



Department for  
Communities and  
Local Government

# Stock Valuation for Resource Accounting

Guidance for valuers - 2016



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# Introduction and Executive Summary

- This Guidance updates the Guidance published in 2010 to valuers of local authority property assets on the bases and methods of valuation for Housing Revenue Account (HRA) assets for resource accounting. The guidance is appropriate for all HRA valuations from April 2016 and reflects recent changes to valuation basis terminology introduced by International Financial Reporting Standards 13.
- It is intended that this Guidance will be reviewed periodically to take account of further amendments to International Financial Reporting Standards (IFRS) and their application in the public sector.
- There have been significant changes to both accounting and valuation standards and guidance since 2010. In summary, Financial Reporting Standards (FRS) issued by the Accounting Standards Board have been replaced by IFRS as interpreted for the UK public sector. The Value to the Business Model has been replaced by the Fair Value / Cost Model, definitions of Finance / Operating Leases have changed significantly, depreciation methodology/the former Major Repairs Allowance (MRA) / componentisation have all been the subject of updates and professional alerts, and most recently IFRS 13 has introduced new Current Value terminology.
- As a result of requests from across the profession including the main regulatory and representative professional bodies, it was considered appropriate to update the existing valuer guidance and to place greater emphasis within the guidance on valuation methodology. Matters relating most specifically to accountancy definition and treatment have either been amended or deleted entirely from this valuer guidance.
- The principles behind the valuation methods in the guidance remain the same as in the previous 2010 guidance and valuers must be aware that Audit requirements for transparent and clear methodologies mean that any deviation from the published guidelines will need very detailed explanation and verification.
- The adjustment factors and accompanying explanatory notes have also been revised to take account of the significant changes in the residential housing market over the last five years. Many valuer practitioners have been consulted through their professional organisations on the preferred adjustment factor approach, and these updated guidelines reflect the consensus of replies.
- Other changes in the guidance update valuation terminology to reflect IFRS 13 and references to Government and other circulars.
- The basis of valuation for the bulk of the housing stock within the HRA is Existing Use Value for Social Housing (EUV-SH) as defined by the Royal Institution of Chartered Surveyors (RICS) Valuation –Professional Standards January 2014.
- It should be noted that although IFRS 13 was introduced to UK IFRS public sector accounting from 1st April 2015, CIPFA in association with HM Treasury have decided that all operational property, plant and equipment are outside the scope of IFRS 13 and therefore operational assets will not be valued to fair value. An operational asset is one used to deliver either front line services or back office functions, whereas the IFRS 13 definition of fair value is based on exit values and market prices for assets; i.e. an asset's highest and best use.

- The valuation methods described in the guidance are known as the Beacon Approach and the Discounted Cash Flow (DCF) Approach. It is for local authorities themselves, drawing on the expertise of their relevant professional advisers, to choose the method of valuation, whether the Beacon Method or the DCF approach. There may be circumstances where the DCF method is appropriate. However, responses to DCLG's public consultation on Transparency in Social Housing Asset Value (published on 11 July 2014), reflected a general consensus among local authorities that, for the purposes of stock valuation for resource accounting, the Beacon approach is likely to be more suitable.
- Use of the Beacon Approach enables greater consistency and comparison between authorities and also enables statistical derivations relating to High Value properties and value significant locations to be extracted as required.
- The general principles and process to follow when using the valuation methods are fully described. Authorities may wish to adapt the process to meet their individual requirements, but the general principles and the key stages should be adopted, albeit in various forms.
- Guidance to the valuation of non-housing and miscellaneous assets is also provided. These assets are expected to form a small part of the HRA properties by number and value. The resources devoted to preparing these valuations should have regard to the materiality of the effect of these values on the accuracy of the total HRA assets.
- Many of the accounting and valuation principles have evolved and changed since the 2010 guidance and valuers must therefore be certain that they are up to date with current guidance and interpretation.
- Audit requirements are also becoming more detailed and the valuer should make careful note of the valuation process followed, assumptions that have been made and supporting information so that the entire process, sources of information and assumptions made are auditable.

# Chapter 1 - Resource Accounting in the Housing Revenue Account

## Key points

- objectives of resource accounting
- use of the guidance
- valuation Approaches
- changes to Basis of Value From 1 April 2015

### 1.1 Introduction

1.1.1 Resource accounting aims to show the resources consumed in delivering services. In the case of the HRA account properties, the service objective is to deliver appropriate housing to those who are unable to obtain suitable housing through the wider housing market.

### 1.2 Objectives of Resource Accounting

- 1.2.1 Resource accounting in the HRA provides a financial framework which is intended to:
- encourage more efficient use of housing assets;
  - increase the transparency within the HRA;
  - assist authorities in planning their housing strategy;
  - bring HRA accounting procedures onto a more directly comparable basis with Registered Social Landlords;
  - achieve consistency with central government resource accounting and budgeting;
  - achieve consistency with resource accounting in authorities' other revenue accounts; and
  - place an authority's HRA onto a more business-like basis.
- 1.2.2 This Guidance seeks to ensure that these objectives continue to be met, post IFRS.
- 1.2.3 The financial framework for the HRA, based on a form of resource accounting, requires authorities to carry out valuations of their housing stock and prepare and maintain business plans.
- 1.2.4 Valuations form an integral part of the HRA accounting process and to ensure consistency of approach, this Guidance has been updated by the Department for Communities and Local Government (DCLG) to provide more specific valuer guidance.

### 1.3 Valuation Background

1.3.1 Local authorities are under a statutory duty to account separately for their Housing Stock and this information is of value not only to local authorities but also to a wide range of potential readers of the accounts, both inside and outside central government. The fact that stock valuations appear in the HRA ensures that an authority's decisions on resource allocation make resource costs apparent. It is

essential that all valuations carried out for the purpose of resource accounting are on a consistent basis.

- 1.3.2 Historically, part of the accounting framework was the element of subsidy, the former MRA, which represented the cost of maintaining the current condition of the stock. In the view of CIPFA/LASAAC Joint committee the MRA, based on the annual cost of replacing individual building components as they reach the end of their useful life, was a reasonable estimate of the cost of wearing out (depreciation) of council dwellings. However, the MRA has not been recalculated since the abolition of HRA Subsidy and the data assumptions are increasingly outdated. It is considered that authorities should, by April 2017, be in a position to calculate componentised depreciation according to proper practices without reference to the former MRA.
- 1.3.3 Following the adoption of IFRS 13 by the UK public sector, from 1<sup>st</sup> April 2015, the basis of valuation for accounting purposes will be Current Value measured by the adoption of the special assumption of EUV-SH. See Chapter 2 – Bases of Valuation for further details.

## **1.4 Use of the Guidance**

- 1.4.1 This Guidance sets out the approach that authorities should adopt only in relation to the preparation of HRA asset valuations, and in particular the valuation approach for general purpose council housing. The valuations will be subject to annual reviews and full revaluations. Revaluations may be carried out on a rolling programme, covering different parts of the stock every year, or every five years for the whole stock. Details are contained in Chapter 14, Revaluations and Valuation Reviews.
- 1.4.2 The aim of resource accounts in the HRA is to put local authority housing on a business like footing and to ensure that accounts “give a true and fair view of” the financial position and transactions of the Authority. To this end the Guidance has had regard to:-
- International Financial Reporting Standards, (IFRS) and incorporating IFRS 13 from 1 April 2015;
  - The IFRS based CIPFA Code of Practice on Local Authority Accounting in the United Kingdom;
  - The Royal Institution of Chartered Surveyors (RICS) Valuation-Professional Standards January 2014 in so far as they are consistent with the requirements and objectives of DCLG.
- 1.4.3 A number of departures from these Standards have been adopted to ensure the objectives are met and details of these variations as they affect the valuation of the property are listed in Appendix 3 as well as in the appropriate place within the Guidance.
- 1.4.4 Valuations should be carried out in accordance with the RICS’ Valuation Standards except where they are varied by this Guidance to reflect the current policy requirements of DCLG.
- 1.4.5 The need for guidance on valuation methodology within the HRA arises from the various valuation techniques that are available for valuing social housing, and the need for consistency of approach between authorities.

## **1.5 Valuation Approach**

- 1.5.1 The two principal techniques currently used for valuing social housing are (I) the 'Beacon Method', based on the value of the property assuming vacant possession, with an adjustment factor to reflect occupation by a secure tenant, and (II) 'Discounted Cash Flow' - a cash flow valuation, based on the income generated by the property.
- 1.5.2 The Beacon Method is relatively easily implemented by general practice surveyors being based upon the Market Valuation of residential dwellings – something in which the majority of valuers are well experienced. The Beacon Method is used by the majority of local authorities undertaking HRA valuations.
- 1.5.3 The Discounted Cash Flow (DCF) method is widely implemented by investment surveyors but may be less familiar to the wider profession as a whole.
- 1.5.4 The Beacon method is used for no other purpose except the special circumstances of a HRA valuation but is an efficient method of arriving at a representative valuation which enables values to be attributed to larger numbers of dwellings comprising a local authority's housing.
- 1.5.5 The DCF valuation technique is universally adopted to arrive at Tenanted Market Value (TMV) for the purposes of Large Scale Voluntary Transfer of housing stock by local authorities to Registered Social Landlords (RSLs).
- 1.5.6 Evidence of vacant possession values of residential dwellings is, generally, plentiful except in times of low market demand or on certain types of residential estate and to that extent therefore the Beacon method is firmly grounded in the transparent Market Value of the Beacon dwellings themselves. Valuations produced by this method are comparable, countrywide in terms of the basis from which they are derived.
- 1.5.7 The DCF method is dependent upon a number of potential variables, i.e.:-
- Rents and projected rental levels in the years following the valuation date;
  - Trends of income and costs in terms of a local authority's housing stock operation over a period of time;
  - A wide range of potential income/costs which may vary from authority to authority;
  - Projected Right to Buy sales and housing acquisitions which may be subject to wide fluctuations depending upon the state of the residential demand at any given time thereby producing potential distortions in anticipated capital income over a period of time.
- 1.5.8 DCF is economic in its implementation especially in the sense that no inspections may be required if full and accurate information is provided by the local authority.
- 1.5.9 The Beacon method permits the disaggregation of valuation information for business and asset management purposes.
- 1.5.10 When the Beacon method is adopted it is for the valuer, whilst being dependent upon certain information to be provided by the local authority e.g. low demand estates etc. to verify basic valuation information from inspection of the Beacon properties. Collection of this information on Beacon Record Sheets provides useful additional business and asset management data for local authorities.

- 1.5.11 When applying the DCF method the valuer is dependent upon income and expenditure information and projections provided by the Local Authority. This information nonetheless should usually be readily available from Business Plans and other Authority sources.
- 1.5.12 Whilst Beacon values are firmly grounded in market evidence, to arrive at EUV-SH requires the application of an adjustment factor to the Beacon value and, whilst the adjustment factor is, in part, derived from market evidence of investment returns prevailing in the private rented sector, it is also derived from anticipated returns to be achieved by a landlord of socially rented domestic property – a somewhat more hypothetical part of the calculation due to a lack of market evidence in this particular sector.
- 1.5.13 The potential weakness of the DCF method is the dependence upon projected income and expenditure flows over a long period of time, usually 30 years and projections over such a period of time are susceptible to many influences, particularly government policy on social housing, the general economic climate, the state of the housing market, fluctuating interest rates etc.
- 1.5.14 The Net Present Value (NPV) which is the end product of the DCF valuation method can be extremely sensitive to fairly small adjustments in the Discount Rate which is adopted for the valuation and in this sense, therefore, the DCF method is not robust in terms of the range of valuer choice when selecting the appropriate Discount Rate to be adopted for the purposes of the valuation.
- 1.5.15 It is for local authorities themselves, drawing on the expertise of their relevant professional advisers, to choose the method of valuation, whether the Beacon Method or the DCF approach. There may be circumstances where the DCF method is appropriate. However, following consultation, DCLG's view is that for the purposes of stock valuation for resource accounting, the Beacon approach is likely to be more suitable.

# Chapter 2 - Bases of Valuation

## Key points

- Property Classification
- Valuation Bases
- IFRS 13 Effective From 1 April 2015 Defining Fair Value
- Change Of Bases Of Value For Surplus Assets

### 2.1 Property Classification

2.1.1 Asset valuations are required for all properties held in the HRA. Section 74 of the Local Government and Housing Act 1989 requires that expenditure and income relating to property specified in that section should be accounted for in the HRA. Guidance on the types of property specified is given in DOE Circular 8/95. If a valuer considers that a property is being wrongly held in the HRA, the matter should be raised with the Chief Finance Officer.

2.1.2 For IFRS Accountancy purposes properties are required to be classified into one of the following groups:

<b>IFRS Classification</b>	<b>Accounting Standard</b>
1. Property Plant & Equipment	IAS 16
2. Leases (both operating and finance)	IAS 17
3. Assets qualifying as Investment Property	IAS 40
4. Assets qualifying as held for sale	IFRS5
5. Assets qualifying as PFI	IFRIC 12

Classification of assets is a matter for Directors of Finance who may require the assistance of the valuer.

2.1.3 It is classification of assets that determines the Basis of Value.

2.1.4 De-minimus levels for the HRA are set by individual authorities and assets below that threshold are not included in the balance sheet and would not be required to be valued. Where individual assets are below the threshold but when grouped are above the threshold e.g. lockup garages they should be valued and included in the balance sheet.

### 2.2 Valuation Basis

2.2.1 **The new IFRS 13 defines Fair Value as being Market Value. However valuers must note that for the UK public sector both the Treasury's technical accounting guide for the preparation of financial statements, (FReM) and CIPFA have continued to interpret Fair Value as Existing Use Value for in-use assets (often informally referred to as operational assets).**

2.2.2 **Further guidance on the basis of valuation is detailed in the Appendices.**

- 2.2.3 Property, plant and equipment which would be expected to include most residential housing stock assets, shall be measured at Current Value using the EUV-SH assumption, as defined in UKVS 1.12
- 2.2.4 The valuation basis for non-housing property which is considered to be used or consumed for the delivery of the housing function, e.g. estate shops, is Current Value for the asset in Existing Use – this requirement is met by providing a valuation on the basis of Existing Use Value in accordance with UKVS 1.2.
- 2.2.5 These valuation bases represent the service potential of the assets to an Authority and in the case of EUV-SH the delivery of the social housing provider’s objectives.
- 2.2.6 Where housing assets are so specialised because of the construction, arrangement, size or specification of the building that there will be no market for sale to a singular owner-occupier, the valuation approach is Depreciated Replacement Cost (DRC). It is considered there will be few, if any, operational properties within the HRA which warrant a DRC approach.
- 2.2.7 Leases and lease type arrangements are accounted for in accordance with IAS 17 – see Chapter 8 Leasehold Housing Property and Chapter 11 PFI Schemes.
- 2.2.8 Non-housing property, e.g. estate shops – see above, may be classified by Directors of Finance as Investment Property if the purpose of these properties is considered to be the earning of rentals or for capital appreciation, or both, rather than the facilitation of service delivery. In this case the basis of valuation is Fair Value represented by Market Value which will reflect any current leases, current cash flows and any reasonable assumptions about future rental income or outgoings and redevelopment opportunities.
- 2.2.9 Full definitions of EUV, EUV-SH and Fair Value as defined by the Royal Institution of Chartered Surveyors (RICS) Valuation Standards (UKVS) 1.3, 1.12 and global valuation practice statements (VPS) 4 are reproduced in Appendix 1.
- 2.2.10 As valuation bases represent entry and exit values, notional additional acquisition costs, where material, should be added to Fair value (EUV and EUV-SH). Expected directly attributable selling costs should be deducted from Fair Value (MV), where material. Guidance on the treatment of these costs is included in Chapter 13, Valuation Reports.
- 2.2.11 Specialised buildings, where there is no market to assess an entry value, should be assessed on the gross cost of rebuilding the asset with the same service potential, less an allowance for depreciation and obsolescence to reflect the fact that the existing property is worth less than a new replacement. This is known as the DRC approach and should be carried out in accordance with the RICS UKGN 2 DRC Method of Valuation for Financial Reporting, subject to CIPFA and HM Treasury requirements.
- 2.2.12 For completeness, the land and building component of the DRC valuation should be stated separately in the report, together with an assessment of the remaining life.
- 2.2.13 Assets “Held for Sale” and “Surplus Assets” shall be accounted for in accordance with IFRS 5. See Chapter 12 for further guidance. Such assets shall be identified and separately accounted for where they meet the strict criteria for classification as

assets. The appropriate basis of valuation from 1<sup>st</sup> April 2015 is Fair Value as defined in IFRS 13 and in the Red Book at VPS 4 paragraph 1.5.1 (a).

# Chapter 3 - Beacon Approach to the Valuation

## Key points

- Beacon Principle
- Basis Of Value – Existing Use Value – Social Housing
- Assumptions Behind The Beacon Principle
- Adjustment Factor To Arrive At Existing Use Value-Social Housing
- Monitoring Trail

### 3.1 Introduction

- 3.1.1 To establish Existing Use Value-Social Housing (EUV-SH) for resource accounting a vacant possession value, adjusted to reflect the continuing occupation by a secure tenant, is one method which can be adopted by authorities for the majority of their dwellings.
- 3.1.2 The Beacon Approach ensures an auditable and consistent method is adopted by local authorities in preparing EUV-SH asset valuations.
- 3.1.3 This method is easy to apply and uses as its starting point dwelling sales mainly from the owner-occupied market. This is a well developed market with evidence of dwelling sales, including ex-council house sales, widely available across the whole of the country. The adoption of this approach provides all authorities with a source of evidence on which to base the valuations. Alternative methods, using rental information and annual outgoings including costs of repair and maintenance, are reliant on a much thinner data bank of evidence, not always accessible or consistent in quality or quantity or geographical spread.

### 3.2 Beacon Principle

- 3.2.1 The recommended approach to arrive at the vacant possession value of the housing stock is to adopt the beacon principle. This approach, if applied consistently across the whole stock, provides an accurate assessment of the vacant possession value, and a data set of beacons that will form the basis for updating at subsequent reviews.
- 3.2.2 The beacon principle is used for large groups of properties that contain properties of similar design, age, type, or construction. A sample property, "the beacon" is selected, which is representative of the group, and a detailed inspection and valuation carried out. For the purposes of this exercise 'representative of the group' means the most typical or frequently occurring type of dwelling within the group.
- 3.2.3 The beacon valuation is compared with the other properties within the group. The aim is to accurately reflect the range of values within the group. Material variations in the value will be reflected in the valuation of the group and the procedures to adopt are set out in Chapter 4.
- 3.2.4 This testing of the beacon value is a refinement of the initial beacon approach. The aim is to reflect any changes in value across the group which otherwise would not merit an additional beacon. If testing was not undertaken the valuation would be a relatively crude process, insensitive to changes in value.

- 3.2.5 For the purposes of this exercise, it is suggested that properties within +/- 5% of the beacon value, should be valued on the beacon valuation. Variations greater than this can be accommodated as a specific variation from the beacon. **However, this should not be regarded as an absolute requirement and there may be situations where this approach would result in far too many beacons.** In such instances, valuers will need to agree with the Authority the appropriate approach in the particular circumstances. Procedures for incorporating any variations from the beacon are covered in Chapter 4. For the majority of the housing stock it is expected that the groups of property valued by the beacon variations will have a range in value of some 30% (i.e. lowest to highest values), across the group as a whole. An additional beacon and archetype group may be required where properties are found to be outside this range. However, there may be situations where this is inappropriate and this should be discussed with the Authority.
- 3.2.6 The Beacon method avoids the necessity of valuing and inspecting each individual property. Only selected properties are inspected and any verification of property information will only be required for the beacon. This approach should be regarded as adequate in terms of the RICS Professional Standards including VPS 2 and a note to that effect included in the final report.
- 3.2.7 Valuers will be reliant on a considerable amount of housing information provided by the authority covering details of tenure, degree of modernisation, service charge costs etc. If the beacon information is found to be inaccurate the matter should be taken up with the Chief Finance Officer to establish the extent of the inaccuracies and how the problems may be resolved. It is essential that information adopted for the valuation is factually correct.

### **3.3 Beacon Valuation - Assumptions**

- 3.3.1 The accuracy of the beacon valuation together with the choice of beacon is a major factor that will determine the quality of the overall asset valuation.
- 3.3.2 The beacon valuation should assume that the property is vacant and that the existing and future use is for residential accommodation, with no potential residential redevelopment of the site, or intensification of use as a result of possible sub-division or extension of the property. No account should be taken of any other alternative development potential that may include demolition and merging of sites.
- 3.3.3 These assumptions have been adopted to ensure that all the beacon valuations are prepared on a consistent basis. The beacon valuations are, in the majority of cases, to be applied to council housing stock which for the foreseeable future will remain as council housing with no requirement for demolition and redevelopment. To include elements of hope value attributable to the possibility of redevelopment of the existing buildings within the existing planning use would include elements of value inappropriate to the groups of property valued by the beacon.
- 3.3.4 Situations where it is inappropriate to make the assumption that the property will remain tenanted for the foreseeable future are dealt with separately in Chapter 5. These situations may arise in areas of low demand and unpopular housing.
- 3.3.5 The assumptions to make in preparing the beacon valuation are set out below. EUV-SH as defined in the RICS Valuation Standards at UKVS 1.12 provides the basic assumptions for the beacon valuation but with additional assumptions to meet the needs of a local authority housing stock asset valuation.

### **Beacon Valuation Assumptions**

Existing use value for social housing (EUV-SH) is the estimated amount for which a property should exchange, on the valuation date, between a willing buyer and a willing seller in an arm's length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion, subject to the following *special assumptions* that the property will continue to be let by a body pursuant to delivery of a service for the existing use:

- (a) at the *valuation date*, any regulatory body, in applying its criteria for approval, would not unreasonably fetter the vendor's ability to dispose of the property to organisations intending to manage their housing stock in accordance with the regulatory body's requirements;
- (b) properties temporarily vacant pending re-letting would be valued, if there is a letting demand, on the basis that the prospective purchaser intends to re-let them, rather than with vacant possessions and;
- (c) any subsequent sale would be subject to all of the above *special assumptions*.

