructure through cash flow or concession finance forms, such as the private finance initiative. These include schools, hospitals, prisons, offices, leisure centres and other serviced accommodation. Through a project agreement, the public sector pays a unitary charge or services payment relating to the provision and availability of space and performance of associated facilities management services. This normally does not include the provision of the purpose of a facility itself, but provides a service to facilitate the public sector delivery, e.g. education and teaching or clinical services and healthcare, which remain with the public sector.

A number of models have been developed, each with variations in detail, e.g. PFI, NPD, PF2, etc., though a reasonably standard contract structure exists for accommodation (or real estate projects), illustrated in the diagram overleaf.



The funding sources usually comprise equity (sometimes provided by both public and private sector), sub debt and senior debt through a facility agreement. Sometimes, the IMS (or lender’s technical advisor) will be asked to provide a secondary duty of care to the project company, which will need to be carefully considered by the IMS and only ever with the lender’s approval. A typical funding structure is illustrated below (adapted from Treasury PF2 guidance). This is an example as such structures can vary.

Project company capital structure	
Developer equity	c. 20-25% of capital structure [may include mezzanine finance]
Public sector equity	
Third-party equity	
Senior lenders [public bonds/private placements/bank debt/other sources]	c. 75-80% of capital structure

© Crown copyright material is reproduced under the Open Government Licence v3.0 ([www.nationalarchives.gov.uk/doc/open-government-licence/version/3/](http://www.nationalarchives.gov.uk/doc/open-government-licence/version/3/))

The project company will fund their bid, design and construction, including all legal and professional team costs, through the funding structure. Upon construction completion and the achievement of what is often called ‘services commencement’, the project company will receive an annual payment (paid monthly), which will fund the project cash flows and support, for example:

- facilities management (FM) costs
- life cycle capital replacements
- project company administration
- debt servicing; and
- equity distributions.

The length of the operational phase, which will provide the cash flows to support the debt servicing, will vary project by project, but will often be 25 or 30 years up to what is

referred to as the ‘expiry date’. At this point the contract will usually enter what is often called ‘handback’, where the facility is brought to the specified condition, with all required supporting documentation and will transfer back to direct ownership of the public sector, who will then also carry full responsibility for the delivery of the facilities management services thereafter should they so wish.

The construction and FM requirements will be captured by output specifications. The FM aspects will include a range of performance standards for each area of service that will link into a payment mechanism. The payment mechanism calculates deductions from the monthly payment made by the public sector body to the project company, for any under performance against performance standards and availability criteria. The performance of FM services will usually be measured against a range of performance standards which will vary in detail and scope project by project. They will normally relate to hard FM services (maintenance and utilities related) and sometimes also soft FM (cleaning and other non-maintenance related FM services).

The performance of the built facility itself will usually be monitored and measured by ‘availability criteria’. These criteria, in addition to accessibility and health and safety, will primarily relate to the compliant environment for each space, e.g. temperature, lighting, etc. usually established by reference to room data sheets. Should the spaces not achieve the required availability criteria they are deemed unavailable and deductions to the monthly payment may be made dependent on the area affected and how long the unavailability lasts.

For the IMS to deliver services for the lender competently, and to deliver a comprehensive technical due diligence, requires a detailed understanding of not only the procurement and construction of the facility, but also the delivery of the various FM services, life cycle management and project company delivery for the entire operational phase. The IMS needs to understand how obligations and liability for delivery at every stage is normally managed by the project company and how risks are passed down to the various subcontracts. Key aspects relate to the protection of project revenues to service the debt (risk of performance and unavailability deductions), how risks relating to default and termination should be managed, and the options for the lender at different stages needs to be understood.

The IMS input will often start during the public sector tendering procurement supporting a bidding consortium. Typical stages include:

**1 Tendering (short-listed consortium)**

Supporting technical due diligence (and draft report) as part of tendering consortium proposals.



### 2 Technical due diligence (preferred bidder)

Should the consortium be successful, complete the technical due diligence to the satisfaction of the lender, including detailed analysis of risks throughout the operational phase.

### 3 Financial close

Ensure that a comprehensive technical due diligence report is presented and approved by the lender, as a condition precedent of the facility agreement.

### 4 Construction phase

Monitor the delivery of the construction works and certify monthly drawdowns from the debt facility to support the payment of the construction subcontract.

### 5 Completion/services commencement

While monitoring the construction works, provide an opinion upon the satisfactory completion of the works and the lead into the commencement of the FM services.

### 6 Operational phase

Visit the site once or twice a year on behalf of the lender to assess ongoing administration of the operational phase by the project company, performance of the FM services and arising deductions.

Should variations be instructed, whether during the construction or operational phase, usually dependent on the scale of the change, it is often required that the IMS signs off those variations from a technical perspective to ensure that the project company has properly considered the impact of the variation and that the risk profile of the project has not changed so that the lender is in no better or worse position.

## 4.3 Non-profit funding

A chartered surveyor with the skills required to deliver a lender's IMS services may sometimes be required to deliver similar services for those providing funding in a non-profit situation, i.e. those providing the funding are not looking for a monetary return on their investment, for example, where grants are being provided. In such situations there will normally be no requirement to repay such funds.

Most of the technical issues discussed in this guidance note remain relevant to delivering IMS services in such situations, though the commercial interest in the success of the project will be different. Those providing such funding, do so understanding the principle that there is a desired and beneficial outcome from the project. As such the funder would want to ensure that the primary objectives underlying the decision to provide such funding are protected.