## **3.4 Vacant Possession Adjustment Factor**

- 3.4.1 The beacon value relates to the sale of a single owner-occupied dwelling. It is derived from the sales of similar ex-council or similar comparable properties, suitably adjusted by the valuer.
- 3.4.2 EUV-SH reflects a valuation for a property if it were sold; with sitting tenants enjoying occupation at less than open market rentals and Retail Price Index linked increases; where the tenants have additional rights including the Right to Buy, and where the landlord has additional liabilities including insurance, repair, maintenance and statutory obligations. Therefore it is necessary to adjust the Beacon Value to reach EUV-SH.
- 3.4.3 The Adjustment Factor (a percentage) is applied to the Beacon Value to calculate the EUV-SH.
- 3.4.4 The Adjustment Factor measures the difference between private open market rented and socially rented property at a regional level. It is the discount which, when applied to the cumulative total of all beacon values, gives rise to the EUV-SH.
- 3.4.5 The Adjustment Factor is the relationship between the capitalised net rent (investment value) of a private dwelling and the equivalent public sector investment. It is determined with reference to the relationship between rents and yield in the private residential sector and the public / socially rented sector.

- 3.4.6 Appendix 4 details the requisite adjustment factors and the methodology used to establish them.**
- 3.4.7 **Valuers are not obliged to use the adjustment factors.** However it should only be necessary to depart from the given factors if the valuer considers that their use does not provide a fair reflection of EUV-SH for the portfolio as a whole in a particular local authority area.
- 3.4.8 In making this decision it is considered that a tolerance of +/- 5 percentage points of the adjustment factor would be acceptable before it was considered the factor did not represent the differential between market rented and social rented property.
- 3.4.9 **If the valuer considers that the adjustment factor does not provide EUV-SH within the stated levels of tolerance they will be required to establish an auditable methodology in arriving at an alternative percentage.** The methodology should reflect all factors specific to that local authority area which impact on the general levels of value of affordable housing. This will involve the valuer considering the wider market for social housing other than the specific local authority property. Factors to consider will include levels of affordable rents, other than local authority rents, the demand for the property, typical levels of management and repair costs for other types of social housing, and the rate of return required for this type of investment.
- 3.4.10 **It is not appropriate to rely solely on the actual rents and costs for the specific local authority properties when considering the appropriateness of the given adjustment factor.** These rents and costs may not be representative of the wider social housing market, affected as they are by historic and current policy. The valuer must have regard to all the evidence including that of other socially rented accommodation when making any valuation adjustments.
- 3.4.11 The reasons for departing from the factor provided in this Guidance must be clearly stated by the valuer together with the methodology and sources of evidence adopted for preparing the alternative.

### **3.5 Audit / Monitoring Trail**

- 3.5.1 The HRA account and the valuations within the account will be subject to audit in the same way as all other local authority accounts.
- 3.5.2 Records of the valuation process, beacon valuations and comparable evidence should be available for audit purposes.

# Chapter 4 - Application of the Beacon Approach

## Key points

- Information Requirements
- Asset Groups, Archetypes, Beacons
- Beacon Records
- Beacon Valuations
- Archetype Valuations
- Asset Group Valuations
- Recording Valuations
- Mining Subsidence/Radon/Contaminated Land

### 4.1 Introduction

- 4.1.1 This chapter sets out in key stages the process to be followed when using the beacon approach for the valuation of the housing stock.
- 4.1.2 The process described in this chapter should cover most of the situations and dwelling types found within an authority's housing stock. Other property types are covered in later chapters.
- 4.1.3 Three basic terms are used throughout the application of the beacon approach. These are:
- **asset group** - a group of properties reflecting appropriate management units e.g. a housing estate, Housing Office Areas, or even specific locations such as a small town;
  - **property archetypes** - dwellings within an asset group which have a number of unifying characteristics material to the valuation e.g. two bed terrace houses;
  - **beacon** - a specific real dwelling representative of an archetype e.g. 15 Smith Road.
- 4.1.4 For ease of reference and to provide an overview of the beacon approach a summary of the key stages is presented below. The stages are expanded in the main body of the chapter at the appropriate paragraph.

<b>Key Stages in the Beacon Approach</b>		
<b>Key stage</b>	<b>Action</b>	<b>Paragraph Ref.</b>
1	collect stock information	4.2
2	divide stock into asset groups	4.3
3	establish archetype groups	4.4
4	identify beacon properties	4.5
5	inspect beacon property	4.6
6	beacon record sheet	4.7
7	comparable sales evidence	4.8
8	adjusting sales evidence	4.9
9	beacon valuation	4.10
10	beacon variations	4.11
11	valuation of the archetype group	4.12
12	adjustment factor	4.13
13	valuation of asset group	4.14

## **4.2 Information Requirements - Key Stage 1**

4.2.1 The quality, quantity and breakdown of information for grouping properties are key factors when using the beacon approach to valuation. To group housing properties by common characteristics requires the following information:

- property address;
- estate/housing group/district/town;
- type - terrace, semi detached, multi storey flat etc.;
- size/no of bedrooms;
- age;
- construction e.g. traditional/non-traditional/defective.

- 4.2.2 This should be regarded as the minimum amount of information required. Anything less makes grouping of property and identifying archetypes very superficial and impacts on the overall accuracy of the valuation. Most authorities should have this information about their stock.
- 4.2.3 Additional information, although not essential, would be advantageous in the following areas for valuation purposes:
- refurbishment programmes over the last three years;
  - service charges for flats/sheltered housing;
  - existing reports/surveys covering mining subsidence, contaminated land, radon risk areas and properties with asbestos.
- 4.2.4 This information will help to establish the condition of the properties relative to one another and service costs for comparison with private sector sales.
- 4.2.5 The following information may also be necessary for identifying and valuing unpopular estates (covered in Chapter 5):
- waiting lists for properties;
  - void levels;
  - tenant turnover;
  - future clearance and redevelopment plans.
- 4.2.6 Stock condition survey information, if available, will provide a valuable source of information on the condition of the stock. This may be a useful tool when establishing property archetypes and variants from the beacon valuation as described in para 4.4 and 4.11.
- 4.2.7 Numbers of Right to Buy Sales, Acquisitions and Demolitions for the financial year in question will be necessary for an accurate check for total stock numbers.
- 4.2.8 Open market sales are the best evidence for establishing vacant possession value. However, additional information using other sources may be useful if market sales are not available. For example:
- Right to Buy valuations;
  - Right to Buy determinations.
- 4.2.9 **Valuers should not rely solely on Right to Buy information** if alternative market values are available, and should always satisfy themselves as to the accuracy of any other sale information used to arrive at Right to Buy figures.

### **4.3 Determination of Asset Group - Key Stage 2**

- 4.3.1 For manageability of the valuation process and also as a means of providing information for the business plan, the operational housing assets should be arranged into 'asset groups'. The asset group is a major component of the valuation, forming the first level of sub division of the total stock value:

### **Asset Group (The first level of sub division of the total Housing Stock)**



Archetype Group



Beacon

4.3.2 The purpose of dividing the stock into asset groups is to:

- provide valuation information at a lower level than the value of the whole stock;
- make the valuation process easier to manage when dealing with large numbers;
- link the asset groups and valuations to the business plan; and
- provide stock groupings which may be used for stock condition surveys.

4.3.3 Groups will, in the main, be made up of housing properties. However, there may be non-housing properties within the group, especially when it is based on a geographical boundary or comprises a large housing estate. The beacon approach would not usually be appropriate for these property types such as shops, management offices etc. but it is important the assets are included in the total valuation. Chapter 9 covers this situation including sample reporting schedules.

4.3.4 A family tree showing a typical breakdown of operational property into asset groups is illustrated at paragraph 4.5.11 below.

4.3.5 The subdivision of the stock into asset groups will depend on the level of detail available about the stock. Asset groups should be cohesive collections of property with common characteristics, e.g. location, type and tenure.

4.3.6 Typical groups may be:

- a large housing estate;
- several estates in the same location;
- a collection of rural villages covering a wide geographical area
- a small town;
- existing management groupings;
- properties covered by an area office;
- special property types, e.g. defective houses, sheltered houses, hostels, property held on ground leases; and
- property groupings used for stock condition surveys.

4.3.7 The number of asset groups within the HRA will depend on the number of properties, the level of information available about the stock and the homogeneity of the stock. Where possible the asset groups should relate to the groupings that have been used within the asset management plan and the business plan.

## **4.4 Determination of Archetype Groups - Key Stage 3**

4.4.1 The asset groups are sub divided into archetype groups, i.e. similar property types which will be valued by a "beacon". This is the second level of sub division of the Housing Stock:

Asset Group



**Archetype Group (The second level of sub division of the total Housing Stock)**



Beacon

- 4.4.2 Archetypes are collections of dwellings types within an asset group which have at least one but usually several similar characteristics such as number of bedrooms, type, degree of modernisation, or possibly location within an estate. Archetypes must have at least one, and preferably several, uniting characteristics material to their valuation.
- 4.4.3 Set out below are examples of typical archetype groups within a housing estate asset group:
- 2 bedroom terrace;
  - 3 bedroom semi-detached;
  - Detached houses;
  - Maisonettes;
  - Multi storey flats;
  - Unpopular housing;
  - Non Traditional housing;
  - Defective dwellings;
  - Sheltered houses;
  - Lockup garages (these may also be considered a separate Asset Group); and
  - Vacant property awaiting redevelopment (these may also be considered a separate Asset Group).
- 4.4.4 Every dwelling in an asset group must be included in an archetype group to ensure its inclusion in the overall valuation.
- 4.4.5 The number of archetype groups in an asset group will depend on the homogeneity of the housing stock. Insufficient archetypes will not capture the variations in value between property types and too many archetypes may not be cost effective in terms of any increase in the accuracy of the valuation. There is no prescribed number of archetypes that should be used, but regard should be had to the purpose of the exercise: to divide the houses into property types to reflect material variations in value.
- 4.4.6 As a general indication for the accuracy of the overall valuation, It is suggested that the range of values across the archetype should not exceed 30% (i.e. lowest to highest values). However this is not prescriptive and should be subject to final discussion between the valuer and the Chief Finance Officer.
- 4.4.7 There will be situations where some property types on estates are not represented in large numbers, e.g. six bedroom properties, bedsitting rooms and detached houses. In these cases, where it is considered there is no material effect on the accuracy of the overall valuation, the properties should be included in the next best match archetype and treated as a variation from the beacon (see para 4.11). To establish an archetype, and corresponding beacon, for a small number of properties is not cost effective in terms of the overall accuracy of the final valuation. This may result in the range of value across the archetype exceeding 30% and a note on the 'beacon record sheet' (see para 4.7) should be recorded.

- 4.4.8 Similar situations will arise within an archetype where some properties have been modernised or are situated in better locations within the scheme but numbers are insufficient for a separate beacon. These properties will be treated as variants from the beacon in line with para 4.11 but they should be identified at this stage if at all possible.

#### **4.5 Identification of the Beacon within the defined Archetype - Key Stage 4**

- 4.5.1 From within the Archetype Groups, representative 'Beacon' properties should be identified. This is the third and final level of sub division of the Housing Stock:

Asset Group



Archetype Group (The second level of sub division of the total Housing Stock)



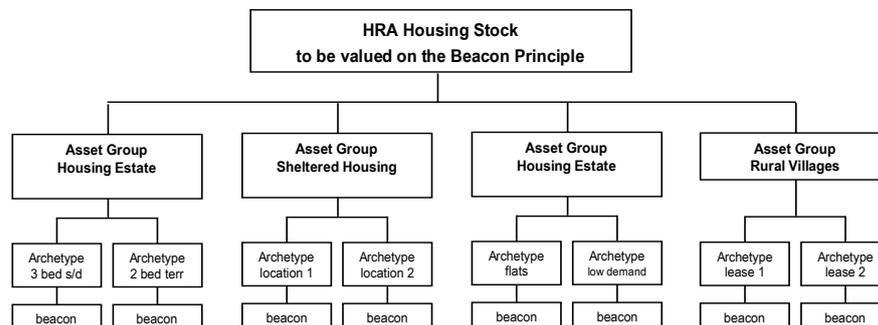
**Beacon (The third level of sub division of the total Housing Stock)**

- 4.5.2 The beacon property provides the basic unit of value and must be a specific real property, which both exists and represents the typical or most frequently represented property type, within the archetype. Beacon choice is important and an external inspection of the archetype properties, together with information from office records about the type, size and condition of the houses, may be necessary to establish a typical property. Valuers will be required to satisfy themselves that the beacon property is representative of the archetype.
- 4.5.3 In rural areas similar types of house may be scattered across very wide geographical areas. In these situations a typical property in one location may be sufficiently representative to be adopted as a beacon for the whole area. Using a location factor to reflect the changes in value across the region may cater for variations in value. The range of values across the asset group may exceed 30% in these cases and this fact, together with the reason for it, should be recorded on the beacon record sheet.
- 4.5.4 In urban locations with many non estate type properties a more robust approach to beacon choice may need to be adopted, having regard to the total numbers of dwellings involved and the effect of their valuation on the accuracy of the value of the portfolio. It may be appropriate to create wide archetype groups such as flats, houses and converted properties within post code areas which define the major variations in property values. A typical type of property within the area should be taken as the beacon property. Variations within the archetype such as a three bedroom property as opposed to a two bedroom would then be treated as variants from the beacon.
- 4.5.5 The range of value across the asset group/archetype for non-estate property may well exceed the 30% range. This range is only a guideline and where circumstances dictate a wider range may be appropriate. When the range of value is in excess of the limits the fact should be recorded on the 'beacon record sheet' (see 4.7).
- 4.5.6 It is a matter of valuer judgement as to the time spent on valuing these non-estate properties but due regard should be had to the numbers involved in relation to the total stock, and the materiality of the accuracy of their valuation to the total value of the portfolio.

- 4.5.7 Large estates, even though in close proximity to one another, may be defined as individual asset groups when information is required on an estate basis for business planning. Where there is a similarity in property types and levels of value it may be appropriate to adopt the same beacon properties for valuing each of the asset groups. For example, a beacon property on one estate could be used as a beacon for other estates if the properties were of similar types and value.
- 4.5.8 It is expected that, depending on the homogeneity of the stock, a beacon will on average cover between 50-600 properties. However, large estates where there is a uniformity of property may be covered by one beacon for considerably greater numbers. Significant numbers of non-estate properties may require a much lower ratio to reflect the various property types.
- 4.5.9 The range of 50-600 is only a guideline and will vary significantly between authorities and between asset groups. The overriding aim is to establish a beacon value which, when applied to the archetype group with variants, will capture the value of the asset group as a whole.
- 4.5.10 For the more individual or unusual properties a beacon approach may not provide a sufficiently accurate valuation. In these cases, and it is anticipated they will be few and far between, it may be necessary to prepare individual valuations. This however will only be the case where the valuation will have a material effect on the accuracy of the value of the portfolio, and the valuer should discuss with the Chief Financial Officer. Specific valuations may be required for these properties for business planning or asset management purposes.
- 4.5.11 The relationship of the beacon to the archetype group and the asset group is illustrated in Figure 1 below:

Figure 1

### Grouping of Housing Property for the application of Beacons



## 4.6 Property Inspection - Key Stage 5

- 4.6.1 Each beacon must be inspected internally and externally and a valuation prepared using the assumptions set out in para 3.3. An external photograph should be taken of the property. In preparing the valuation, tenants' improvements and tenants' waste (i.e. deterioration of the property due to lack of repair, maintenance and decoration which is the responsibility of the tenant), should be excluded from the valuation. These items are excluded as they will not be common to all the properties valued by the beacon.
- 4.6.2 Where it is obvious that tenants' waste is common to the whole archetype group and it is unlikely that the authority would be able to recover the costs of rectifying the damage, the properties should be valued as they stand. This is most likely to occur in areas of low demand with a high turnover of tenants.
- 4.6.3 Details of the inspection should be incorporated onto the beacon record sheet as detailed at 4.7 below.
- 4.6.4 The inspection is not a building survey and should be limited to a general surface examination of those parts of the property which are accessible. That is those parts that are visible and readily available for examination from ground and upper floors having regard to safety, practicality and the constraints of being a visitor to the property. There is no requirement to inspect lofts, lift floor coverings, carry out damp meter tests or inspect external services. Due weight should be given to information provided by the occupier during the onsite inspection.
- 4.6.5 It is anticipated that the inspection will take in the region of 20-30 minutes and this should be regarded as being adequate for the purpose of the exercise (RICS Valuation - Professional Standards VPS2).

4.6.6 The limit of the inspection to the beacon types should be detailed in the final report.

## **4.7 Beacon Record Sheet - Key Stage 6**

4.7.1 A record of the inspection, together with the photograph should be incorporated into a 'beacon record sheet' which will be a key piece of information for any future monitoring exercise and review of the valuations.

4.7.2 The beacon record sheet is the definitive source of information on the beacon for this and subsequent valuation reviews. The record sheet allows for a variety of information and as a minimum the following details should be recorded:

- address of beacon property;
- date of inspection;
- valuation date;
- accommodation;
- age and type: e.g. 1930's semi-detached;
- construction;
- asset group;
- archetype group and number within the archetype;
- comparable evidence;
- adjustments of comparables;
- valuation of beacon; and
- variation in value across the archetype.

4.7.3 An example of a beacon record sheet is enclosed at Appendix 2. Authorities should adapt the layout to one which best suits their needs, as long as the key information is incorporated. The beacon record sheets will form part of the final report and together will make up a beacon portfolio. This portfolio will be a key piece of information for subsequent valuation reviews.

## **4.8 Comparable Sales Evidence - Key Stage 7**

4.8.1 The criterion for selecting the comparable evidence is to find sales information which best fits the beacon with the minimum of adjustments. Details of three comparable sales upon which the beacon valuation has been based should be included on the sheet wherever possible. There will be situations where the evidence is limited, and these situations should be noted.

4.8.2 There are several types of comparable evidence on which to base the valuation of the beacon. There may be an active resale market within the estate or surrounding properties, Right to Buy valuations, Right to Buy determinations as well as sales within the private sector in the surrounding location.

4.8.3 Each type of information must be assessed for its accuracy, reliability and relevance to the valuation of the beacon property.

4.8.4 Market sales within the estate or area of similar property should be regarded as a primary source, and to a lesser degree Right to Buy valuations and determinations. Although Right to Buy valuations will relate to similar property types, they do not have the veracity of an open market sale and therefore should be weighted when valuing the property.

- 4.8.5 Re-sales on estates may be of property that has been substantially improved and it is essential that the condition of re-sales is established and adjusted to fit the beacon.
- 4.8.6 Sales from the private sector may be helpful in setting general levels of value within a location, especially for non-estate type property, but it may be necessary to make adjustments to this type of evidence to allow for a "council estate" factor, where appropriate.
- 4.8.7 In some circumstances it may be necessary to draw information from other estates or areas where there is a re-sale market, and make adjustments for the particular area in question. This may apply in particular to specific property types such as sheltered houses, defective property, high rise flats and maisonettes. Where this is the case the beacon record sheet should be noted accordingly.
- 4.8.8 Auction sales, cash transactions and investment sales should also be considered in the absence of any relevant owner occupied evidence. Valuation guidance when this type of situation is encountered is provided in Chapter 5.
- 4.8.9 The order of preference, subject to the valuer's judgement, for comparable sales information is:
- open market re-sales of similar Right to Buy properties in the immediate locality; and
  - open market re-sales of similar Right to Buy properties on similar council estates/areas.
- 4.8.10 Other sources include:
- Right to Buy valuations and determinations which should be considered in conjunction with additional sale evidence such as that listed below;
  - market sales from the private sector in the immediate locality; and
  - market sales from auctions, cash transactions and investment sales.
- 4.8.11 The most recent sales information should be adopted and, where the available evidence is dated, it must be cross checked with other more recent information on sales in adjacent locations, to establish any movements in value.

## **4.9 Adjusting Sales Evidence - Key Stage 8**

- 4.9.1 In most cases it will be necessary to adjust the comparable sales evidence to fit the beacon property. Typical adjustments will be for:
- degree of modernisation;
  - size/number of bedrooms;
  - type: e.g. semi-detached, terrace;
  - construction e.g. Airey, Orlit;
  - location; and
  - freehold/leasehold.
- 4.9.2 For consistency of approach it may be useful to set up a scale of adjustments, especially for frequently occurring variations such as location, number of bedrooms, absence/presence of central heating, terrace as opposed to semi detached etc.

- 4.9.3 Adjustments should be kept to a minimum and where evidence is plentiful adjustments should generally be no more than 15% of the comparable sale. Substantial adjustments to sales evidence may lead to inaccuracies in the valuation. Where substantial adjustments are being made the final valuation should be crossed checked against other evidence such as Right to Buy valuations and determinations.
- 4.9.4 There will be situations where relevant sales evidence is sparse through lack of a market e.g. unusual property types or remote locations with few properties. In these cases adjustments to comparables may be greater than 15% and details should be recorded on the beacon record sheet.

#### **4.10 Beacon Valuation - Key Stage 9**

- 4.10.1 The adjusted sales evidence should then be applied to the beacon property to form the beacon valuation. This must be recorded on the beacon record sheet. The valuation is the 'building block' on which the valuation of the archetype group is based and it will also provide important information for updating the valuation, when required. It is essential that the beacon record sheet contains all the relevant information as set out in para 4.7.2 as well as any additional information which would be useful for future re-valuations.

#### **4.11 Identifying Variants from the Beacon - Key Stage 10**

- 4.11.1 On completion of the beacon valuation, sample properties within the archetype group may need to be inspected. The purpose of the inspections is to test the value of the beacon across the archetype properties, to establish the degree and extent of any variations in value. The aim is to capture any variations in excess of +/-5%, from the beacon and reflect these variations in the value of the archetype. Without this procedure the beacon method is rather a crude approach to the valuation of the archetype.
- 4.11.2 The +/- 5% should capture the minor differences between properties such as presence/absence of bay windows, slight differences in floor areas, layout of accommodation etc. and it will not be necessary to identify properties with these minor variations from the beacon. These properties will taken at the beacon value.
- 4.11.3 All sources of information should be used to establish the identity and type of other variants if this has not already been carried out. Sources include estate plans for location within the estate and stock condition surveys and modernisation programmes for establishing condition. A roadside inspection marking significant property variations on a plan may be a useful approach to adopt.
- 4.11.4 Inspections of these identified variants may be limited to a roadside inspection if the reason for the variation is location within the estate or presence/absence of garage space. Internal inspections may be appropriate if the variation results from a modernisation scheme.
- 4.11.5 The number of inspections will be depend on:
- the homogeneity of the archetype;
  - the numbers within the archetype;
  - property inspections already carried out for Right to Buy; and
  - quality of information about the stock.

- 4.11.6 The numbers to inspect should be sufficient for testing the beacon valuation and provide sufficient information for adjusting the beacon value to account for the variation. It is expected that only one inspection of each variant type will be necessary and that may be limited to a roadside inspection.
- 4.11.7 For consistency a scale may be useful when adjusting the beacon valuations for the variations, especially for adjustments such as location, which may be common to all the archetypes. The variants should fall within the suggested value ranges for archetype groups i.e. no greater range than 30% (i.e. lowest to highest values). Where it is found there are substantial numbers of properties exceeding these limits it may be appropriate to establish another archetype group and beacon.
- 4.11.8 Where archetype groups cover a wide range of property types, which may be the case for street properties, the variations from the beacon value may be much larger to accommodate the different types of property included in the archetype. The resources devoted to preparing these valuations should have regard to the materiality of the effect on the accuracy of the total HRA asset value.
- 4.11.9 Variations from the beacon should not usually be necessary for major property variations except where dealing with non estate property as detailed at para 4.5.3. Differences resulting from property type, size/number of bedrooms, etc. will normally be accommodated by a separate archetype and beacon. Only where the archetype includes several property types each with low numbers, so not warranting individual beacons, should adjustments be necessary for these major variations.
- 4.11.10 No formal record of the inspection of the variants is required but details including numbers and variant type should be recorded on the beacon record sheet. Variations to the beacon value should also be recorded on the beacon record sheet. An example is set out in Appendix 2.

## 4.12 Valuing the Archetype Group - Key Stage 11

- 4.12.1 **The value of the archetype when there are no variations in value, or the variations are de minimus i.e. within +/- 5% of the beacon value, is the beacon value multiplied by the number of properties in the archetype.**
- 4.12.2 Where there are variations to the beacon value, the number of properties exhibiting the variation should be multiplied by the variant value. The valuation of the archetype as a whole is simply a matter of building up the values of the variant groups to establish the archetype value as shown in the example below:

Property Type	Number	Value of Beacon or Variant Property	Vacant Possession Value of Group	%	EUV – SH
Beacon (3 Bed)	30	£110,000	£3,300,000	35	£1,155,000
2 Bed Variant	26	£100,000	£2,600,000	35	£ 910,000
4 Bed Variant	12	£125,000	£1,500,000	35	£ 525,000
<b>Totals</b>	<b>68</b>		<b>£7,400,000</b>		<b>£2,590,000</b>

- 4.12.3 Where the valuer is utilising a spreadsheet format to capture individual property values it will be important to ensure filters for archetypes and variants are accurately set up with the correct stock numbers.
- 4.12.4 In some cases, it may not be possible to identify the exact number of properties with each variant characteristic. In these cases the valuer should discuss and agree numbers with the Chief Finance Officer.
- 4.12.5 The unit of valuation is the HRA portfolio and no deduction should be made to the beacon values on the grounds that a larger portfolio would command a lower price than a portfolio with fewer numbers of stock. Not only is the assumption one that is inappropriate in terms of resource accounting, but also there is no evidence to suggest that the sale of a local authority housing portfolio is adversely affected purely by the numbers of dwellings within the portfolio.

### **4.13 Adjustment Factor - Key Stage 12**

- 4.13.1 The value of the archetype, based on the beacon value, is adjusted to take account of the occupation of secure tenants at less than market rents to arrive at EUV-SH. The adjustment factors will be adjusted periodically and are listed in Appendix 4 together with a methodology on the approach that has been adopted in their derivation. There should be no departure from the adjustment factor unless the valuer has evidence which shows the level of adjustment does not provide a fair assessment of EUV-SH for that particular portfolio. In these cases a full account of the alternative method for deriving the factor, and the supporting data, must be provided to the authority. **This information will be required for audit purposes.**
- 4.13.2 The adjustment factor is only applied to properties where the appropriate basis of valuation is EUV- SH and the beacon approach has been adopted.
- 4.13.3 However there will be circumstances, even when the beacon approach has been adopted, where an adjustment factor is not appropriate for establishing EUV-SH, e.g. in areas of unpopular housing where there is no difference between market and existing rents and these are dealt with in Chapter 5.
- 4.13.4 Valuations of other types of property, such as hostels, bed and breakfast accommodation and specialised sheltered accommodation where included in the HRA, may require no further adjustment if occupation is not by means of a secure tenancy and the basis of valuation is EUV. These property types are dealt with in Chapter 9.

### **4.14 Valuing the Asset Group - Key Stage 13**

- 4.14.1 The value of each asset group is the total of all the property archetypes contained within the group.
- 4.14.2 A summary of all the asset group valuations should form part of the valuation report. However, the final form and content of the valuation report should be discussed and agreed with the Chief Finance Officer.

4.14.3 Any additional individual properties that have been identified as part of the group will be recorded on separate schedules as indicated at the end of Chapters 8 and 9. These will also form part of the valuation report.

#### **4.15 Mining Subsidence/Contaminated Land/ Radon Risk/Asbestos**

4.15.1 A standard approach should be adopted to cover all these environmental issues. Unless the authority has provided reports covering mining subsidence, contaminated sites, areas of radon risk and properties with asbestos, it should be assumed the properties are not so affected and the final report should be worded accordingly. This approach should only be adopted if the valuer, having carried out the valuation exercise, has no evidence to the contrary, either historical or current.

4.15.2 Where the valuer has reason to suspect properties are located in areas so affected, a note to this effect should be included in the report with a recommendation to the authority to obtain the necessary specialist advice. The valuations in these areas will reflect, to the extent the market would do so, the known risks associated with any of these factors.

# Chapter 5 - Absence of Owner Occupied Market

## Key Points

- Unusual Construction And Types
- Unpopular Houses/Vacant Houses
- Use Of Adjustment Factor
- Stages Of Decline
- Reporting

### 5.1 Introduction

5.1.1 In some cases there may be a scarcity of sales of similar houses sold for owner occupation, making it difficult to establish an accurate beacon value based on this source of evidence.

5.1.2 This may arise because:

- the properties, though of a type sold for owner occupation such as terraces, flats etc. are of a type of construction unattractive to the owner occupied market because of difficulties raising finance, e.g. system built property, houses classed as defective under the Housing Act 1985, section 528;
- properties are not a type sold for owner occupation, e.g. bed sit accommodation with shared facilities; and
- properties are situated in unpopular locations where there is no demand for owner occupation.

5.1.3 The beacon approach, as set in Chapter 4, should still be adopted for these property types but modified, in line with this chapter, to take account of the various situations that may be encountered.

5.1.4 The properties in this section would normally be let on secure tenancies. More specialised accommodation for vulnerable members of the community where occupation is not usually on the basis of a secure tenancy (e.g. sheltered housing with additional support or hostels for the homeless) is detailed in Chapter 9.

### 5.2 Unusual Construction and Type - but not Low Demand Valuation Approach

5.2.1 The properties in this category are those which, although not unpopular, do not sell for owner occupation. This may be a result of difficulties raising mortgage finance because the houses are classed as defective or because they are of a type unattractive to the owner occupied market, e.g. maisonettes/high rise flats.

5.2.2 These properties should be identified by the authority and where numbers are substantial the properties should be categorised as an asset group, or an archetype within an asset group, along the lines set out in Chapter 4. However where the valuer is of the opinion that values are not significantly different to other properties without

the characteristics, it is quite reasonable to include the properties in the appropriate property archetype without any value deduction.

- 5.2.3 Where properties are few in numbers in isolated pockets and surrounded by areas where there is an established owner occupied market, it may be appropriate to include them within one of the main property archetypes. The valuation approach in these instances should be as in Chapter 4, based on the value of the archetype beacon which should be adjusted to reflect the poorer environment/location and type of property.
- 5.2.4 What is important is to be able to identify all such properties whether they are valued lower or not. The numbers of such properties should be recorded on beacon record sheets or they may be identified on spreadsheets by the use of filters.
- 5.2.5 Where the properties form a separate archetype, such as Orlit houses or bed sitting rooms, the beacon approach should be adopted drawing on all possible sales information and making adjustments to reflect the attributes of these properties.
- 5.2.6 Sales of other property types may form a basis for the beacon valuation. Sales of property such as studio apartments / starter homes may form a basis for the valuation of bedsitting room type of accommodation. Sales of flats may establish a tone of value for maisonettes. Auction sales and cash sales may provide evidence for properties where a mortgage is unobtainable because of the type of construction.
- 5.2.7 It is important when valuing these unusual property types to look in the wider geographical area including the private sector and other Council estates for sales evidence. The evidence should be adjusted for the location and property type to provide the beacon value, and beacon record sheets noted accordingly.
- 5.2.8 It may be useful in these situations, as a check, to consider the value of the nearest property where there is an owner occupied market to establish a benchmark against which these unusual property types can be compared.
- 5.2.9 Where the properties are also unpopular, the process outlined below should be adopted.

### **5.3 Areas of Unpopular Housing**

- 5.3.1 One or more of the following characteristics may identify these localities:
- none/low levels Right to Buy applications;
  - none/low levels Right to Buy sales;
  - none/low levels re-sales;
  - high levels of long term vacant property;
  - high levels of difficult to let property;
  - high turnover of tenants;
  - high incidence of voids;
  - very low property values in absolute and relative terms;
  - poor reputation of the area; and
  - planning blight.
- 5.3.2 In some instances whole streets or parts of an estate may be boarded up or tower blocks partially occupied or estates may have large numbers of vacant properties scattered throughout the area because tenants are reluctant to take up a tenancy.

- 5.3.3 The authority will have housing management information to help identify any such areas of housing.
- 5.3.4 Identification and categorisation of these areas of unpopular housing should be discussed with the Chief Finance Officer. The authority may categorise empty housing as surplus to requirements or awaiting re-development. **The basis of value for surplus property has changed with effect from 1 April 2015 and is Fair Value.**
- 5.3.5 The extent of these areas will vary between authorities but not all vacant property should be regarded as falling into this category.
- 5.3.6 Vacant properties awaiting re-letting in areas where there is a demand should be included in an archetype group in the usual way as described in Chapter 4. The same approach should be adopted for properties in popular locations that have been vacated for refurbishment or possible redevelopment. The fact they are vacant is not because they are unpopular and the valuation approach is as in Chapter 4. This will provide the appropriate signals for resource accounting and bring to the attention of the authority the value and resources tied up in the existing asset.

## **5.4 Unpopular Housing Valuation Approach**

- 5.4.1 Properties falling within this category may form significant areas of property and should be classed as an archetype group. Where there are small pockets of low demand/vacant units in otherwise popular housing estates, i.e. one particular street or one particular tower block, they should be included within one of the main property archetypes and treated as a variation from the beacon. The valuation approach in these instances should be as in Chapter 4, based on the value of the archetype beacon which should be adjusted to reflect the particular circumstances of these properties.
- 5.4.2 The valuation approach in Chapter 4 establishes EUV-SH by applying an adjustment factor to vacant possession value, which is based on owner occupation. The use of an adjustment factor for substantial areas of unpopular houses may not always be appropriate. The sources of evidence for establishing values of unpopular houses will be taken from sales of poorer quality properties, often bought as high risk/high return investments and probably not necessarily for owner occupation. In some cases the level or 'tone' of open market rents obtained for the private sector properties will be no different from the level of rents for social/affordable housing including council rents, having regard to general location, environment, and condition and the different types of tenancy involved. In these situations the use of an adjustment factor to beacon values could significantly undervalue the asset.
- 5.4.3 It is a matter of valuer's judgement, following discussions with the Chief Finance Officer, to establish whether affordable/social rents for the property archetype/asset group have a similar 'tone' to private sector rents. It will be necessary when considering this issue to compare like with like, having regard to the fact that private sector rents may often be for furnished accommodation on short term lets. This evidence will require to be adjusted to reflect a secure tenancy which is unfurnished and provides security of tenure.
- 5.4.4 For a consistent approach it is recommended that as part of the ground work in valuing these unpopular properties, the general level of affordable/social rents is compared with a notional market rent on the same terms and conditions. The comparison may be appropriate for the whole asset group if it comprises an

unpopular estate or for an archetype where there are unpopular areas within the defined asset group.

- 5.4.5 A robust approach should be adopted having regard to the implications of the decision for the overall accuracy of the valuation. Where the valuation approach as set out in para. 5.4.1. has been adopted and the assets are included within an existing archetype, the value of the unpopular properties should be adjusted by the appropriate factor only if the affordable/social rents are less than the equivalent private sector rent.
- 5.4.6 For larger numbers of property which form separate archetypes and asset groups, in making the decision, it may be useful to consider the impact of the adjustment factor on the capital value of a typical property. By the nature of the general environment, capital values will generally be relatively low and to adjust by a factor of 30%-40% range may provide an unrealistic valuation.
- 5.4.7 Where it is considered that the level of affordable/social rents for the property archetype is not materially different from private sector rents a note to this effect should be made on the beacon record sheet. Details of the general level of affordable rents for the archetype and evidence of open market rents should be included on the sheet as this information will be necessary when updating the valuations in subsequent years and for audit purposes.
- 5.4.8 No adjustment factor is necessary in these situations as the beacon valuation will represent EUV-SH.

## **5.5 Unpopular Housing Information**

- 5.5.1 To establish EUV-SH in areas of unpopular housing will involve looking at different sectors of the housing market including:
- cash sales to individual investors;
  - auction sales;
  - speculative sales;
  - investment sales to private sector landlords;
  - rates of return on residential investments;
  - council rents; and
  - private sector rents.
- 5.5.2 The aim is to establish the capital value of the property in the absence of an owner occupied market. There may be sufficient evidence to establish capital values directly by comparison with auction sales, investment sales etc. These will be mainly be related to the investment market and what a prospective purchaser would pay assuming the property was to be let at a market rent.
- 5.5.3 Any plans for these areas should be discussed with the Chief Finance Officer as there may be a council decision to demolish the properties in the short to medium term. These decisions should be reflected in the valuations in as much as the market would do so and will effectively make the properties short life properties.
- 5.5.4 Where no decisions have been made about the future of these types of property the valuer, in preparing the valuation, should assess the long term viability of social housing in the area. Information on future demand for social housing, population

movements, employment prospects and age profile of the current tenants should help to build up a picture which an investor would reflect in the purchase price.

- 5.5.5 A possible source of evidence for the valuation of short life properties is the private investment market for low value properties which, by the reason of their repair and condition, may only have a relatively short life. Analysis of these sales may be useful in providing information on the required rates of return for investments of this nature.
- 5.5.6 It may be useful as a check to consider the value of adjacent property where there is an owner occupied market to establish a benchmark against which these low value properties can be assessed.
- 5.5.7 All the information should be evaluated against the characteristics of the properties as a basis for the value of the archetype group.

## **5.6 Grouping of Unpopular Housing**

- 5.6.1 The approach to the valuation, where there are substantial numbers of properties, is to divide the properties into archetypes, as set out in Chapter 4, or to treat them as one mixed archetype group. The latter approach may be the most appropriate where, because of a lack of an owner occupied market, an investment approach has to be adopted for the valuation. A mixed archetype group will also be appropriate where all the properties, irrespective of type, are vacant and boarded up. This will be necessary where it is likely the properties have a short life in their existing use.
- 5.6.2 Set out below are various scenarios which may be encountered on these types of estates and the valuation approaches that should be adopted. These scenarios will not cover every type of situation but should provide guidance as to how property groups with certain characteristics should be treated for the asset valuation. The scenarios represent the various stages of decline that might be found either within an estate or for the estate as a whole.
- 5.6.3 At any one time an asset group may have areas of housing of all the types described below. In these situations it may be appropriate to group the properties into archetypes to match the various stages as described.

## **5.7 Mixed Archetype of Vacant and Let Property - First Stages of Decline**

- 5.7.1 These areas will be characterised by a pepper potting of vacant and tenanted properties, but although properties are difficult to let, tenancies are allocated and taken up. Property turnover may be high and the estates may be of a type which provide short term accommodation with voids higher than the average. If the estate has a considerable number of long term voids and there is little prospect of such property ever being let, the estate should be regarded as in the second stage of decline which is dealt with para 5.8 below.
- 5.7.2 The future of the properties should be discussed with the Chief Finance Officer to establish whether there are any plans for demolition of all or parts of the estate, and in the absence of any strategy the long term viability of the estate for social housing should also be considered.
- 5.7.3 Archetype groups should be established in the usual way, but in these areas the range of values across property types may be narrow and all types may fall within the

30% range set out in Chapter 4 para 4.4.6. The residential investment market is not as sensitive to variations in property type as the owner occupied market. Subject to valuer's judgement it may be reasonable to place all the properties, especially if they form part of a demolition/redevelopment unit, in one archetype group and adopt a beacon value based on all the information available.

- 5.7.4 All the sources of comparable evidence as listed at 5.5.1 should be evaluated to establish a beacon value for a typical property within the archetype group. In areas where there is a residential investment market it will be possible to ascribe a beacon value based directly on the capital value of the comparable sales. An investment approach may also be adopted using a market rent for the beacon property and a rate of return derived from sales of other investment property. This would need to be adjusted to reflect the nature of the beacon and its setting within the estate and wider geographical area.
- 5.7.5 In considering and adjusting the comparable sales evidence it is important that adjustments are made to reflect the viability of social housing in the locality, especially if it is considered there is no long term future for the estate. The estate may have a limited life because of the plans of the authority to demolish or because it is considered the letting demand will fall away dramatically in the short to medium term. Some private sector sales may already reflect these factors if they are of existing surplus local authority housing, or private sector property in poor condition where future tenant demand is uncertain. In these cases the price paid will represent the short term nature of the investment.
- 5.7.6 If this is not the case and the comparable sales are effectively long term residential investments it may be necessary to adjust the sales to reflect any risk there is in the viability of the archetype for social housing. Adjustments would usually be reflected in the rate of return required on the investment and the number of years remaining before the property became unlettable.
- 5.7.7 Adjustments may also be necessary to reflect the longer void periods which may be encountered within the local authority stock as opposed to the private sector. Longer voids increase the income risk of the investment and should be accounted for by adjusting the return an investor would require on the investment.
- 5.7.8 The value of the archetype is the number of properties within the archetype multiplied by the beacon value. The valuation will require to be adjusted by the appropriate adjustment factor if it is considered that the general level of rents for the properties is less than private sector rents. In making the decision regard should be had to paras. 5.4.1 to 5.4.8.
- 5.7.9 Where it is considered that there is little difference between market rents and the rent passing or little difference in the capital value of the property, irrespective of whether it is let at a social or private rent, no adjustment factor should be used as this could significantly understate the value of the property.

## **5.8 Mixed Archetype of Vacant and Let Property - Second Stage of Decline**

- 5.8.1 In some areas there may be little evidence of an investment market making it unrealistic to ascribe a unit value to the properties. Even where there is a general market, the Council properties may be so unpopular and potential demand for tenanted accommodation be so low as to make a sale unrealistic under the terms of EUV-SH.

- 5.8.2 A characteristic of these properties is the very high level of long term voids and the possibility they will never be re-let. It is a matter of valuer judgement following discussion with the Chief Finance Officer and using housing management information to establish whether it is reasonable to assume a future demand for these long term void properties.
- 5.8.3 The important consideration in these cases is the fact that a proportion of the properties are providing a service as housing accommodation and as such they have a 'value in use' to the authority. This is in line with the basic accounting principle of value to the business. The remaining service potential to the authority may be low, but the properties have not yet reached the stage as detailed at 5.9. That scenario may arise in the future in the absence of regeneration of the property and the area.
- 5.8.4 Archetype groups should be established in the usual way but it is anticipated that all the properties will be placed in a single group. The point of creating the archetype is to distinguish the properties from surrounding asset groups/archetypes which do not have these problems.
- 5.8.5 The future plans for the area should be discussed with the Chief Finance Officer as there may be a council's decision to demolish the properties in the short to medium term.
- 5.8.6 Where no decisions have been made about the future of these areas, an assessment should be made of the viability of the existing tenancies and, in the long term, the viability of social housing in the area. Information on existing tenancies concerning turnover, frequency of re-lets and length of tenancies, should provide information on the immediate demand for social housing. Population movements, employment prospects and age profile of the current tenants should help to build up a picture of the longer term prospects for the estates.
- 5.8.7 The value in use to the authority may be assessed by a simple investment valuation of the group as a whole based on market rents with an allowance for long and short term voids and other outgoings assuming only minimal care and day to day maintenance. The aim is to establish a capital value, which in these types of cases, would be restricted to some form of high risk investment market. It is anticipated that it would be unrealistic to assume the properties will remain tenanted for much more than five years and this should be reflected in the valuation. An alternative approach is to value a typical property and apply this valuation to the number of properties which are currently or are expected to remain tenanted for the remaining life of the estate. The remaining properties within the archetype have a nil value.
- 5.8.8 The guiding principle when valuing these property groups is that the service potential represented by the value in use of the existing tenanted properties, however small, must be accounted for in the balance sheet.
- 5.8.9 Where it is considered there is little difference between market rents and the rent passing, or little difference in the capital value of the property irrespective of whether it is let at a social or private rent, no adjustment factor should be used as this could significantly understate the value of the property.

## **5.9 Vacant Property Archetype - Final Stages of Decline**

- 5.9.1 Where the archetype group is made up of vacant/boarded up property and investigation reveals the properties are impossible to let, the value of the archetype should be recorded at nil.