Technical due diligence will be from a different perspective, i.e. assessing that all the key strategic objectives of the funding body are being met by the proposed development and that there is a full understanding of objectives and how they should be realised by those receiving the funding. In addition, a technically competent project should be evidenced and many of the same issues will need to be assessed as described in this guidance note. The primary goal being that the anticipated project development is likely to be successfully delivered, to ensure the funding has been prudently and appropriately targeted and released, and that this can be evidenced to the decision-making body and stakeholders of those providing the funding.

The technical review, prior to providing such funding, will usually follow a prescribed template covering all the required project elements to be assessed. The recipient of the funding will need to provide all the necessary information required and readily make themselves and appropriate members of their team available for discussions and meetings to review every element of the development. Such reviews will often be required for each stage of the project and will need to be successfully completed to allow the next tranche of funding to be made available.

Such funding may sometimes be provided in a single upfront payment or in a number of tranches, each with their own technical review being required. Should the funding (or part of the funding) be released on a progress basis, the IMS will need to be satisfied that funds are being properly spent and that the funding recipient can properly evidence such spend. Often, spend against agreed heads of cost will be tracked and any variation to anticipated spend will need to be fully reconciled by the funding recipient and verified by the IMS. Technical reviews and progress reporting will operate in much the same way as described for the IMS in this guidance note.



## Confidence through professional standards

RICS promotes and enforces the highest professional qualifications and standards in the development and management of land, real estate, construction and infrastructure. Our name promises the consistent delivery of standards – bringing confidence to the markets we serve.

We accredit 118,000 professionals and any individual or firm registered with RICS is subject to our quality assurance. Their expertise covers property, asset valuation and real estate management; the costing and leadership of construction projects; the development of infrastructure; and the management of natural resources, such as mining, farms and woodland. From environmental assessments and building controls to negotiating land rights in an emerging economy; if our members are involved the same professional standards and ethics apply.

We believe that standards underpin effective markets. With up to seventy per cent of the world's wealth bound up in land and real estate, our sector is vital to economic development, helping to support stable, sustainable investment and growth around the globe.

With offices covering the major political and financial centres of the world, our market presence means we are ideally placed to influence policy and embed professional standards. We work at a cross-governmental level, delivering international standards that will support a safe and vibrant marketplace in land, real estate, construction and infrastructure, for the benefit of all.

We are proud of our reputation and we guard it fiercely, so clients who work with an RICS professional can have confidence in the quality and ethics of the services they receive.

### United Kingdom RICS HQ

Parliament Square, London  
SW1P 3AD United Kingdom

**t** +44 (0)24 7686 8555

**f** +44 (0)20 7334 3811

[contactrics@rics.org](mailto:contactrics@rics.org)

#### Media enquiries

[pressoffice@rics.org](mailto:pressoffice@rics.org)

### Ireland

38 Merrion Square, Dublin 2,  
Ireland

**t** +353 1 644 5500

**f** +353 1 661 1797

[ricsireland@rics.org](mailto:ricsireland@rics.org)

### Europe

[excluding UK and Ireland]

Rue Ducale 67,  
1000 Brussels,  
Belgium

**t** +32 2 733 10 19

**f** +32 2 742 97 48

[ricseurope@rics.org](mailto:ricseurope@rics.org)

### Middle East

Office G14, Block 3,  
Knowledge Village,  
Dubai, United Arab Emirates

**t** +971 4 446 2808

**f** +971 4 427 2498

[ricsmenea@rics.org](mailto:ricsmenea@rics.org)

### Africa

PO Box 3400,  
Witkoppen 2068,  
South Africa

**t** +27 11 467 2857

**f** +27 86 514 0655

[ricsafrica@rics.org](mailto:ricsafrica@rics.org)

### Americas

One Grand Central Place,  
60 East 42nd Street, Suite 2810,  
New York 10165 – 2811, USA

**t** +1 212 847 7400

**f** +1 212 847 7401

[ricsamericas@rics.org](mailto:ricsamericas@rics.org)

### South America

Rua Maranhão, 584 – cj 104,  
São Paulo – SP, Brasil

**t** +55 11 2925 0068

[ricsbrasil@rics.org](mailto:ricsbrasil@rics.org)

### Oceania

Suite 1, Level 9,  
1 Castlereagh Street,  
Sydney NSW 2000, Australia

**t** +61 2 9216 2333

**f** +61 2 9232 5591

[info@rics.org](mailto:info@rics.org)

### North Asia

3707 Hopewell Centre,  
183 Queen's Road East  
Wanchai, Hong Kong

**t** +852 2537 7117

**f** +852 2537 2756

[ricsasia@rics.org](mailto:ricsasia@rics.org)

### ASEAN

Suite 10, 25th Floor,  
Samsung Hub, 3 Church Street,  
Singapore 049483

**t** +65 6692 9169

**f** +65 6692 9293

[ricssingapore@rics.org](mailto:ricssingapore@rics.org)

### Japan

Level 14 Hibiya Central Building,  
1-2-9 Nishi Shimbashi Minato-Ku,  
Tokyo 105-0003, Japan

**t** +81 3 5532 8813

**f** +81 3 5532 8814

[ricsjapan@rics.org](mailto:ricsjapan@rics.org)

### South Asia

48 & 49 Centrum Plaza,  
Sector Road, Sector 53,  
Gurgaon – 122002, India

**t** +91 124 459 5400

**f** +91 124 459 5402

[ricsindia@rics.org](mailto:ricsindia@rics.org)