- 5.9.2 Areas of housing of nil value will most likely comprise groups of property which are vacant and cannot be let. It would be unusual to return a nil value for an archetype group where there are still tenanted properties as the asset is providing a service. However, there may be some instances where either by inaction or historical accident or where the authority are clearing the area for demolition, a small minority of houses remain tenanted but are surrounded by vacant/boarded up units.
- 5.9.3 In these circumstances it will still be appropriate to return a nil value for the archetype, if it is reasonable to assume that these few tenanted properties are un-lettable following the departure of the existing tenants.
- 5.9.4 If the properties have been declared non-operational the appropriate basis of valuation is Fair Value (market value) and is dealt with in Chapter 12.

## **5.10 High Rise Unpopular Housing**

- 5.10.1 There will be cases where floors of high rise flats and maisonettes have been allowed to fall vacant for refurbishment or upper floors vacated for redesign of the roof space, whilst the lower floors are in occupation.
- 5.10.2 Where refurbishment work is in progress the valuation approach is as set out in Chapter 10 (Land and Buildings in the Course of Development/Refurbishment). Where work has yet to commence, but floors have been vacated, the vacant properties should be valued at nil, and the occupied units in line with the approach set out above. This approach should not be adopted where properties, in otherwise popular estates are vacant prior to a refurbishment or redevelopment scheme, para. 5.3.4 refers.

## **5.11 Unpopular Housing Beacon Record Sheet**

- 5.11.1 A beacon record sheet should be completed in the usual way for these types of property but it may not be possible to supply the same level of detail for comparable sales evidence as this may be drawn from a variety of sources.
- 5.11.2 The beacon record sheet should show the reasoning behind the value of the beacon and or archetype and any assumptions that have been made concerning redevelopment.

## **5.12 Negative Valuations**

- 5.12.1 Negative values are not usually appropriate for operational property within the context of resource accounting because:
- where the asset is still providing a service, i.e. the property is still tenanted, the asset has a value to the authority; and
  - if the asset is no longer providing a service, i.e. because it cannot be let, it has a nil value to the business as an operational property in its existing use, not a negative value.
- 5.12.2 However, where the valuation is negative because of a legal liability such as a dilapidation claim on a leasehold property, a negative value must be recorded in the valuation report.

# Chapter 6 – Discounted Cash Flow Approach to the Valuation

## Key points

- Prescribed Method Of Valuation
- Information Required
- Inspections

### 6.1 Introduction

- 6.1.1 The Discounted Cash Flow (DCF) method of valuation produces an EUV-SH value for the housing stock by discounting, to the required valuation date, income and expenditure streams arising from the housing stock operation.
- 6.1.2 This methodology is, in many respects, similar to that adopted in arriving at what is referred to as Tenanted Market Value, i.e. the basis of valuation for the purpose of large scale Voluntary Transfers of local authorities' housing stock to Registered Social Landlords (RSLs).
- 6.1.3 The method requires a conversion to a capital value of the income and expenditure streams which flow, over a period of time, from the housing stock operation.

### 6.2 Component Parts of the Valuation – Information Required

- 6.2.1 The following information in respect of items of annual income and expenditure will usually be required to enable a DCF valuation to be undertaken for HRA purposes:

#### Income

- Rental income flows reflecting council's policy on increases in rent levels, voids and bad debts etc.
- Lock-up garages – numbers and potential demolitions etc.
- Other income – items could be many and varied from authority to authority.

#### Expenditure

- Refurbishments to meet appropriate standards , Decent Homes Standard
- Repairs.
- Management and administration costs.
- Other costs.

#### Other

- Size of the housing stock, i.e. numbers of units and potential changes in those numbers due to, e.g. demolitions/stock reductions and sales under the RTB scheme.
- Access to Stock Condition Surveys.

- 6.2.2 As described above, the crucial issue is for the valuer to be in possession of all of the relevant items of actual and projected income and expenditure involved in running the HRA and this will necessitate close liaison between the valuer and the appropriate council's personnel in Housing and Finance etc.

### **6.3 Valuation Methodology**

- 6.3.1 Once the above information is available, the valuer is in a position to estimate the income and expenditure streams over the timeframe selected for the valuation. This is usually a period of 30 years.
- 6.3.2 Income and expenditure sums will be projected for each of the ensuing 30 years and discounted to a present day value by the use of a selected discount rate; and average rents per unit are estimated in 'real terms', i.e., excluding general inflation.
- 6.3.3 When discounted totals of income and expenditure for the full period are calculated, a cumulative discounted surplus or deficit will result to arrive at Net Present Value (NPV), i.e. the EUV-SH of the housing stock.
- 6.3.4 The valuation itself will be carried out on a bespoke spreadsheet, designed for the purpose, of which many different types are in existence.

### **6.4 Inspection**

- 6.4.1 It follows that the DCF method of valuation is essentially a desktop exercise which is based upon information supplied by the local authority and the objective of which is to produce, in a single operation, a valuation to EUV-SH of the entire stock.
- 6.4.2 Extensive, full internal inspections of individual council dwellings, therefore, are not required.
- 6.4.3 If the DCF methodology is to be adopted, **it would be prudent for the valuer and Finance Director to discuss the process with the auditors prior to undertaking the valuations to ensure that audit requirements are fully met.**

# Chapter 7 – Application of the Discounted Cash Flow Approach

## Key points

- Information Required
- Timescale
- Discount Rate

### 7.1 Introduction

- 7.1.1 This chapter sets out in key stages the process to be followed when using the DCF approach for the valuation of housing stock. Authorities may wish to adapt the process to meet their individual requirements, but the general principles of the method and the various key stages should be adopted, albeit in various forms.
- 7.1.2 The process described in this chapter should cover most of the situations and dwelling types found within an authority's housing stock. Other property types are covered in Chapter 9. The use of DCF may, or may not, be appropriate for these properties depending on the type of property and its' particular characteristics.
- 7.1.3 Under a DCF method all future cash flows are estimated and discounted to convert them to their Present Values at the valuation date. The sum of all future cash flows, incoming and outgoing is the Net Present Value (NPV) which represents the EUV-SH of the property comprised in the HRA portfolio.
- 7.1.4 Four key stages are:
- assembly of information required from the local authority,
  - selection of time period for DCF valuation,
  - analysis of information and estimation of future income flows, and;
  - selection of discount rate.

### 7.2 Discounted Cash Flow Valuation Spreadsheets

- 7.2.1 Where a DCF approach to valuation is the preferred methodology it will be clear that the valuer is heavily dependent upon council's sources for the detailed information which forms the basis of the DCF calculation.
- 7.2.2 The nature of this information in respect of income and expenditure is described below.
- 7.2.3 Valuers who are familiar with the DCF method will have access to a DCF spreadsheet of which many models exist. Many such spreadsheets, designed for the DCF purpose, are in existence and will, no doubt, perform the valuation function equally well providing that the adopted spreadsheet makes provision for all income and expenditure flows.

7.2.4 Sample spreadsheets may express income and expenditure flows in overall terms and/or in terms of a rent/cost average, i.e. expressed in terms of the average per dwelling unit.

### **7.3 Information Requirements**

7.3.1 The following information in respect of items of annual income and expenditure will usually be required to enable a DCF valuation to be undertaken for HRA purposes.

7.3.2 Housing stock details of the opening stock at the beginning of the year and the projected closing stock at the end of the year will be required including reasons for any changes:

- demolitions, stock reductions;
- transfer sales of part of stock;
- Right to Buy sales.

7.3.3 Knowledge of numbers of the opening stock and projected closing stock will enable the valuer to arrive at an average number of units for the year.

7.3.4 Stock Condition Surveys will be an important source of information for the valuer in estimating future expenditure.

#### **7.3.5 Income**

- Rents. Historic data relating to rental income over, say, the previous 3 years will be required together with anticipated rental income flows over the period of the DCF valuation and this will reflect the size of the stock at the valuation date, together with any projected reductions in stock levels for the reasons described at 7.3.2 above.
  - i. The DCF calculation will not reflect any intention to create/acquire any new housing stock during the period of the DCF valuation as the object of the exercise is to arrive at a valuation of the HRA assets existing at the valuation date.
  - ii. Adopted rental income flows will take into account proposed rental increases and this will be based upon council/central government policy for the increase/decrease of rents to be charged for council dwellings.
  - iii. At the time of undertaking a DCF method of housing stock valuation, therefore, the valuer will need to reflect in that valuation the method by which the relevant council intends to implement current government policy and build into the DCF formula the consequent anticipated changes in rents in this respect .
- Voids, Bad Debts. Projections for rental income growth will also need to be adjusted to take into account reductions in total rental income due to voids and bad debts – Councils will be able to provide this information.
- Other Income. Items under this heading may vary widely from authority to authority but examples might include garage site rents, rechargeable repairs, grants and service charges, etc. The principle remains that the valuer's task is to assess income flows from such sources over the period covered by the DCF calculation and discount these amounts to the valuation date.

- Lock-up Garages. The local authority may, or may not, require Lock-up Garages to be included in the valuation, but their nature in terms of homogeneity, regular income, expenditure streams, etc. lends itself to a DCF approach. Information required is similar to that in respect of dwellings, i.e. opening stock, projected closing stock, average numbers of units for the year, etc.

### 7.3.6 Expenditure

- Repairs. In global terms, this item represents the repair and maintenance of the housing stock and repairs may be of many different types, but examples would include planned maintenance, voids/change of tenancy repairs, response repairs etc.
- Refurbishments/Capital Expenditure. This item relates to expenditure proposed for the existing stock and could include programmed renewals, improvements, refurbishments to meet quality standards, e.g. Decent Homes Standard etc. But local authorities will be in a position to furnish the valuer with sufficiently detailed information from business plans, Standard Delivery Plans and other sources - which will include costs, projected cash flows, borrowing needs, etc. - in respect of this type of proposed expenditure to enable the valuer to make realistic estimates as to the timing and cost of such works.
- Management and Administration Costs. This category of expenditure is likely to include many diverse items and will vary from authority to authority but will normally include direct staff costs involved in management and administration and any central support costs. This category may also be a receptacle for a variety of items which are not included elsewhere e.g. management initiatives, tenant participation, allocations policy, property insurance, etc.
- Other Costs. These would typically include garden and grounds maintenance, sheltered housing, demolition costs, disability adaptations, hostels, etc.

## 7.4 Time Period for Discounted Cash Flow Valuation

- 7.4.1 When the valuer is in possession of all required information relating to income and expenditure, these cash flows can be plotted over the timeframe selected for the DCF valuation.
- 7.4.2 This will usually be a period of 30 years although others are possible.
- 7.4.3 In a period of 30 years it would be expected that most short life and medium life components would receive maintenance attention or outright renewal, e.g. kitchens, bathroom, heating systems, windows, electrics, etc., although this will depend upon the quality of the item at the valuation date (see Condition Surveys). Longer life items, e.g. external walls, would be unlikely to be included in such a timeframe.
- 7.4.4 Perhaps of greater significance, however, a 30-year timescale is likely to be adopted for the reason that this is the typical period over which RSLs would normally be expected to repay finance borrowed for the purposes of housing stock acquisition and/or capital expenditure - it is, therefore, the "going rate" in the social housing market.
- 7.4.5 RSLs are required to have a 30 year funding strategy in place.

## **7.5 Discount Rate**

- 7.5.1 The discount rate adopted by the valuer will reflect a number of factors including the cost of borrowing and rates prevalent in investment markets, risk (e.g. in situations where the housing stock is of poor quality – with subsequent implications for rental demand).
- 7.5.2 In most circumstances, the prime concern of a potential purchaser will be that purchaser's cost of borrowing, i.e. if the purchaser is required to repay interest upon the funds which have been borrowed to finance the acquisition of the property, then such a purchaser would require the rental income flows produced by the housing stock to finance the repayments of principal plus interest.
- 7.5.3 When a local authority's housing stock is sold for the purposes of the continuation of the existing use, the transaction takes the form of a Large Scale Voluntary Transfer to a RSL which has the capacity to raise funding in the private financial markets.
- 7.5.4 The stock is valued to Tenanted Market Value (TMV) which is, essentially, the same DCF method of arriving at EUV-SH for HRA purposes.
- 7.5.5 Such valuations for stock transfer purposes, typically, adopt a discount rate in the range of 6% - 7% and this, together with the purchaser's level of borrowing costs, provide a useful guide to the discount rate to be adopted in a DCF valuation for HRA purposes.
- 7.5.6 For these reasons, a rate within the range above would meet the underlying rationale of the valuation methodology.
- 7.5.7 Slight variations in the discount rate can be made to reflect the particular circumstances of the housing stock which is the subject of the valuation, e.g. the discount rate might be eased upwards to reflect a housing portfolio which is of especially poor quality with implications for rental income, but a discount rate, sufficiently robust to cover most circumstances, would be in the region of 6.50%.
- 7.5.8 This represents a 'real' rate of return, i.e. the effects of inflation/deflation are ignored and it is consistent with the remainder of the inputs into the cash flow and has the advantage for the valuer that there is no need to forecast inflation rates.

# Chapter 8 – Leasehold Housing Property

## Key Points

- IAS 17 Definitions
- Summary of Lease Classifications

Key documents are:

- **International Accounting Standard 17 (IAS 17)**, which details how leases must be classified and accounted for under IFRS
- **Red Book - RICS Valuation - Professional Standards**
- **Red Book - UKGN 1 “Land and buildings apportionments for lease classification under IFRS”** [formerly known as RICS Valuation Information Paper No. 9 (VIP 9)]; this is written specifically to address issues found in UK leasing practice and markets
- **CIPFA Code of Practice on Local Authority Accounting, Section 4.2 “Leases and Lease-Type Arrangements”**.

## 8.1 Introduction

- 8.1.1 IFRS introduces significant changes to the treatment of leased assets for capital accounting purposes.
- 8.1.2 IAS 17 replaces SSAP 21 (UKGAPP) for leased assets. Its purpose is to ensure that entities properly account for the substance of any leasing agreement or hire purchase contract involving any asset (including property).
- 8.1.3 It is not written from a property perspective however, having to accommodate all forms of leased assets, and this can create difficulties in interpreting and understanding its provisions in a property context.
- 8.1.4 IAS 17 **is not** to be applied as the basis of measurement for:
- (a) property held by lessees that is accounted for as investment property (see IAS 40 Investment Property);*
  - (b) investment property provided by lessors under operating leases (see IAS 40);*
  - (c) biological assets held by lessees under finance leases (see IAS 41 Agriculture);*
  - (d) biological assets provided by lessors under operating leases (see IAS 41).*
- 8.1.5 The main tasks which valuers may become involved with in connection with accounting for a lease are:
- Lease classification *(required on first occasion of being accounted for under IFRS)*

- Assistance with the assessment of the Present Value of Minimum Lease Payments (PV of MLP) under a finance lease (*required on first occasion of being accounted for under IFRS*)
- Assessment of fair value of a finance lease (*required on first occasion of being accounted for under IFRS and on the occasion of each revaluation*)

8.1.6 For the purpose of valuer guidance specifically related to the HRA, it should be noted that leases must be classified as finance or operating leases in accordance with the provisions of IAS17 and CIPFA guidance

8.1.7 In summary, the lease classifications will require the following valuations shown in the table

Lessor of Operating Lease	<p>Usually accounted for as an Investment Property, therefore Fair Value.</p> <p>However, if asset is regarded by client as being held for the delivery of broader policy objectives, Current Value as for an owner occupied operational asset (i.e. underlying existing use value of the asset ignoring the lease)</p> <p><b>Note: - in practice it is very unlikely that any HRA properties could be properly classified as investment property.</b></p>
Lessee of Operating Lease	<p>No value required as not captured on the balance sheet (<i>unless accounted for as an Investment Property by lessee</i>).</p> <p>(But note that any capital expenditure on Tenant's Improvements may require to be separately valued to Current Value)</p>
Lessor of Finance Lease	<p>No figure normally* required from valuer (<i>*but residual figure may be needed if land was treated as a finance lease</i>)</p>
Lessee of Finance Lease	<p>Current Value of the leased interest (which is not value of the legal interest in the lease but the underlying freehold existing use value of the property as if owned as risks and rewards of ownership are considered to have transferred)</p>

# Chapter 9 - Other Assets and House Types Including Sheltered Housing and Shared Ownership

## Key points

- Types of Property
- Information Requirements
- Report Schedules
- Contamination/Radon/Mining Subsidence

Key documents are:

- CIPFA Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

## 9.1 Introduction

9.1.1 Although the HRA is primarily concerned with general purpose council houses, there may be other properties (dwellings and non dwellings) within the account which are either ancillary to the housing function or are providing accommodation for specific groups of people. For example, sheltered accommodation with varying degrees of support may form part of the HRA assets. Non-housing property may include lock-up garages let exclusively or mainly to HRA tenants. These will normally be considered part of the HRA although where an authority has a policy of letting of garages, on a long-term basis, to people who are not HRA tenants, it may be more appropriate to account for them in the General Fund.

9.1.2 Other possible operational assets are play areas, grassed areas and gardens, community centres, shops and council offices (e.g. area housing or estate offices directly supporting the housing function). The decision as to whether costs for these assets should be charged to the HRA is for the authority to make in the light of local circumstances and the use made of the assets.

9.1.3 For land held for residential development see Chapter 12.

## 9.2 Property Types

9.2.1 The following types of property may be included within the HRA. The list is not exhaustive and where properties have not been categorised discussion should take place with the Chief Finance Officer prior to the valuation:

- play areas/communal gardens/landscaping;
- lock up garages/garage sites;
- offices (possibly shops depending on categorisation);
- hostels/sheltered housing;
- meeting halls/community centres (usually classed as specialised properties); and
- shared ownership schemes.

### **9.3 Information**

9.3.1 The following information will be required as part of the valuation process:

- shops/offices - floor areas, details of rent passing and terms of lease;
- lock up garages - numbers, rent passing, types of tenancy, voids, waiting lists, number of vacants;
- environmental factors - reports covering mining subsidence, contaminated land, radon risk, asbestos;
- For any other properties where relevant, details of leases, licenses, fees, charges and any other operational costs.

### **9.4 Open Spaces/Play Areas/Communal Gardens**

9.4.1 Areas of landscaping and communal gardens included within the HRA will usually be reflected in the beacon values for the surrounding houses, and would not fall to be accounted for separately. Larger areas of operational space such as designated play areas, play grounds, playing fields, parks and formal gardens will usually be classed as community assets and valued at historic cost. Where, however, the asset is included in the HRA and is not classed as a community asset, a valuation on basis of Current Value (Existing Use Value) should be prepared. The valuation should reflect a level of value for the existing use, e.g. recreational land together with the value of any play equipment that has been installed if not accounted for elsewhere.

9.4.2 A beacon approach to the valuation is probably not appropriate and individual valuations should be prepared for the identified assets and identified on a separate schedule. For consistency a level of value or 'tone' value for these areas could be adopted across the authority.

9.4.3 Community assets are: 'Assets that the local authority intends to hold in perpetuity, that have no determinable useful life, and that may have restrictions on their disposal'. If the asset is used for a specific operational purpose, it does not qualify as a community asset and should be valued accordingly.

9.4.4 Care must be exercised to ensure the definition of community asset is correctly applied. A community asset such as a park may contain within its boundaries properties used for either operational or non –operational purposes. It is for the Chief Finance Officer, with the advice of service managers and valuers, to determine if any separate treatment of those assets is required.

### **9.5 Lock up Garages**

9.5.1 The valuer should consult the Finance Director about the appropriate accounting treatment and whether IAS40 or IAS17 should apply.

9.5.2 As these properties are of similar design a beacon approach to the valuation is probably the most appropriate, however valuers may also consider reviewing the total income stream produced and capitalising at an appropriate market rate.

- 9.5.3 The grouping of the garages for valuation purposes will depend on how the information on numbers and rents is held by the authority. Where there is little subdivision across the stock it may be necessary to treat all the garages as one asset group for the whole stock. Alternatively where garages are identified at estate level, a valuation as a separate archetype within the asset group will provide more information for the business plan.
- 9.5.4 The valuation of investment property will have regard to the level of rents, types of lease and the outgoings such as management, voids etc. Where information is not available for the whole stock, an alternative approach would be to value a typical garage for which information is available. The resulting capital value -with adjustments where necessary for condition, demand, etc.- should then be adopted for the remaining properties.
- 9.5.5 There may be locations where the garages are in poor repair, vacant and unoccupied. If these have been categorised as non-operational properties the appropriate basis of valuation is Fair Value (MV assumption – see Chapter 12).
- 9.5.6 Where the assets are categorised as operational it may be appropriate in some situations to return a nil value. This situation may arise in areas where a nil value has been placed on the surrounding houses.
- 9.5.7 Individual lock up garages have a relatively low value and may be below the de minimus threshold set by the authority. Groups of garages however may well exceed the 'de minimus' level and for the purposes of the asset valuation, where properties are of a similar type, they should be grouped and valued accordingly.

## **9.6 Offices, Shops and Miscellaneous Assets**

- 9.6.1 The valuer should consult the Finance Director about the appropriate accounting treatment and whether IAS40 or IAS17 should apply.
- 9.6.2 Unless there are sufficient physical similarities between the properties and they are let on identical leases and rents, individual valuations may be required as opposed to a beacon approach.
- 9.6.3 Roadside inspections should be carried out of all the properties but the valuer should make a judgement as to whether all the properties require internal inspections. If the authority has provided sufficient information on floor areas, an internal inspection of a sample of properties may be sufficient for the purpose of the valuation. A note to this effect must be included in the final report.

## **9.7 Hostels/Sheltered Housing**

- 9.7.1 The nature of these properties will vary widely from authority to authority depending on the degree of services they provide. The most likely type of property will be:
- temporary accommodation/hostels; and
  - various types of sheltered accommodation.
- 9.7.2 Hostels/temporary accommodation where there is little income or market evidence of sales may be more properly valued on a Depreciated Replacement Cost approach (see below). The reason is that the use of the property is so specialised there is no

market for the property in the wider local authority area. In larger towns and cities, however, there may be sufficient evidence of sales for similar types of use to establish a Current Value (Existing Use Value).

- 9.7.3 In some cases authorities use properties which would otherwise be in the owner occupied market for temporary housing/hostels. The occupants of the property may have individual rooms but share the public rooms, bathrooms and kitchen. Where there are no formal secure tenancy agreements, the property should be valued with vacant possession assuming a continuing use as residential accommodation, i.e. Current Value (Existing Use Value).
- 9.7.4 Where there are a significant number of these properties it may be appropriate to adopt a beacon approach to arriving at a typical Current Value (Existing Use Value) which could be adjusted to reflect the varying types of properties. The resources devoted to preparing these valuations should have regard to the materiality of the effect of these valuations on the accuracy of the total HRA. It is not envisaged that all these properties should be inspected internally and a roadside inspection may be sufficient.
- 9.7.5 Sheltered accommodation, where there is a significant element of care and shared facilities, may be better compared to the residential home market. Regard should be had to the quality of the accommodation and facilities provided, in comparison with similar accommodation in the private sector. In valuing these properties regard should be had to the wider market outside the local authority's area as the residential home market is not so site/location specific as the owner occupied market. The basis of valuation for these types of property is Current Value (Existing Use Value).
- 9.7.6 Where, however, the sheltered accommodation is more akin to general purpose housing with some additional support (such as warden call systems, shared laundry facilities, common rooms, etc), the valuation approach as set out in Chapter 4 should be adopted and the values adjusted to reflect these features in as much as the market would do so. The basis of valuation is EUV-SH arrived at by the beacon approach and adjustment factor. The properties should be included in an asset group, either as a separate archetype or part of an archetype, possibly as a variant from the beacon.
- 9.7.7 Comparable sales for this type of accommodation may be difficult to establish and it will be a matter of adjusting the available information to establish a beacon value. Details should be recorded on the beacon record sheet in line with the Guidance as set out in Chapter 4.

## **9.8 Meeting Halls/Community Centres (Specialised Properties)**

- 9.8.1 The approach to the valuation for specialised properties, in the absence of any useful or relevant recent sales transactions, is depreciated replacement cost in accordance with UKVS 1.15 and UKGN 2. Valuations adopting this approach should be expressed in the final report as subject to the prospect and viability of the continuance of the occupation and use in accordance with UKVS 1.15.
- 9.8.2 The Chief Finance Officer should be notified where it is the intention to adopt a depreciated replacement cost valuation for some property assets. The terms of the report should be agreed, including the approach to VAT and whether a modern substitute or replacement of the existing approach is to be adopted.

- 9.8.3 It will be necessary to provide an indicative Fair Value (Market Value assumption) where this is materially different from the DRC.

## **9.9 Shared Ownership**

- 9.9.1 Where the authority own a share of the interest in the property, the value of the equity share must be accounted for in the portfolio valuation. The approach is to value the property based on the beacon value assumptions and calculate the appropriate equity share. This share should then be adjusted to reflect the occupation at less than market rents by adopting the regional adjustment factor.
- 9.9.2 Where there are discrete areas of shared ownership accommodation it may be appropriate to group them into a separate archetype group with a beacon. However, where numbers are small, they should be included in the best match archetype group and valued as a variant from the beacon and recorded as such on the beacon record sheet.

## **9.10 Reporting Schedules and Procedures**

- 9.10.1 A beacon record sheet should be prepared for lock up garages with details of how the valuation was prepared and the numbers of units included in the valuation. The valuation should also be recorded on a separate schedule which will form part of the final report and give details of the value, (see sample schedule at end of this chapter).
- 9.10.2 Sheltered accommodation, which is more akin to general purpose housing as described at paragraph 9.7.6 and shared ownership schemes, should also have a beacon record sheet.
- 9.10.3 Beacon record sheets are not required for the other types of property as it is expected they will be few in number and value. These valuations must be included on report schedules which form part of the final report. The report schedule must include the address of the property, description, valuation, (Existing Use Value /depreciated replacement cost and indicative Current Value) and remarks.
- 9.10.4 The value of the operational non-housing assets requires to be shown as a separate item in the balance sheet, hence the necessity at this stage for schedules for housing and non-housing assets. A specimen report schedule is included at the end of this chapter.
- 9.10.5 It is recommended that houses valued to Existing Use Value as detailed in paragraph 9.7.4, are not included in archetype groups and asset groups to avoid an adjustment factor being adopted along with the other property. These properties valued to Existing Use Value should be recorded on a separate schedule and a specimen is included at the end of this chapter.
- 9.10.6 Valuers must be aware that in all the foregoing if Fair Value is used then IFRS13 requires them to make certain additional disclosures regarding both the valuation technique applied and the 'Level of Inputs' used – refer to Appendix 1.

## **9.11 Contamination / Radon / Mining Subsidence / Asbestos**

- 9.11.1 The same standard approach should be adopted for these environmental issues as in Chapter 4, para 4.15.

## Housing Revenue Account Asset Valuation - 1 April 2016

### Specimen Schedule - - Operational Property Non-Housing

UPRN	Address	Description and Area	CV (EUV) £'s	DRC £'s	Land apport £'s	Building apport £'s	Remaining life estimate	Remarks
1	2 Smith Court	Ground floor office in multi storey block extending to 50m <sup>2</sup> used as advice centre	70,000		17,500	52,500	35	Originally a flat but converted to office use as difficult to let
2	The Milton Meeting Hall, Milton Estate	Substantial purpose built with kitchen and w/cs for use by local tenants extending to 200m <sup>2</sup> built in 1955 on a 0.2 ha site		220,000	40,000	180,000	20	Open market value £100,000 assuming use as a store
3	Play area to rear of 1,2,3 Smith Court	0.05 ha site set out as children's playground with slide and other equipment	15,000		9,000	6,000	10	New playground for use by tenants on the estate
4	1 Clover Row	Shop extending to 30m <sup>2</sup> in parade of 5 on large estate. Leased for 15 years from 1/4/2014, FRI at £5,000 per annum	50,000		12,500	37,500	30	The situation where a shop is classed as operational will be infrequent
5	500 lock up garages across the authority	Blocks of garages, single storey with flat felt roofs and metal u/o doors	250,000		150,000	100,000	20	Generally in good repair and in demand

These valuations are not adjusted for directly attributable acquisition costs which are dealt with in Chapter 13.

## Housing Revenue Account Asset Valuation - 1 April 2016

### Specimen Schedule - Operational Property Special Housing

UPRN	Address	Description and Area	CV (EUV) £'s	DRC £	Land apport £	Building apport £	Remaining life estimate	Remarks
1	4 The Square	Three storey terrace house with 8 bed sits with shared kitchen and bathrooms and welfare support	300,000		105,000	195,000	45	Value assumes VP as a dwelling house. No secure occupation
2	St Martin's Hall	500m <sup>2</sup> former YMCA hostel now adapted and used as accommodation with additional welfare support		400,000	60,000	340,000	20	DRC based on replacement with mod equiv. Open market value £150,000 assuming use as a store
3	The Mews	Purpose built sheltered units with communal dining and recreational areas and residential staff	300,000		100,000	200,000	40	value has regard to private residential home market
4	1,3,5,7 Castle Mains Cottages	Shared Ownership Scheme	100,000		20,000	80,000	40	Value based on 50% share owned by the authority

These valuations are not adjusted for directly attributable acquisition costs which are dealt with in Chapter 13.

# Chapter 10 - Land and Buildings in the Course of Development or Refurbishment

## Key Points

- Basis Of Valuation
- Valuation Approach
- Report Schedules
- PFI Schemes (See Chapter 11)

Key documents are:

- The Code, Chapter 4.1.

## 10.1 Introduction

10.1.1 The usual valuation approach for land and buildings in the course of refurbishment is set out in the RICS Valuation – Professional Standards, January 2014 at UK Appendix 2 paras 3.18 to 3.21.

10.1.2 Chapter 4.1 of the Code includes adaptation and interpretation for the public sector context. Paragraph 4.1.1.6 states that Infrastructure, community assets and assets under construction (excluding investment property – see section 4.4 of the Code) shall be measured at historical cost. The option given in IAS 16 to measure the carrying amount of these classes of assets at Fair Value has been withdrawn.

10.1.3 Valuations for the HRA may depart from the RICS Valuation Standards in order to recognise the large numbers of development / refurbishment contracts which could be ongoing at the date of valuation.

## 10.2 Valuation Approach

10.2.1 The reason for departure from the RICS Valuation Standards is to recognise the difficulties authorities may have in identifying each redevelopment / refurbishment scheme within the HRA. Contracts will vary in size and number from authority to authority and may often form part of a larger refurbishment scheme carried out over a period of years. To avoid authorities having to identify each contract and to ensure a consistent approach, the following procedures should be adopted.

10.2.2 Land and buildings in the course of development at the date of valuation could be classified into the following types:

- new build development by or on behalf of the authority; and
- redevelopment / refurbishment schemes of existing property.

## 10.3 New Build Scheme

10.3.1 Assets under construction shall be measured at historical cost.

## **10.4 Redevelopment / Refurbishment Schemes of Existing Property**

10.4.1 Redevelopment / refurbishment schemes will range from the re-fitting of windows / rewiring / new external works, often with the tenants remaining in residence, to major schemes where the tenants are moved out for a temporary period. Schemes may also include the complete removal of the upper floors of maisonettes to reconfigure the properties and provide a new roof and a more attractive asset.

10.4.2 The approach to adopt in these cases depends on the time scale of the work involved. In the absence of any specific changes to the reporting requirements it is recommended that the categories set out in the previous guidance are adopted. There will be two categories of schemes, hereafter described as Category 'A' and 'B'.

## **10.5 Category A Schemes**

10.5.1 Schemes in progress at the valuation date and scheduled for completion within twelve months of the valuation date are classed as Category A Schemes. The valuation should assume the contract work has been completed.

10.5.2 Example:

A contract has been let for the installation of full gas central heating in 100 terrace houses. The contractor was on site at the date of valuation and it is scheduled for completion within two months of the valuation date.

10.5.3 This departure should be referred to in the final report.

10.5.4 Assets under construction shall be measured at historical cost.

10.5.5 Anticipated schemes at the valuation date where contract work has not been let, or where the contractor has not taken control of the site, should be ignored and the properties valued as existing.

## **10.6 Category B Schemes**

10.6.1 Schemes in progress at the valuation date where contract work on site will extend beyond twelve months of the valuation date are classed as Category B Schemes. This category will cover the more complex schemes that may cover a wide range of works over the period.

10.6.2 The valuation will be the value of the existing buildings prior to the current contract commencing with, stated separately, the cost of the contract work completed by the valuation date.

10.6.3 Example:

A tower block of 100 flats is undergoing complete refurbishment including new external cladding, new kitchens and bathrooms. The contract has various stage target completion dates but final completion will take longer than twelve months from the valuation date.

10.6.4 At the valuation date the EUV-SH of the property is £30,000 per unit on the basis that no work under the contract has taken place. (Beacon approach and adjustment factor). The contract work completed to date for the cladding is £750,000.

10.6.5 There will be schemes that comprise new build and refurbishment. In these cases it will be necessary to treat each part of the development in accordance with the above paragraphs.

## 10.7 Report Schedules

10.7.1 Land and buildings in the course of redevelopment, and valued on that basis, should be shown on a schedule to be included with the valuation report. The schedule should include the address of the property, description, valuation of the site and retained building and the cost of works to date. A sample report schedule is included at the end of this chapter.

10.7.2 The total value of the HRA assets should exclude the cost of the contract works which are shown separately in the report.

10.7.3 The departure from the RICS Valuation Standards for properties valued assuming the work has been completed should be recorded in the final report. See Appendix 3.

## 10.8 Completed Schemes

10.8.1 On completion of the refurbishment works, the assets valued on the basis of new build or Category B Schemes should be revalued at the next annual review and included in an appropriate asset group.

<b>Housing Revenue Account Asset Valuation - 1 April 2016</b>							
<b>Sample Schedule - Land And Buildings In The Course Of Development / Refurbishment</b>							
<b>Ref No.</b>	<b>Address</b>	<b>Description and Area</b>	<b>land and buildings excluding contract work £</b>	<b>Land £</b>	<b>Retained buildings £</b>	<b>Contract work to valuation date £</b>	<b>Remarks</b>
1	1-4 The Cedars	Four new houses in a rural location		100,000	n/a	375,000	New development on greenfield site
2	East Court	100 flats Multi-storey block of flats undergoing complete redevelopment	3,000,000 (inc land)			750,000	Retained buildings valued to EUV-SH

# Chapter 11 PFI Schemes - Assets Covered by HRA Private Finance Initiative Schemes

## Key Points

- Service Concession
- Basis Of Valuation

Key documents are:

- IFRIC 12
- Code of Practice on Local Authority Accounting Chapter 4.3
- HM Treasury Financial Reporting Manual (FReM)

### 11.1 Introduction

11.1.1 Section 4.3 of the Code applies to Public Private Partnerships (PPP) and Private Finance Initiative (PFI) arrangements (see paragraphs 4.3.1.3 and 4.3.1.4) where:

- a) the local authority controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and where;
- b) the local authority controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the infrastructure at the end of the term of the arrangement.

11.1.2 Increasingly, most PPP and PFI arrangements are expected to appear on authorities' balance sheets.

11.1.3 Schemes where the dwellings are included on the authority's balance sheet should be included in the HRA asset valuation and valued in accordance with this Guidance as set out in Chapter 4.

11.1.4 Where HRA dwellings are not included in the authority's balance sheet for the period of a PFI contract, the authority will need to consider whether the contract is, in substance, a lease (which might be either an operating lease or a finance lease). Section 4.2 of the Code of Practice includes guidance on making this assessment. Where the contract is, in substance a lease, the authority should refer to Chapter 8 of this Guidance. Where the contract is not, in substance a lease, those dwellings should not be included in this stock valuation exercise. At the end of the contract, however, the dwellings will usually return to the authority's balance sheet, and should then be valued in accordance with this Guidance.

### 11.2 Interpretation

11.2.1 CIPFA guidance on PFI and PPP arrangements is to be found at Chapter 4.3 of the Code of Practice.

11.2.2 Prior to the adoption of IFRS, PFI interests where the risks and rewards were considered to have been transferred to the service provider were kept off the balance sheet. The only valuation required from the valuer for accounting purposes was the value of the residual interest, and then only in certain circumstances. This reversionary interest would normally have been subject to indexations and revaluations.

11.2.3 The new accounting arrangements under IFRS are very different, both in their scope and the approach required. After detailed consideration, HM Treasury established that the PFI approach for the UK's public sector should be consistent with private sector companies through application of the principles of IFRIC Interpretation 12 (IFRIC 12), and CIPFA has followed this in its Code of Practice (4.3.1.1).

11.2.4 In order for a PFI contract to fall within the scope of IFRIC 12, the contract must in substance be a service concession and an asset which qualifies as "infrastructure" must be used to provide the services.

11.2.5 **What is infrastructure?** Infrastructure is the term used in IFRIC 12 to refer to the assets used by the operator to deliver services (which may or may not be recognised on an authority's balance sheet). Examples include roads, street lighting, schools, telecommunications networks and non-current assets used for administrative purposes in delivering services to the public. The scope of "infrastructure" assets is therefore wide and most PFI assets are likely to fall within it.

11.2.6 **What is a service concession?** The Finance Director of each authority, in consultation with its accountants and auditors, will be responsible for determining whether a qualifying service concession exists. Section 4.3.2.4 of the Code defines what constitutes a service concession. Most service concessions require to be accounted for under IFRIC 12.

11.2.7 For a contract to fall within the scope of IFRIC 12, there are features which it must possess, the first two of which are that:

- the private sector provider provides services to the authority and / or services to other parties on behalf of the authority;
- the contract involves the use of an asset that is dedicated to the arrangement in providing those services

11.2.8 IFRIC12 notes that a service concession: "typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining it for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes".

11.2.9 Service concessions often include the following features:

- the procuring entity is normally a public sector body, or in some cases is an entity to which the responsibility for the function has been devolved;
- the operator is responsible for managing at least some of the assets and services i.e. it is not acting merely as an agent;
- the contract sets the initial price and the mechanism through which future prices are to be set or regulated; and

- the operator is obliged to transfer the asset to the public sector body at the end of the contract, in a specified condition for little or no additional consideration.
- 11.2.10 The arrangement must contractually oblige the private sector operator to provide the services related to the infrastructure to the public on behalf of the grantor (the public sector) (IFRIC 12.3). Contracts that do not involve the transfer or creation of an asset for the purpose of the contract fall outside the scope of IFRIC 12, as do arrangements that do not involve the delivery of services to the public.
- 11.2.11 **Which service concessions are within the scope of IFRIC 12?** IFRIC 12 focuses on which party controls the asset and applies the following tests:
- Does the authority control or regulate the services provided using the asset, to whom the services are provided, and the price charged for the services?
  - Does the authority control any significant residual interest in the asset at the end of the concession?
- 11.2.12 Where the answer to both these questions is 'yes' then the authority will need to recognise the PFI scheme as 'on-balance sheet'. This applies whether the asset was previously owned by the contractor or by the grantor, or was constructed or acquired from a third party for the purpose of the service arrangement.
- 11.2.13 Regarding the second test, IFRIC 12 states that the residual interest of the asset is the "estimated current value of the infrastructure as if it were already of the age and in the condition expected at the end of the period of the arrangement." Most PFI schemes include "hand-back conditions" in the contract, whereby the operator is required to ensure that the assets transferred to the authority are in sufficiently good condition to continue in operation for a specified period. The presence of such a clause is usually a strong indication that the asset will have a significant residual value unless the specified period is very short.
- 11.2.14 Under the financial arrangements in the concession, the operator will normally have recovered the cost of the asset, together with the financing costs, from the price charged over the life of the contract and the contract will include a clause whereby the Authority acquires the asset automatically at the end of the scheme for either a nil or a token payment.
- 11.2.15 However where the asset is used for its entire useful life during the concession (i.e. its entire economic benefits consumed) and there is little or no residual interest, then this second test is simply ignored. The arrangement will still fall within the scope of IFRIC 12 if the grantor controls or regulates the services as described in the first test above.
- 11.2.16 In most PFI schemes, it is anticipated that the local authority will be found to control the operation of the asset through the contract – e.g. where are the services provided, to whom and what price. Additionally, the specialised nature of many PFI assets means that they will normally transfer to the local authority at the end of the contract.
- 11.2.17 It is expected that most PFI schemes will be recognised as 'on-balance sheet' under IFRS, and auditors are indeed requiring that most PFI contracts considered to date be classified in this way.
- 11.2.18 A useful flowchart is available at Chapter 6 para 6.2.33 of the HM Treasury Financial Reporting Manual (FReM).

## 11.3 Valuation Approach

- 11.3.1 The authority will identify which assets it considers qualify as PFI or service concession assets and will request their valuation.
- 11.3.2 HM Treasury FReM (para 6.2.39) provides that the asset will be recognised when the two tests for recognition are met:
- When it is probable that future economic benefits associated with the asset will flow to the organisation; and
  - When the cost of the asset can be measured reliably.
- 11.3.3 The CIPFA Code at 4.3.2.9 advises that this will normally be when the asset is made available for use (unless the local authority bears part of the construction risk).
- 11.3.4 Where the operator enhances infrastructure already recognised, the local authority shall recognise the fair value of the enhancement.
- 11.3.5 The authority is required to recognise the infrastructure as its own asset, together with a corresponding liability to pay for it. Following initial recognition under IAS 17, the asset will be accounted for in accordance with IAS 16 and is initially and subsequently measured at its Fair Value in the same way as other assets of that generic type.
- 11.3.6 **Therefore the figure which the client will normally require from the valuer is the Current Value of the underlying asset, the asset being recognised as “if owned” by the authority – akin to the approach to assessing the lessee’s interest in a finance lease.**
- 11.3.7 This should not be referred to as a freehold valuation as this would cause confusion and:
- it cannot be a freehold valuation since the grantor does not hold the freehold,
  - there is a corresponding liability which the grantor has to account for;
- 11.3.8 Dependent on the fate of the asset at the end of the service concession, the useful life used may have to be less than the physical remaining life. Current value is measured as the market value subject to the assumption of continuance of the existing use (EUV). Where the asset is a specialised asset and the Current Value cannot be determined by reference to market evidence, the depreciated replacement cost (DRC method) will be used with the usual necessary cost, age and physical remaining life inputs.
- 11.3.9 The fact that the asset is being maintained to a specified contractual requirement does not negate the need to depreciate it.
- 11.3.10 Where the authority automatically acquires the asset at the end of the service concession, its estimated economic remaining life will not be restricted to the length of the PFI contract but should instead reflect the life of the asset itself. This is because the asset is being viewed from the perspective of the grantor, to whom the residual interest will normally return after expiry of the PFI contract. **This means of course that no separate valuation of the reversionary interest is now required as this residual value is now subsumed into the contributed asset’s value.**

- 11.3.11 Where componentisation is applied, component depreciation will need to be applied to the elements within an overall asset and where this is done the estimated economic lives of some components may be less than the life of the service concession; i.e. in other words it will as usual reflect the life of the physical component in situ, which may be shorter than the service concession, rather than anticipating and reflecting lifecycle replacement.
- 11.3.12 Following initial measurement, the asset will be treated as any other item under IAS 16 and its current value will need to be kept up to date by the authority.
- 11.3.13 Where an indication of impairment occurs, it should be subject to an impairment review.
- 11.3.14 For reporting, note that PFI and service concession assets are not treated as a separate class of asset.

## **11.4 Outsourcing Arrangements on Part of an Asset**

- 11.4.1 The valuer may also come across instances where part of the asset has been leased out under a PFI type agreement and may be asked to provide the appropriate valuations. An example may be where the local authority has outsourced the provision and maintenance of a housing estate district central heating system. It is for the authority to decide on the accounting treatment of such an arrangement and the valuer may be required to provide the appropriate asset valuations, both of the houses and the central heating system.
- 11.4.2 In such instances care should be taken to avoid double counting in the asset valuations. If this type of outsourcing arrangement is to be accounted for separately, the asset valuation of the houses may be prepared on the basis that the central heating is excluded. Clearly the assumptions need to be agreed with the client and the report should make it clear what has been excluded from the valuation and why.

## **11.5 PFI Schemes Which Predate IFRS**

- 11.5.1 PFI schemes that existed off-balance sheet prior to the introduction of IFRS require to be restated as if the new accounting requirements had been applied to the transaction from the inception of the contract.
- 11.5.2 For existing schemes, where no valuation was obtained at the time, authorities can either:
- Obtain a retrospective valuation of the PFI property's Fair Value as at the date on which it was made available to the authority; or
  - use the cost of the asset as set out in the final version of the operator's financial model as an estimate of the asset's Fair Value at that time.
- 11.5.3 The liability is to be measured at its Current Value at the valuation date, and this will normally be the outstanding liability in respect of the property (that is, excluding the interest and service elements), discounted by the interest rate implicit in the contract.

## **11.6 PFI and Existing Assets of the Authority**

- 11.6.1 A PPP or PFI arrangement may make use of the existing assets of a local authority. A local authority shall recognise enhancements to those assets and any additional infrastructure which is provided by the operator.
- 11.6.2 The liability is to be measured at its Current Value at the valuation date, and this will normally be the outstanding liability in respect of the property (that is, excluding the interest and service elements), discounted by the interest rate implicit in the contract.
- 11.6.3 Where the arrangement involves a permanent transfer of an asset to the operator, the local authority shall derecognise the asset.

# Chapter 12 – Discontinued Operations, Surplus Assets and Property “Held for Sale”

## Key Points

- Basis Of Valuation
- Categorisation Of Assets
- Special Assumptions
- Negative Values
- Report Schedule

Key documents are:

- IFRS 5

### 12.1 Introduction

12.1.1 Those properties that are not directly occupied, used or consumed in the delivery of a service must be accounted for and the values shown separately in the balance sheet.

12.1.2 IFRS 5 introduces two categories of Property “Held for Sale” (i.e. surplus / non-operational property).

- Held for Sale;
- Discontinued Operations.

### 12.2 Non-current Assets Held for Sale and Discontinued Operations

12.2.1 Land and /or buildings that cease permanently to be used for service delivery purposes by an authority become non-operational assets. Establish whether the property has been declared surplus by the authority and whether it is considered by them to have been “abandoned” or whether they consider it qualifies as “held for sale”, either individually or grouped with other assets.

12.2.2 Examples are where a building ceases to be used because it has become additional to or unsuitable for the authority’s requirements, both current and within the foreseeable future. The building’s closure may be prior to a proposed demolition, redevelopment or disposal.

12.2.3 Short periods of closure, where the non-occupation is only temporary and the authority envisages a use for the asset within the foreseeable future, are insufficient to qualify the property as a non-current asset “held for sale or discontinued operations”.

12.2.4 A non-current asset is subject to depreciation charges based on its valuation. **However its value does not attract the depreciation charge if it qualifies as “held for sale”.**

## **12.3 Basis of Valuation**

12.3.1 The basis of valuation for non-current assets is Fair Value (Market Value assumption) in accordance with RICS Valuation Standards, UK Appendix 1.5. This is an exit value, and the valuation basis is one that recognises all the potential value of the asset and provides a valuation that an authority should achieve on an outright sale. The property is not required for its service potential and there is no requirement for it to be retained in existing use.

12.3.2 Selling costs directly attributable to a sale should be deducted from the valuation, where material.

12.3.3 Guidance as to the appropriate level of deductions is included in Chapter 13.

## **12.4 Categorisation of Non-current Assets Held for Sale or Discontinued Operations**

12.4.1 Categorisation and identification of assets will be a matter for the Chief Finance Officer, with assistance from the valuer. Non-current assets “held for sale or discontinued operations” are those held by the authority but not directly occupied or used in the delivery of services.

12.4.2 IFRS 5 States that:

- An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use (para.6).
- For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable (para.7).
- For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, except as permitted by paragraph 9, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. (para.8).
- An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and Fair Value less costs to sell. (para.15).
- An asset classified as held for sale, or included within a disposal group that is classified as held for sale, is not depreciated.

12.4.3 A body shall not classify as held for sale a capital asset that is to be abandoned (use ceases but not held for sale). This is because its carrying amount will be recovered principally through continuing use.

12.4.4 IFRS 5 permits only an asset that is to be sold to be classified as held for sale. Assets to be abandoned are classified as held and used until disposed of, and thus are depreciated.

## **12.5 Methodology**

12.5.1 A beacon approach may not be appropriate for non-operational assets because of the diversity of property within this categorisation. Valuations should be prepared in accordance with the RICS Valuation Standards. The number and type of inspections must be adequate having regard to the purpose of the valuation and whether and when the valuer has previously inspected the property (RICS Valuation-Professional Standards VPS2). The final report should include a statement concerning the extent of the inspections carried out for these non-operational properties.

## **12.6 Vacant Housing Assets**

12.6.1 Although the categorisation of non-housing properties is relatively straight forward, in the case of housing assets the situation may not be as clear cut. Set out below are guidelines for distinguishing non-operational housing assets from operational property, which may be useful in discussions with the Chief Finance Officer.

12.6.2 Non operation housing assets should be:

- vacant (it would be unusual for occupied property to be non-operational); and
- subject to a formal council decision to sell/demolish/redevelop.

12.6.3 Vacant units awaiting new tenants or units which are declared unlettable, but upon which no formal decision has been made, should still be classed as operational property. The valuation approach in these cases is set out in Chapters 4 and 5 depending on the reasons why the properties are vacant.

12.6.4 There will be a wide range of types of vacant units which are classed as non-operational, from rows of terrace houses to tower blocks and deck access estates. In preparing the Fair Value due regard should be had to all possible alternative uses, in as much as the market would do so.

12.6.5 The units that have been declared surplus should be amalgamated to form a single lot, in as much as the market would do so.

## **12.7 Difficulties in Identifying "Non-operational" Assets**

12.7.1 In some circumstances, difficulties can be experienced in determining whether or not an asset has ceased to be available for operational use.

12.7.2 This is particularly the case where an asset is only being partially used. The authority may suggest that part of a single block is unused, closed and surplus to requirements but it is more likely that this is an indication of under-utilisation of space in the block. A useful test is to consider whether the vacant part has sufficient "stand alone" characteristics, e.g. separate entry/exit provision. It should not normally be assumed that an asset has been taken out of operational use unless the complete asset is capable of independent disposal. Partial closure of individual buildings (e.g. a four storey building with the three upper floors closed and the ground floor still in use) is not regarded as making an asset capable of independent disposal. Exceptionally,

where the partial closures of buildings are a precursor to a planned withdrawal from a discrete site, this may be permitted.

12.7.3 Entirely incidental use of property should not prevent it being treated as non-operational and an assessment to Fair Value (MV); for example, the casual storage of furniture in a former office block.

12.7.4 A property may be temporarily empty where good management practice dictates that some space is kept vacant to give operational flexibility; for example where flats are kept vacant during periods of major refurbishment, temporary overspill accommodation needs to be held in readiness to house the displaced tenants. In this instance, the asset does not qualify as non-operational because it fails the test of "no foreseeable need".

12.7.5 **The final decision regarding the classification of the property remains with the client.**

## **12.8 Reversion to "Operational" Status**

12.8.1 There will be rare occasions where, due to an unexpected change of circumstances, a property that has been declared surplus to requirements and valued accordingly is brought back into use by the authority. When approached by the authority, the valuer should provide a revaluation of the asset as an operational property, either specialised or non-specialised reflecting the new use.

## **12.9 Land Held for Redevelopment**

12.9.1 Land declared surplus to requirements or held for redevelopment by the authority should be valued having regard to all potential uses and possible site amalgamations (RICS Valuation - Professional Standards, VPS4). In some locations there may be no demand for any further development of any kind. Levels of value in these areas will be related to open space / recreational land values taking into account the contingent liabilities associated with these areas.

12.9.2 Development sites may be assembled on a piecemeal basis as and when houses are demolished. If the whole area has been declared surplus with part demolished and part remaining, the complete site should be valued as a single asset with an allowance for demolition costs on the properties remaining.

12.9.3 When preparing the valuation the planning situation may be uncertain and any risk in obtaining a prospective planning permission or delay forms part of the market and must be reflected in the Fair Value.

12.9.4 The authority in some situations may require the valuation to reflect the full potential of the site, assuming a planning permission has been granted for a potential alternative use, without making any allowance for risk or delay of obtaining such permission. A valuation on this basis is particularly useful for asset management and business planning purposes. Such an assumption is a 'special assumption' (see RICS Valuation - Professional Standards, VPS4, Section 3).

12.9.5 The appropriate value for the balance sheet is Fair Value, and any additional valuation based on special assumptions should be included in the remarks column of

the report schedule and not included in the overall asset value. A note to the accounts should record the value on the special assumption.

## **12.10 Other "Non-operational" Properties**

12.10.1 Shops, offices, industrial units, masts and aerials should be valued to Fair Value having regard to the existing leases and any potential value for redevelopment / change of use on expiry of the lease. TV masts and aerials which are frequently found on the tops of multi storey flats should also be included in the asset register based on the value of the rental income received.

12.10.2 Lock up garages may also be classed as non-operational depending on whether they are delivering a service for which the authority has either a statutory or discretionary responsibility. When classed as non-operational the Fair Value must have regard to alternative potential uses in as much as the market would do so.

## **12.11 Negative Values**

12.11.1 In some instances the Fair Value of the asset may have a negative value. There may be no market for vacant property and demolition costs may exceed the value of the cleared site. A negative value in reality assumes the authority has a contingent liability arising from a disposal of the asset.

12.11.2 In some situations where the asset has a negative value there is no legal or statutory requirement on the authority to incur the expense e.g. site remediation / demolition. In these situations a nil value should be reported. (see VPS 3 L5-6).

12.11.3 Discussion with the Chief Finance Officer about the authority's intentions and their statutory obligations will be useful in identifying these situations.

12.11.4 Negative values must be stated separately in the report and not offset against positive values.

## **12.12 Contamination/radon risk/mining subsidence/ asbestos**

12.12.1 A standard approach should be adopted for these environmental issues as set out in Chapter 4. Unless the authority have provided reports covering mining subsidence, contaminated sites, and areas of radon risk, the properties should be assumed to be not so affected and the final report should be worded accordingly. This approach should only be adopted if the valuer, having carried out the valuation exercise has no evidence to the contrary, either historical or current.

12.12.2 In some situations where the asset has a negative value there is no legal or statutory requirement on the authority to incur the expense e.g. site remediation / demolition. In these situations a nil value should be reported. (see VPS 3 L5-6).

12.12.3 Discussion with the Chief Finance Officer about the authority's intentions and their statutory obligations will be useful in identifying these situations.

12.12.4 Negative values must be stated separately in the report and not offset against positive values.

## **12.13 Valuation Report**

12.13.1 The valuation report will require the positive and negative values of non-operational assets to be stated separately. The individual assets should be incorporated into a schedule, which includes the address of the property, description, Fair Value, Fair Value with special assumptions if appropriate, and remarks. A sample schedule is included at the end of this chapter.

## 12.14 Report Schedules

12.14.1 Beacon record sheets are not necessary for these individual valuations but the values must be recorded on schedules, which will form part of the valuation certificate. A sample report schedule is included at the end of this chapter.

<b>Housing Revenue Account Asset Valuation - 1 April 2016</b>				
<b>Non-Operational Property</b>				
<b>Address</b>	<b>Description and area</b>	<b>FV (MV) £'s</b>	<b>FV (MV) special assumptions £'s</b>	<b>Remarks</b>
1 1-21, 2-20 Cedar Street	40 houses awaiting demolition	300,000	500,000	FV assumes redevelopment potential for housing. FV special assumption assumes planning permission obtained
Vacant site at Cross Street	0.5 ha site for housing development	175,000		Site has planning permission for residential development
Red Court	Multi storey block awaiting demolition	(150,000)		Council decision to demolish no demand for residential development, demolition costs exceed site value
<b>Total Positive Value - £475,000</b>				
<b>Total Negative Value - (£150,000)</b>				

These valuations are not adjusted for directly attributable selling costs which are dealt with in Chapter 13.

# Chapter 13 - Valuation Reports

## Key points

- Valuation Report And Property Schedules
- Notional Costs Of Acquisition And Disposal
- Beacon Portfolio

### 13.1 Introduction

13.1.1 The valuer will be required to provide two documents for the final report:

- a valuation report;
- a beacon portfolio.

### 13.2 The Valuation Report

13.2.1 The report is the document that supports the figure reported in the balance sheet and consists of a preamble which sets out the basis of valuation, the stock number adopted for the valuation, the valuation date, assumptions, limitations and the agreed departures from the RICS Valuation Standards together with the total valuation of the HRA assets. The minimum content of valuation reports are set out in the RICS Valuation - Professional Standards January 2014 at VPS 3.

13.2.2 The second part of the report should include the property schedules showing the asset group valuations and the schedules itemising all the properties that have not been valued on a beacon approach (or DCF approach if appropriate). The incorporation of these schedules will allow a reader of the report to follow the make up of the final valuation.

13.2.3 The exact format of the report is the responsibility of the valuer subject to the requirements of the RICS Professional Standards VPS 1 and VPS 3. The valuer responsible for undertaking the valuation must sign the report and any subsequent valuation reviews.

13.2.4 Any requirement for a breakdown of values for properties of different tenures and between bases of valuation should be agreed with the client and will depend on the authority's specific requirements.

### 13.3 Notional Directly Attributable Acquisition and Disposal Costs

13.3.1 UKVS 1.5 states that the valuer must not include directly attributable acquisition or disposal costs in the valuation. Where required by the client to reflect costs these must be stated separately.

- 13.3.2 For the HRA assets the costs associated with entry values, such as professional fees including legal and valuation advice, are likely to be material even though they may only be a small percentage of the total asset valuation. Valuers are advised that an addition should be made for these costs and, unless they have evidence to the contrary, an addition of a maximum of 2% of the value of the assets (EUV) should be made.
- 13.3.3 Disposal costs, where material, should also be accounted for in a similar manner and, where appropriate, include the costs of marketing. Costs may not be significant where authorities have very little property which is valued to Fair Value Market Value and, in these cases, the notional disposal costs should be regarded as not material and a statement to that effect included in the final report. Where the valuer considers that the extent of the property is such that costs would be material, a deduction should be made of up to a maximum of 2% unless there is evidence to the contrary. In line with the RICS Valuation-Professional Standards January 2014 UKVS 1.7 the deduction for these costs must be shown separately from the actual valuations.
- 13.3.4 The suggested percentages do not include any allowance for Stamp Duty Land Tax any other direct or indirect taxes that may be payable on either acquisition or disposal.

#### **13.4 Unadjusted Vacant Possession Valuation as a Note to the Accounts**

- 13.4.1 In addition to the balance sheet valuation (EUV-SH) it is also a requirement that, as a note to the accounts, the value of the properties should also be provided on the basis of the Fair Value (vacant possession value) as provided by the beacons. The inclusion of this valuation ensures that the economic cost to Government of providing council housing at less than open market rents will be shown in the accounts.

#### **13.5 The Beacon Portfolio**

- 13.5.1 The beacon portfolio is a document as described in Chapter 4 containing all beacon record sheets and the archetype and asset group valuations. The portfolio is a key piece of information as not only will it provide the basis for the valuation reviews, but it will also form a key piece of evidence in any future monitoring exercise. The beacon record sheets can be grouped into asset groups and indexed, for ease of use.
- 13.5.2 The precise format of the beacon Portfolio is not prescribed, however authorities should ensure the information detailed in para 13.1 above is available, whatever their final choice of format.

# Chapter 14 - Revaluations and Valuation Reviews

## Key points

- Purpose And Approach – Including Valuation Frequency
- Commissioning Of Valuation Services
- Requirements And Methodology
- Treatment Of Improvements, Assets In Course Of Development, Leases
- Valuation timetable

### 14.1 Purpose and Approach

14.1.1 The purpose of full revaluations and valuation reviews is four fold:

- the HRA assets will always be shown in the balance sheet at current valuation (an important consideration in terms of asset management and business planning);
- signs of impairment as well as increases in value will be noticed at an early stage (an aid to business planning);
- unacceptably large swings in value should be avoided at full revaluations;
- to ensure the valuation reflects changes in stock numbers.

14.1.2 IAS16 (para.31) states that: “revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.” Valuers should also note para 4.1.2.37 of the Code.

14.1.3 The aim of the full revaluation is to account for all the changes in the value of the stock by revaluing the asset and archetype groups and the beacon properties.

14.1.4 The aim of the review exercise is to capture any significant changes in value "in year" and to avoid major fluctuations on the quinquennial revaluation.

14.1.5 The requirement for the annual review/revaluations is to put into effect on a formal basis the requirements of the Code of Practice on Local Authority Accounting and to provide a consistent approach for all authorities.

14.1.6 There is no prescriptive approach that authorities must adopt to ensure current values are used in the balance sheet. There are a variety of approaches and authorities should adapt these to meet their needs and availability of resources. Any programme of reviews and revaluations must ensure that all parts of the stock have been fully re-valued at intervals of not more than five years. (para. 4.1.2.38 of the Code).

14.1.7 Possible approaches include:

- a full revaluation every five years with desktop reviews in the other four years;

- a full revaluation of 20% of the stock every year with a desktop review of the remainder, informed by the results of the revaluation; and
- a full revaluation of a varying percentage of the stock over the five years with desktop reviews for the remainder, informed by the results of the revaluation.

14.1.8 The last two approaches allow the costs of the exercise to be spread more evenly between the years without any detriment to the accuracy of the overall valuation. Where these approaches are adopted all the asset and archetype groupings and the remaining life of the whole HRA portfolio should be reviewed at least every five years. This is to ensure any changes in the distribution of dwelling types within the portfolio are fully reflected.

## **14.2 Commissioning the Valuations**

14.2.1 A commissioning document for the initial valuation should include a requirement for annual reviews and part revaluations, where appropriate.

14.2.2 The valuations should be carried out by a professionally qualified valuer. There is no restriction on whether this should be an internal or an external valuer and this reflects the position as set out in IAS16 (32) that “the Fair Value of land and buildings is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.”

14.2.3 The RICS Valuation – Professional Standards January 2014 additionally requires that where a full valuation has been undertaken by an internal valuer, this is subject to review by an external valuer – using a representative sample sufficient to enable the external valuer to express an opinion on the overall accuracy of the valuation (UKVS 1.1.5).

14.2.4 Qualified valuer is a person conducting the valuations who holds a recognised and relevant professional qualification and having sufficient current local, national knowledge of the particular market, and the skills and understanding to undertake the valuation competently (4.1.2.14). This definition of qualified (internal or external) valuer should be followed when commissioning the valuations.

14.2.5 On completion of the exercise, valuations may be subject to monitoring to ensure that authorities have complied with the Guidance and that a consistent valuation approach has been adopted across the country.

## **14.3 Minimum Requirements for the Review**

14.3.1 As a minimum the annual review should:

- update the stock numbers in the asset and archetype groups to account for disposals and demolitions, acquisitions and newly constructed dwellings;
- take account of material movements in value at the asset group level, including impairment;
- capture major changes in value of significant asset groups resulting from major refurbishment schemes;
- include in the asset groups property originally classed as in the course of development, but now complete.

## 14.4 Annual Review Methodology

14.4.1 The approach should be based on a desktop review of the DCF assumptions or beacon valuations to establish any changes in value and how they impact on the asset group as a whole. To establish trends in value it may be appropriate to consider several different sources of information including:

- sales of comparable property types that have taken place during the year - this should be regarded as the prime source of information;
- information at the local level of movements in house prices as published by the Land Registry and leading mortgage lenders;
- regional and national indices showing general trends that could be used as a basis for informed opinion of any changes in value of the portfolio; and
- changes in rental levels, investment yields and property management costs.

14.4.2 When reviewing the relevant valuations and assumptions it is important to look at events that have taken place which may have a downward effect on values. Such events or 'trigger events' may indicate impairment has occurred and, when identified, a valuation review must be carried out to comply with the Code of Practice on Local Authority Accounting. These impairment reviews are effectively included in the annual desktop valuations and so it is important to consider the possibility that downward movements in value may have taken place.

14.4.3 Events or changes in circumstances potentially leading to impairment may include a decline in demand for social housing, a rapid deterioration in the general environment or a substantial decline in the quality of the property.

14.4.4 Having looked at all the sources of information the annual review should be carried out at the asset group level. It is not necessary for all the individual archetype groups to be re-valued individually except in particular circumstances where major changes have taken place. If it is evident that increases are generally uniform across the whole asset group, an index should be established which is a fair reflection of the movement in value for the asset group as a whole over the reporting period.

14.4.5 A more detailed exercise may be necessary where there have been major changes to archetype groups' values through impairment, major refurbishments etc.

14.4.6 The non-housing assets and non-operational property should also be reviewed having regard to changes in the local and national property market for the specific group of properties. It is important when reviewing these properties to understand the purpose of the review which is to avoid unacceptably large swings in value at full revaluation.

14.4.7 As these assets are expected to form a small part of the HRA both in number and value, the resources devoted to these updates should have regard to the materiality of the effect of these values on the accuracy of the total HRA asset value. In some cases movements in value may not be material and if this is the case the existing valuations should be adopted.

14.4.8 However there will be circumstances where it is appropriate to update values of these non-housing and non-operational assets and either an index based on market evidence within that property sector or local/regional property market evidence where available, may be applied. The approach adopted should be discussed and agreed with the Chief Finance Officer.

14.4.9 Where the asset is valued on the depreciated replacement cost basis, the review should have regard to an appropriate building cost index as published by the Building Cost Information Service (BCIS). The land element should also be revised having regard to movements in values. It may be appropriate to take the index used on the buildings or an index used for other similar types of property within the portfolio. Alternatively, local or regional land transactions may be considered. As these properties will be small in numbers and value in relation to the total portfolio a pragmatic approach should be taken having regard to the purpose of the review, which is to avoid major swings in value at the revaluation.

14.4.10 It will be necessary, where valuations have been apportioned between land and buildings for calculating depreciation, to review the remaining life of the asset. A robust approach should be adopted and it may be appropriate for the remaining life of these non-housing and non-operational assets to be revised only on full revaluation when the properties are revisited.

## **14.5 Typical Stages in the Annual Review Process**

14.5.1 Set out below is a typical review process. Valuers may wish to adapt this process to meet their individual requirements:

- establish details of property disposals and acquisitions/redevelopments and recast the numbers in the archetype/asset groups and non-operational schedules;
- recalculate existing asset group valuations to account for revised stock numbers (the valuations subject to review are exclusive of any notional acquisition and disposal costs);
- review beacon values to establish an index to reflect changes at the asset group level or archetype level where necessary;
- revise the value of the asset groups; and
- review other categories of properties.

## **14.6 Annual Review Inspections**

14.6.1 Internal/external inspections should not normally be required. The review should be regarded as a desktop exercise which will reflect general market changes in the portfolio valuation.

## **14.7 Information on Changes to the Portfolio**

14.7.1 It will be the responsibility of the local authority to supply the necessary details for the preparation of the annual review and details should be available from estate records and audit trails for the activities that have taken place during the year. There will be no requirement for the valuer to verify the information and the valuation report for the desktop review should include a statement to this effect.

14.7.2 Information required will include:

- revised stock numbers, as at a specified date, broken down to allow identification at the archetype group level. The stock number and date at which it is taken should be included in the report;
- details of new development schemes treated as buildings in the course of development/refurbishment in the existing valuation, but now completed;
- details of other major refurbishment schemes which have been completed. Major schemes are ones where the properties have been completely refurbished,

- frequently requiring the tenant to be moved out during the course of the work; and
- details of any development/refurbishment schemes either still in progress or initiated since the last valuation.

14.7.3 In the absence of information to the contrary, it should be assumed that no significant changes have taken place to the properties from the date of the previous full revaluation or review and that properties are in a similar condition to that at the date of the original inspections.

## **14.8 Treatment of Improvements**

14.8.1 During the review period there will be changes to the stock because of general maintenance and refurbishments. A pragmatic approach should be adopted having regard to the availability of information on schemes that have taken place and the materiality of the effect of any changes in value on the accuracy of the total HRA assets.

14.8.2 For example the refitting of new kitchens in properties which form only a small part of an archetype group should be ignored. Not only will the numbers of properties affected be small, relative to the total stock number, but also the improvement is unlikely to be significant in relation to the total value of the stock. To capture and value all the work that has taken place in year is beyond the scope of a desktop review. Abstracting the information on an annual basis will not be cost effective for the purposes of the review valuation. This information, however, should be available and included in the full revaluation.

14.8.3 The approach in 14.8.2 should be adopted for the majority of small improvement schemes including those where the beacon property has been improved. The review is intending to capture general changes in the market, not specific changes in individual or small groups of properties. These changes should be taken into account at the full revaluation.

14.8.4 Completed major refurbishment schemes which affect large numbers of houses within an asset group should be accounted for if the work has made a significant difference to the vacant possession value of the property. The type of scheme envisaged is one of total refurbishment often with the removal of the tenants for short periods. These specific increases over and above the general level of increase for the asset group should be accounted for.

14.8.5 Some assets may have been included as buildings in the course of development/refurbishment in the existing valuation. These assets will require revaluation and included in an appropriate archetype group at the review following their completion.

14.8.6 The level of detail required in valuing the additional work carried out in year is ultimately a matter of judgement for the valuer and dependent on the level of information available. The purpose of the valuation review is to capture the major changes in value in the portfolio as measured by changes in value of the asset groups.

## **14.9 Assets in the Course of Construction at Review**

14.9.1 New build schemes in the process of construction at the date of review should be included in accordance with Chapter 10 para 10.3.

14.9.2 Category A Schemes will be reviewed automatically as part of the asset group review as any work will be already reflected in the valuation.

14.9.3 Category B Schemes that are complete should be included in an archetype group and valued on the appropriate beacon for the group, possibly as a variant as set out in Chapter 10 para 10.8.1.

## **14.10 Property Held on Lease by the Authority**

14.10.1 Valuers should be aware of the requirements set out in Chapter 8. However, this is a desk based review and detailed lease assessments should not be necessary.

14.10.2 As a minimum the total reported value for these assets should be reviewed to take account of:

- acquisitions and disposals;
- finance leases should reflect the requirement to value the underlying freehold interest; and
- the remaining properties should be indexed having regard to indices used for other assets in the portfolio.

## **14.11 Revaluations of All or Part of the Portfolio**

14.11.1 Full revaluations of all or part of the stock must be carried out in accordance with this and subsequent guidance. This will involve re-inspecting the beacon properties or establishing new beacons and property groupings where necessary.

## **14.12 Method of Reporting Annual Reviews**

14.12.1 It is important when carrying out the annual reviews to establish an audit trail identifying the changes in stock numbers and values from year to year. This will help in all subsequent reviews and full revaluations. The format of schedules for housing assets and other property types should be agreed by the Chief Finance Officer to meet the particular reporting requirements of the authority.

14.12.2 When preparing the report for the desktop review the valuer must specify clearly the work which the reviewer has carried out, including the extent of any inspections, and the information relied on and provided by the authority.

14.12.3 A statement to the effect there may have been other changes to the locality and local planning policy, which have not been brought to the attention of the valuer and may affect the valuation, should be incorporated into the report.

## **14.13 Timetable**

14.13.1 Annual reviews, re-valuations and/or rolling programmes of revaluations should be carried out in line with this Guidance on an annual basis.

# Appendix 1 - Valuation Bases, Fair Value Hierarchy and Level of Inputs

## 1. Introduction

- 1.1 The basis of financial reporting and asset valuations for financial statements has changed considerably over the last 10 years and it is important that the valuer understands both the current position and the ongoing changes through the adoption of IFRS
- 1.2 IFRS, as interpreted for the UK public sector by CIPFA and HM Treasury, replaced UKGAAP (FRS and SSAP) in central government with effect from 1 April 2009 and in local and regional government with effect from 1 April 2010.
- 1.3 In summary, this required a fundamental re-assessment of the basis of asset valuations, definitions and assumptions to be made resulting from the change to IFRS and the resulting need for RICS definitions and guidance to match both IFRS and International Valuation Standards definitions (IVS),
- 1.4 The UKGAAP basis of valuation for financial reporting, Existing Use Value (EUV) is not a recognised valuation basis under IFRS accounting and the most recent changes brought about by IFRS 13 have not changed this position.
- 1.5 IFRS 13, introduced with effect from 1<sup>st</sup> April 2015, has brought major changes in valuation basis terminology, but not in underlying valuer practice.
- 1.6 CIPFA in association with HM Treasury have decided that all operational property, plant and equipment are outside the scope of IFRS 13 and therefore operational assets will not be valued to fair value. An operational asset is one used to deliver either front line services or back office functions, whereas the IFRS 13 definition of fair value is based on exit values and market prices for assets; i.e. an asset's highest and best use.
- 1.7 The basis of value to be used for operational assets will be known as Current Value, as defined in the CIPFA Code of Practice 2015/16. This entails an adaptation to IAS 16 to the effect that assets which are held for their service potential and are in use are to be measured as Current Value in existing use.
- 1.8 Current Value is not a basis of value featured in RICS Red Book VPS 4. The possible measurement approaches available to use to arrive at the Current Value of operational assets are as follows:
  - **Existing Use Value (EUV)** as defined at UKVS 1.3 for non-specialised operational assets.
  - **Depreciated Replacement Cost (DRC)** in accordance with UKVS 1.15 and UKGN 2 for specialised operational assets
  - **Existing Use Value – Social Housing (EUV-SH)** in accordance with UKVS 1.12 for social housing (local government only)

## 2. Summary of Valuation Bases

### 2.1 Fair Value

Fair Value is defined in IFRS 13 as:

***‘The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date’***

2.2 For this purpose, Fair Value is considered to equate to Market Value.

2.3 Valuers undertaking HRA valuations should therefore note that assets which qualify as Investment Assets, as Surplus or as ‘Held for Sale’ will be valued to Fair Value in accordance with IFRS 13 and RICS Red Book VPS 4 para 1.5.1 (a).

2.4 Valuers should also be aware that there is a separate and distinct definition of Fair Value adopted by the IVSC but this is not relevant to HRA work.

## 3. Existing Use Value

3.1 The Red Book provides the following explanation and definition:

“Valuations based on existing use value (EUV) shall adopt the definition set by RICS. Existing use value is to be used only for valuing property that is owner-occupied by a business or other entity for inclusion in *financial statements*.”

Definition:

3.2 The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion, assuming that the buyer is granted vacant possession of all parts of the asset required by the business, and disregarding potential alternative uses and any other characteristics of the asset that would cause its *market value* to differ from that needed to replace the remaining service potential at least cost. (UKVS 1.3)

## 4. Depreciated Replacement Cost

4.1 IAS 16 prescribes the accounting treatment for property, plant and equipment and provides that fixed assets will continue to be held on the balance sheet at valuation, which for specialised properties is likely to be their Depreciated Replacement Cost (DRC).

4.2 CIPFA Code of Practice states that for operational (i.e. “in use”) specialised property assets, a DRC approach method of valuation, may be used where there is no market-based evidence of Current Value because of the specialised nature of the property and the item is rarely sold, except as part of a continuing business.

4.3 Where a valuer, following discussion with the client, determines that DRC is the most appropriate, clients and their valuers should have regard to UK GN2.

Note: Para 1.5 of UKGN 2 advises that where DRC is used for valuations in the public sector, there may be specific requirements within the rules governing these valuations that amend specific parts of the UKGN 2 guidance, and that such requirements take precedence over UKGN 2; use of the instant building approach in the public sector is one such example.

4.4 Specialised property is defined in UKGN 2 as:

‘a property that is rarely, if ever, sold in the market, except by way of a sale of the business or entity of which it is part, due to the uniqueness arising from its specialised nature and design, its configuration, size, location, or otherwise.’

4.5 Para 2.3 informs the valuer that “DRC is a form of cost approach that is defined in the Glossary as:

*“The current cost of replacing an asset with its modern equivalent asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.”*

4.6 DRC is a method of last resort. It is only used where there is no active market for the asset being valued; that is where there is no useful or relevant evidence of recent sales transactions due to the specialised nature of the asset. It does not follow that where DRC has been the valuation method in the past, it automatically remains appropriate to use DRC for the latest valuation, since there might be sufficient evidence of an emerging market.

4.7 The broad stages of assessment in the DRC method are:

1) assessment of the estimated replacement cost (ERC) or gross replacement cost (GRC) of the building on an element basis.

2) assessment of the physical and functional obsolescence adjustments to be applied to align the modern equivalent asset (MEA) with the actual asset and arrive at the net replacement cost (NRC) or depreciated replacement cost (DRC) of the building.

3) assessment of the value of the site (EUV)

4.8 The DRC approach is based on the economic theory of substitution. It involves comparing the actual asset being valued with another, that being a hypothetical substitute, described in International Valuation Standards Guidance Note 8 as the Modern Equivalent Asset.

4.9 The value of the property will normally be based on the cost of a modern equivalent asset that has the same service potential as the existing asset and then adjusted to take account of obsolescence.

4.10 The aim is to arrive at the Current Value of the actual specialised asset - what a hypothetical buyer would pay for it. The underlying theory is that the potential buyer would not be willing to pay any more to acquire the asset being valued than the cost of acquiring an equivalent new one. Once the cost of an equivalent new one (the GRC) is established, adjustments have to be made to that cost to arrive at the price

that the buyer would pay for the actual existing asset; i.e. **to reflect the differences between the modern equivalent asset and the actual asset.**

- 4.11 This reflects the fundamental principle that what is being valued remains not some aspirational perfect replacement asset but the actual asset (i.e. the valuer is not attempting to arrive at an end figure which represents the Current Value of the modern replacement asset which the client aspires to hold).

## 5. Existing Use Value – Social Housing

- 5.1 The Red Book provides the valuer with the following explanation and definition:

Valuations of social housing for the *financial statements* of registered social housing providers shall be on the basis of either:

(a) existing use value for social housing (EUV-SH) (for housing stock held for social housing) or

(b) *market value* (for housing stock that is surplus)

- 5.2 Definition:

**“Existing Use Value for Social Housing (EUV-SH) is the estimated amount for which a property should exchange, on the *valuation date*, between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion, subject to the following *special assumptions* that the property will continue to be let by a body pursuant to delivery of a service for the existing use:**

- **at the *valuation date*, any regulatory body, in applying its criteria for approval, would not unreasonably fetter the vendor’s ability to dispose of the property to organisations intending to manage their housing stock in accordance with that regulatory body’s requirements;**
- **properties temporarily vacant pending re-letting should be valued, if there is a letting demand, on the basis that the prospective purchaser intends to re-let them, rather than with vacant possession and**
- **any subsequent sale would be subject to all of the above *special assumptions*.”**

## 6. Fair Value Hierarchy and Level of Inputs

- 6.1 For those classes of assets where Fair Value is used, IFRS 13 requires the valuer to make certain additional disclosures regarding both the valuation technique applied and the ‘**Level of Inputs**’ used in terms of what is known as the ‘**fair value hierarchy**’. In respect of valuation techniques used to arrive at fair value, the three widely used techniques are the market approach, the cost approach and the income approach.

- 6.2 IFRS 13 paras 76 to 90 prescribe a fair value hierarchy consisting of three levels used to describe the nature of the inputs to the valuation technique used to measure the fair value. These are:

**Level 1 Inputs** – quoted prices (unadjusted) in active markets for identical assets that the authority can access at the measurement date

**Level 2 Inputs** – inputs that are observable for the asset, either directly or indirectly, other than the quoted prices for identical assets captured at Level 1 above

**Level 3 Inputs** – unobservable inputs for the asset.

- 6.3 For those property assets which require to be valued to Fair Value (i.e. market value), whichever valuation technique is used (market, cost or income) **it is considered that the inputs used will usually constitute a Level 2 Input.**
- 6.4 It is considered that the valuation technique applied in respect of Fair Value figures will usually be the **market approach**. The market approach is described at paragraphs B5 to B7 of IFRS 13; it uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets.
- 6.5 It is also considered that the inputs to this technique will usually constitute **Level 2 inputs**. Level 2 inputs are inputs that are observable for the asset, either directly or indirectly. The inputs used took the form of analysed and weighted market evidence such as sales, rentals and yields in respect of comparable properties in the same or similar locations at or around the valuation date.

## Appendix 2 - Sample Beacon Record Sheet

<b>Local Authority</b>	Anywhere MBC		
<b>Council Reference</b>	123456		
<b>Property Address</b>	10 First Street Anytown		
<b>Post Code</b>	AB1 123		
<b>Use</b>	General Needs Housing		
<b>Age</b>	<b>Type</b>	<b>No. of Storeys</b>	<b>Floor No.</b>
1920's	HS - Semi-detached House	2	
<b>Construction</b>	Brick and render/tile. UPVC double glazed windows		
<b>Accommodation</b>			
<b>Kitchen</b>	<b>Reception</b>	<b>Bedrooms</b>	<b>Kitchen /Diner</b>
1	1	3	
			<b>Bathrooms</b>
			1
			<b>Cloaks /WC's</b>
			<b>Other</b>
			See Notes
			2
<b>Floor Area</b>	<b>Type of Measurement</b>		
92	GEA - Gross External sq m		
<b>Parking</b>	NP - No Parking		
<b>Valuation Date</b>	01 April 2016		
<b>Beacon Value (Vacant Possession)</b>	£105,000		
<b>Date of Inspection</b>	<b>Inspected By</b>		
03 February 2016	John Smith MRICS		



<b>Asset Group</b>	2	Pre-1945 Semi-Detached Houses
<b>Archetype Group</b>	28	
<b>No. Within Archetype</b>	22	

#### Comparables

Comparable A, sold November 2015 for £79,500. 3 bed semi. Comparable B, sold December 2015 for £99,312. 3 bed semi, car space. Comparable C, sold August 2016 for £121,000. 3 bed semi. Comparable D, sold January 2016 for £130,500, 3 bed semi. Comparable E, sold January 2016 for £125,000. 3 bed semi.

#### Adjustment of Comparables for beacon Valuation

Comparables A and B, adjust upwards for location. Comparable C, D and E adjust downwards for age, construction and condition.

#### Quality Indicators

<b>Comparables</b>	<b>Condition of Beacon</b>	<b>Quality of Locality</b>
Good	Good	Good

#### Variation Across the Archetype

(From £95,000 to £125,000)

Variant	Amount Variation	Percentage Variation	Variance	Value
2 Bed	£-10,000		£-10,000	£95,000
4 Bed	£20,000		£20,000	£125,000
3 Bed Village A	£5,000		£5,000	£110,000
3 Bed Village B	£5,000		£5,000	£110,000
3 Bed Village C	£5,000		£5,000	£110,000
3 Bed Village D	£15,000		£15,000	£120,000

#### Notes

Gas central heating. UPVC double glazed windows. Front, rear and side gardens. External doors and remainder upvc 2008. New kitchen/bathroom units 2009.

Property Types	Number	Value of Beacon or Variant Property	Vacant Possession Value of Group	%	EUV – SH
Beacon	7	£105,000	£735,000	41	£301,350
2 Bed	7	£95,000	£665,000	41	£272,650
4 Bed	2	£125,000	£250,000	41	£102,500
3 Bed Village A	2	£110,000	£220,000	41	£90,200
3 Bed Village B	2	£110,000	£220,000	41	£90,200
3 Bed Village C	1	£110,000	£110,000	41	£45,100
3 Bed Village D	1	£120,000	£120,000	41	£49,200
<b>Totals</b>	<b>22</b>		<b>£2,320,000</b>		<b>£951,200</b>

# Appendix 3 – Existing Standards and Departures from the RICS Valuation - Professional Standards January 2014 and Assumptions and Limitations in the Valuation Report

## 1. Departures from the RICS Valuation – Professional Standards January 2014

### 1.1 Additional Market Value: Valuations for HRA Assets

#### ***Existing Standard***

Where there is a significant difference between the existing use value and *market value* of the same property if it were surplus, the valuer must provide an opinion on both bases and explain the reasons for this in the report. (UKVS 1.4)

(Valuers should note this does not apply to social housing which is covered by the provisions of UKVS 1.12 for EUV-SH.)

When reporting a *valuation* which has been estimated by using *depreciated replacement cost* methodology, the valuer must state in the report:

- (a) the *Market Value* for any readily identifiable alternative use, if higher; or
- (b) if appropriate, a statement that the *Market Value* on cessation of the business would be materially lower.

### 1.2 Land and Buildings in Course of Development - One of Two Bases to be Adopted

#### ***Existing Standard***

Assets in the course of development should be valued to Fair Value (Market Value) of the land and buildings either:

- for the proposed use by the business, provided that planning consent has been granted; or
- in their existing state. RICS Valuation Professional January 2014 UK appendix 2, paragraph 3.18

#### ***Departures***

- HRA properties have been valued subject to the terms of the occupational agreements.

- Existing property in the course of development, subject to conditions set out in Chapter 10 of this Guidance, will be valued assuming the current contract work has been completed.

### ***Reasons for Departures***

- The properties are subject to occupational agreements and this is an essential element of the function of the business. The legal obligations and liabilities under the occupational agreements must be recognised in the valuation.
- To avoid the necessity for local authorities to identify the costs of every refurbishment programme, however small.

## **2. Assumptions and Limitations to be Included in the Report**

### **2.1 Inspections and Investigations - Must be Adequate and Their Limits Made Clear**

#### ***Existing Standard***

Inspection and investigations must always be carried out to the extent necessary to produce a valuation that is professionally adequate for its purpose. RICS Valuation – Professional Standards VPS 2.1

#### ***Agreed Procedure***

An inspection of the beacon property is considered adequate for the valuation of the HRA residential assets.

Inspections and investigations on properties not valued on the beacon approach should have regard to RICS Valuation – Professional Standards VPS 2

#### ***Reasons for Agreed Procedure***

The full inspection of properties additional to the beacon is not necessary because of the similarity of the property types covered by the beacons.

### **2.2 Verification - The Valuer Must Judge the Quality of Information Provided and Necessity for Verification.**

#### ***Standard***

The valuer will obtain information from the inspection and other sources, which may require verification as to accuracy and completeness.

Inspections and investigations must always be carried out to the extent necessary to produce a which is professionally adequate for its purpose. RICS Valuation – Professional Standards VPS 2.1

### ***Agreed Procedure***

The authority will supply all the necessary information for adopting the beacon for valuation. The valuer will verify the information in respect of the beacon property only.

Information necessary for the valuation of assets not valued by the beacon approach will be supplied by the authority. In the absence of information to the contrary, from inspections etc., the valuer will rely on the information provided.

The report must specify the sources, responsibility for and nature of the information relied upon and whether the valuation has been carried out without the definitive information normally available when carrying out the valuation. RICS Valuation - Professional Standards, VPS 3

### ***Reasons for Procedure***

It is assumed that the information provided by the authority is of sufficient veracity for the purposes of the valuation.

## **2.3 Contamination / Radon / Mining Subsidence Reports**

### ***Existing Standard***

For valuations to Existing Use Value (EUV) it may be appropriate to ignore the costs of decontamination of a site known to be contaminated where the continued occupation of the buildings for existing use is not prejudiced and there is no current duty to remedy such pollution during the continued occupation. (See commentary in RICS Valuation - Professional Standards UKVS 1.3.5).

Other environmental issues usually have regard to the needs of the client, the history of the specific site and the location in general. The valuer should inform the client of any issues that arise and may have a material effect on the valuation.

If contamination is suspected, or other environmental matters have to be considered, valuers are recommended to inform the client if they believe that it could have a significant impact on the valuation and agree the assumption that should be made in completing the valuation and included in the report. RICS Valuation – Professional Standards VPS 3.7 (i)

### ***Agreed Procedures for all Environmental Issues***

A standard approach should be adopted to cover all these environmental issues. Unless the authority have provided reports covering mining subsidence, contaminated sites, and areas of radon risk the properties should be assumed to be not so affected and the final report worded accordingly. This approach is appropriate if the valuer, having carried out the valuation exercise has no evidence to the contrary, either historical or current that the assets are so affected.

Where the valuer has reason to suspect properties are located in areas so affected, a note to this effect should be included in the report with a recommendation to the authority to obtain the necessary specialist advice.

Valuations based on comparable sales where the same factors arise will reflect, to the extent the market would do so, the known risks associated with any of these issues. This should be noted in the final report.

Where the valuations are based on comparable evidence not so affected by these environmental issues, a note in the report should indicate that no adjustments have been made to the valuations for any potential costs of remediation.

# Appendix 4 - Adjustment Factors and Technical Details

## 4.1 Definition of EUV-SH

4.1.1 EUV-SH is to be used for inclusion in Financial Statements for housing stock held for social housing. UKPS 1.12 defines EUV-SH as

**“Existing Use Value for Social Housing (EUV-SH) is the estimated amount for which a property should exchange, on the *valuation date*, between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion, subject to the following *special assumptions* that the property will continue to be let by a body pursuant to delivery of a service for the existing use:**

- **at the *valuation date*, any regulatory body, in applying its criteria for approval, would not unreasonably fetter the vendor’s ability to dispose of the property to organisations intending to manage their housing stock in accordance with that regulatory body’s requirements;**
- **properties temporarily vacant pending re-letting should be valued, if there is a letting demand, on the basis that the prospective purchaser intends to re-let them, rather than with vacant possession; and**
- **any subsequent sale would be subject to all of the above *special assumptions*.”**

4.1.2 In the case of local authority’s housing, service for the existing use means the delivery of appropriate housing to those who are unable to obtain suitable housing through the wider housing market.

4.1.3 This value can be obtained by taking the cost of buying a vacant dwelling of a similar type, and applying an adjustment factor according to the type of tenancy and regional factors to reflect the fact that the property is used as social housing.

4.1.4 The adjustment factors have been reviewed and updated from the 2010 guidance and reflect the variable strength/weakness of the private rental market regionally, changes in yields and continued rent restructuring in the public sector.

## 4.2 What is the Adjustment Factor?

4.2.1 Valuers arrive at a Market Value for a council’s total housing stock based on Beacon valuations of individual representative properties. The Market Value is then adjusted to reflect the fact that the property is socially rented (i.e. reflecting such factors as, let at less than Market Rent, and security of tenure for the tenant).

4.2.2 This figure is referred to as EUV–SH for resource accounting purposes.

4.2.3 The Valuation Office Agency (VOA) undertakes research into rents and yields in both the private and public sector.

4.2.4 Average net rents per annum are analysed for the private and social rented sectors and capitalised to a Market Value figure using an appropriate yield reflecting the various investment risks of both sectors. The Adjustment Factor, expressed as a percentage, is the resulting correlation between the Market Value figures, for example.

A. Private Sector rent £5316pa x yield of 4.5% = £118,133

B. Local authority rent £3528pa x yield of 7.5% = £47,040

B Divided by A = 39.82%

**Check** - £118,133 (Market Value) x 39.82% = £47,040 (EUV –SH)

## 4.3 Rent and Yield Background

4.3.1 As explained, the revised adjustment factors are based on the ratio of private and public sector rents and yields. The rationale behind the rental levels, yield rates and resultant adjustment factors are explained below. **It is therefore important for the valuer to understand that the adjustment factor is a derived percentage, applied to the market value to obtain an adjusted Existing Use Value, but it does not represent the difference between EUV-SH and Market Value.**

4.3.2 Rental levels were established on a regional basis using a variety of sources including: Guide to Local Rents - Cambridge Centre for Housing and Planning Research, HM Rent Service and Local Housing Allowance Direct (now part of the VOA), RICS and private sector market research. Average net rents have been adopted; these were available for one, two, three and four bedroom properties for each of the regions in both the public and private sector.

4.3.3 Information on yields has been derived from the RICS, Building Society, Chartered Surveyor firm publications, and government publications. Research and consultation was also undertaken with professional bodies including RICS and the Association of Chief Estates Surveyors (ACES).

4.3.4 The 2010 adjustment factor percentages were derived from comparison analysis of a nationally uniform net yield of 4.75%. That yield was adopted for the private sector analysis for all regions. At the time the guidance made clear that there was insufficient research available to support any material regional variations in private yields.

4.3.5 As a result of this updating exercise evidence is now available that shows some regional variation in the private yield. The new adjustment factors are based on a yield of 4.5% for London, 4.6% for the South East and 4.75% for the rest of England.

4.3.6 It should also be noted that there may be sub regional variations, particularly in London, however when the evidence was taken 'as a whole' the impact on regional yields was minimal. Valuers should have regard to the advice contained within paragraphs 3.4.7 to 3.4.11 of this Guidance if they feel it is justifiable to depart from the published adjustment factors.

- 4.3.7 In respect of socially rented yields, it is widely accepted that when compared to the private sector there would be a significant difference to reflect the additional risk and liabilities of this type of investment however these investments do not come to the market often, consequently there is insufficient market evidence alone on these yields. Additional consultation with professional bodies (RICS and ACES) has also been taken into account and as a result, the difference of 3% between the private sector yield and the public sector yield has reduced marginally. In London the revised yield is 6%, and in the rest of England 7.5%.
- 4.3.8 If valuers have sufficient local evidence that indicates different figures they are again directed to paragraphs 3.4.7 to 3.4.11 of this Guidance if they believe that in their particular local authority's area there should be a departure from the published adjustment factor.

## 4.4 Deriving the Adjustment Factor

- 4.4.1 Based on the above information the rental values were capitalised using the resultant yields on a regional basis for each dwelling type. The resulting ratios for each region were averaged with appropriate weighting given to the proportion of types of property in both the public and private sector.
- 4.4.2 A greater regard was had to the ratio generated by the dwelling type which had the most evidence. For example in Yorkshire and Humber 43.5% of private rents evidence was from two bed properties, and 9.6% from 4 bed properties.
- 4.4.3 The resultant 'adjustment factors' are as detailed in the attached table.

<b>Adjustment Factors for England</b>	
<b>Region</b>	<b>Adjustment Factor</b>
North East	44%
North West and Merseyside	40%
Yorkshire and the Humber	41%
East Midlands	42%
West Midlands	40%
Eastern	38%
London	25%
South East	33%
South West	35%

## 4.5 Material Changes to the Adjustment Factors for valuations from April 2016

- 4.5.1 There is a material change in adjustment factors from 2010 and this is mainly due to the difference in the yields outlined above.
- 4.5.2 Results typically show an increase in the adjustment factor from 2010 levels. This will result in an increase in the EUV-SH value for the majority of local authorities.
- 4.5.3 The adjustment factor is applied directly to the vacant possession value of the housing stock to arrive at EUV-SH.
- 4.5.4 For example, based on the adjustment factors in the table, the following calculations would be appropriate for housing stock in West Yorkshire:

Property Type	Number	Value of Beacon or Variant Property	Vacant Possession Value of Group	%	EUV – SH
Beacon (3 Bed)	30	£110,000	£3,300,000	41	£1,353,000
2 Bed Variant	26	£100,000	£2,600,000	41	£1,066,000
4 Bed Variant	12	£125,000	£1,500,000	41	£615,000
<b>Totals</b>	<b>68</b>		<b>£7,400,000</b>		<b>£3,034,000</b>

# Appendix 5 - Lease Classification Proforma (IAS17 Qualitative and Quantitative Tests)

## INTERNATIONAL ACCOUNTING STANDARDS IAS17 LEASE ASSESSMENTS

### QUALITATIVE ASSESSMENT QUESTIONNAIRE

**PROPERTY ADDRESS:**

**PROPERTY REFERENCE NUMBER:**

**LEASE / DOCUMENT REFERENCE NUMBER AND DATE:**

IAS 17 looks at the substance of the transaction rather than the legal form and relies on the "substantially all the risks and rewards" test. If any of the following questions - is answered in the affirmative, this is indicative of a finance lease, but note that no one question is conclusive.

The following questions, if answered in the affirmative, might be suggestive of finance lease attributes:

**Qualitative Criteria:** (If the answer to a question is not a clear "yes" or "no", please provide additional information)

	Primary Question	(Yes/No)?	Additional Information	Lease Clause / Deed Reference
1	Does the lease transfer ownership of the asset to the lessee by end of the lease term? [IAS 17/10(a)]			Clause / Ref. Number:  Comments:
2	Does the lease give the lessee the option to purchase the asset at less than open market value at the time of the sale? [17/10(b)]			Clause / Ref. Number:  Comments
3	Is the lease term for the			Clause / Ref. Number:

	major part of the asset's economic life even if title is not transferred? [17/10 (c)]			Comments
4	Is the present value of the minimum lease payments at least equal to substantially all of the value of the leased asset? IAS17/10 (d).			
5	Are the buildings of such a specialised nature that only the lessee can use them without major modification? [17/10(e)]			Clause / Ref. Number:  Comments
6	On early cancellation of the lease does the lessee have to bear the lessor's losses, as predetermined in the lease terms? [17/11(a)]			Clause / Ref. Number:  Comments
	<b>Primary Question</b>	<b>(Yes/No)?</b>	<b>Additional Information</b>	<b>Lease Clause / Deed Reference</b>
7	Does the lease contain terms that result in the gains or losses from fluctuations in the residual value of the asset accruing to the lessee? [17/11(b)]			Clause / Ref. Number:  Comments
8	Under the lease does the lessee have the facility to continue the lease for a secondary period at a rent substantially lower than market rent? [17/11(c)]			Clause / Ref. Number:  Comments
9	Are the lease payments based on a system which does not provide for significant contingent rent variations during the term by reference to the open market?			Clause / Ref. Number:  Comments
10	Does the lease contain a payment structure derived from specific interest rates or rates of return which would be required by a lender?			Clause / Ref. Number:  Comments

**ONLY NECESSARY TO CONTINUE IF ANSWERS ABOVE ARE  
INCONCLUSIVE**

	<b>Additional Questions</b>	<b>(Yes/ No)?</b>	<b>Additional Information</b>	<b>Lease Clause / Deed Reference</b>
11	Was there, at inception, a reasonable expectation that the building could have some useful remaining economic life?			Clause / Ref. Number:  Comments
12	Does the lease provide for significant contingent rent variations during the term by reference to an open market or turnover?			Clause / Ref. Number:  Comments
13	Were the initial passing rent and other aspects of the lease set at prevailing market rates / terms?			Clause / Ref. Number:  Comments
14	Is the lease free of contractual terms which might oblige the lessor to continue the lease at substantially less than normal market terms			Clause / Ref. Number:  Comments
15	If the lessee wishes to sublet or sell (or assign) their lease rights, are there terms in the lease that allow the lessor to control the key terms or the sublet / sale?			Clause / Ref. Number:  Comments

**CONCLUSIONS AND RATIONALE:**

**DATE OF QUALITATIVE ASSESSMENT:**

**Name**

**Date**

# INTERNATIONAL ACCOUNTING STANDARDS

## IAS17 LEASE ASSESSMENTS

### QUANTITATIVE ASSESSMENT QUESTIONNAIRE

The following information, **as at the date of lease inception**, may be required to assist with calculating the minimum lease payments:

	<b>Information required:</b>	<b>Response</b>	<b>Comments / source of data</b>
1	Construction date		
2	Cost of construction		
3	Original life of building (consider effect of subsequent refurbishments / improvements)		
4	Life of building at lease inception		
5	Improvements carried out since inception		
6	Start date of lease / inception date		
7	Length of lease / lease end date		
	<b>Information required:</b>	<b>Response</b>	<b>Comments / source of data</b>
8	Description / demise (e.g. does the lease cover all or part of the property)?		
9	Building area		
10	Any capital payments / receipts		
11	Has the lease been purchased outright?		
	<i>a) Amount paid</i>		
	<i>b) Date amount paid</i>		
	<i>c) Period purchased</i>		

	<i>d) Is a peppercorn rent being paid, if so, please provide details?</i>		
12	Site area		
13	Lease Rent and review basis:		
	<i>a) Initial rent / stepped rents</i>		
	<i>b) Estimated rental value (ERV)</i>		
	<i>c) Rent review basis</i>		
	<i>d) Rent review period</i>		
	<b>Information required:</b>	<b>Response</b>	<b>Comments / source of data</b>
	<i>e) Break clauses?</i>		
	<i>f) Renewal rights?</i>		
	<i>g) Full repairing and insuring (FRI) lease?</i>		
	<i>h) Alienation</i>		
	<i>i) Permitted user</i>		
14	Rate of return		
15	Freehold land value		
16	Any non-standard clauses; e.g. loan for construction repaid as additional rent?		
17	Did the lessee to enter into or renew a lease receive a lease incentive? Examples are a rent-free period, an up-front payment, or pre-existing lease commitment of the lessee. If so, what was the nature and amount of the lease incentive?		

**CONCLUSIONS AND RATIONALE:**

**DATE OF QUANTITATIVE ASSESSMENT**

**Name :**

**Date:**

## QUANTITATIVE ASSESSMENT: EXAMPLE CALCULATIONS

UPRN / Property Code Number:

### PROPERTY ADDRESS

<b>Valuation Date (lease inception)</b>	<b>01/01/2000</b>	
Construction date	<b>01/01/1990</b>	
Original life of building	<b>60</b>	years
Life of building at lease inception	<b>50</b>	years
Length of lease	<b>25</b>	years
Building NIA	<b>1,000</b>	sq.m
Site area	<b>0.1</b>	hectares
Lease Rent	<b>£100,000</b>	p.a
Rate of return	<b>7.00%</b>	
Residual Value	<b>£263,213</b>	

### 1 ASSESS THE FREEHOLD VALUE

#### Valuation of freehold interest

Initial lease rent	£100,000
YP in perpetuity, S.Rate	14.2857
Fair Value	<u>£1,428,571</u>

### 2 APPORTION FREEHOLD VALUE BETWEEN VALUE WITHIN LEASE AND RESIDUAL

#### (Deduct land or buildings value)

Fair Value	£1,428,571
less residual value	<u>£263,213</u>
<b>Fair Value within Lease</b>	<b><u>£1,165,358</u></b>

### 3 APPORTION FREEHOLD VALUE BETWEEN LAND AND BUILDINGS

Fair Value	£1,428,571	
Replacement cost of building (depreciated) at lease inception	£1,000,000	<b>70%</b>
Land Element	£428,571	<b>30%</b> <b>£4,286,000</b>

### 4 APPORTION BUILDINGS VALUE BETWEEN VALUE WITHIN LEASE AND RESIDUAL

Fair Value Buildings at lease inception	£1,000,000	0.7
less PV of buildings residual value	£145,463	
<b>Buildings value within lease</b>	<b>£854,537</b>	

### 5 APPORTION THE VALUES UNDER THE LEASE

Fair Value within Lease	£1,165,358	
less Buildings value within lease	£854,537	0.73328
<b>land element within lease</b>	<b>£310,821</b>	0.26672

### 6 APPORTION MINIMUM LEASE PAYMENTS BETWEEN LAND AND BUILDINGS

apportioned as in 5 above	£100,000	
Buildings element	£73,328	
Land element	£26,672	£100,000

### 7 CALCULATE INTEREST RATE IMPLICIT IN THE LEASE

Freehold value	£1,428,571
Residual Value	£263,213
Minimum lease payments	£100,000
Implicit interest rate	8.581051722 %

# Appendix 6 – Componentisation – Description of Components relevant guidance

- 6.1 For information to assist valuers the following is a list of relevant source guidance together with 26 separate elements taken from the Building Cost Information Service (BCIS). The list is only for information purposes and it is for the responsible Finance Officer of the local authority to determine appropriate accounting policies, de-minimus levels, etc.

It is the role of the auditor to establish whether those policies are appropriate and do not result in material misstatements in the financial statements.

## 6.2 Relevant Guidance on Componentisation

- RICS Red Book UK Appendix 5, Section 7
- CIPFA's LAAP Bulletin 86 (issued June 2010)
- **CIPFA's LAAP Bulletin 86 Update (issued February 2015)**
- CIPFA Code of Practice Chapter 4
- IAS 16, paras 43 to 62
- RICS Red Book UK Appendix 4 (Accounting for depreciation & associated apportionments under UKGAPP)
- IVS 300 and 310

## 6.3 Definition of Elements Based on BCIS Analyses

### 1. Substructure:

All work below underside of the screed or, where a screed does not exist, underside of the lowest floor finish including damp proof membrane. Where floor construction does not provide a continuous platform, the flooring surface is included, e.g. floorboards on joists. Excavations and foundations including piling, ground beams, reinforced slabs, sleeper walls and joists.

### 2. Frame:

Loadbearing framework of concrete, steel or timber. Main floor and roof beams, ties and roof trusses of framed buildings. Casings to stanchions and beams for structural and protective purposes.

### 3. Upper Floors:

Upper floors, continuous access floors, balconies and structural screeds including suspended floors over or in basements.

### 4. Roof:

Structure including coverings, eaves and verges plates and ceiling joists, gable ends, internal walls and chimneys above plate level, parapet walls and balustrades. Drainage including gutters, rainwater heads and outlets (except downpipes; included in disposal installation). Roof lights, including opening gear, frame kerbs and glazing. Pavement lights.

## **5. Stairs:**

Structure including ramps, stairs and landings other than at floor levels. Escape staircases. Finishes to treads, risers, landings, other than at floor levels, ramp surfaces, strings and soffits. balustrades and handrails to stairs, landings and stairwells.

## **6. External Walls:**

External enclosing walls including basement walls (excluding items in Roof Structure). Chimneys forming part of external walls up to plate level. Curtain walling, sheeting rails and cladding. Vertical tanking. Insulation. Applied external finishes.

## **7. Windows and External Doors:**

Includes frames, linings and trims. Shop fronts, fanlights and sidelights. Ironmongery. Lintels, sills, thresholds, associated cavity damp proof courses and work to reveals of openings.

## **8. Internal Walls and Partitions:**

Includes insulation, chimneys forming part of internal walls up to plate level, screens, borrowed lights and glazing. Movable space-dividing partitions. Internal balustrades (except those included with Stairs). WC cubicles.

## **9. Internal Doors:**

Includes sliding and folding doors, frames, linings and trims. Hatches, fanlights and sidelights. Ironmongery. Lintels, thresholds and work to reveals of openings.

## **10. Wall Finishes:**

Preparatory work and finishes to surfaces of walls internally. Picture, dado and similar rails. Self finished surfaces on wall insulation. (Other self finished surfaces are included elsewhere with their base).

## **11. Floor Finishes:**

Preparatory work, screeds, skirtings and finishes to floor surfaces. (Excludes items included with Stairs and structural screeds included with Upper Floors).

## **12. Ceiling Finishes:**

Preparatory work and finishes to surfaces of soffits (except items included with Stairs) but including sides and soffits of beams not forming part of a wall surface. Suspended ceiling construction and finishes.

### **13. Fittings:**

Equipment items usually supplied and fixed under a main contract by a general building contractor including shelving, cupboards, wardrobes, benching, counters etc., curtain track, pelmets and blind boxes.

### **14. Sanitary Appliances:**

Baths, basins, sinks etc.; toilet roll holders, towel rails etc.; traps, waste fittings, overflows and taps.

### **15. Services Equipment:**

Kitchen, laundry, hospital and dental equipment and other specialist mechanical and electrical equipment related to the function of the building. (Local incinerators are included with Disposal Installation).

### **16. Disposal Installation:**

Internal drainage including waste, soil, anti-siphonage and ventilation pipes. Rainwater downpipes. Floor channels and gratings. Ground drains in buildings up to the external face of external walls. Refuse disposal including ducts, waste disposal units, chutes and bins. Local incinerators and flues thereto. Paper shredders.

### **17. Water Installation:**

Mains supply from the external face of external walls including valves, meters and rising mains. Cold water service including storage tanks (header tanks and heating pipework are included with Heat Source), distribution pipework to sanitary appliances and to service equipment. Hot or mixed water services including storage cylinders, pumps, calorifiers, instantaneous water heaters, distribution pipework to sanitary appliances and services equipment. Steam and condensate pipework (except to Heat Source and to Space Heating) to and from services equipment within the building. Insulation to pipework etc. in this element.

### **18. Heat Source:**

Boilers, mounting, firing equipment, pressuring equipment, instrumentation and control, ID and FD fans, gentries, flues (except where an integral part of the structure), water supplies and tanks, fuel conveyors, oil and gas supplies, storage tanks etc., water or steam mains pipework, pumps, valves and other equipment (local heating is included with Space Heating).

### **19. Space Heating and Air Treatment:**

Water or steam heat emission units e.g. radiators and pipe coils, control and distribution pipework from the heat source. Ductwork, fans and controls for ducted warm air. Cable and off-peak electric heating system including storage radiators. Local gas, electric or other heaters including fireplaces, except flues. Heating with ventilation or cooling includes all equipment and pipework from the heat source.

### **20. Ventilating Systems:**

Mechanical ventilating systems, not incorporating heating or cooling installations, including dust and fume extracting and fresh air injection. Unit extract fans, rotating ventilators and instrumentation and controls.

## **21. Electrical Installation:**

All work from the external face of the building including distribution boards, main switchgear and power correction. Power supplies to other engineering services and special installations. Standby equipment and earthing. Lighting fittings.

## **22. Gas Installations:**

Town and natural gas services from meter or, in the absence of a meter, from point of entry. Distribution pipework to appliances and equipment.

## **23. Lift and Conveyor Installations:**

Lifts and hoists including gantries, trolleys, blocks, hooks and ropes. Downshop leads, pendant controls and electrical work from and including the isolator (structural work included elsewhere). Escalators and conveyors.

## **24. Protective Installations:**

Sprinkler installations and CO<sub>2</sub> extinguishing systems including tanks, controls etc. Fire fighting installations including hose reels, foam outlets, dry risers, and wet risers solely for fire fighting. Lightning protection and earthing.

## **25. Communications Installations:**

Fire, burglar and security alarm installations. Door, timed and call signal installations. Clocks, telephones, public address, radio, television and pneumatic message system installations.

## **26. Special Installations:**

All other separately identifiable mechanical or electrical installations not included elsewhere, e.g. chemical gases, medical gases, vacuum cleaning, window cleaning equipment and cradles, compressed air, treated water, refrigerated stores and associated plant (except plant required for Space Heating).