



# Stock Valuation for Resource Accounting

## **Guidance for valuers - 2010**



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DVS  
Valuation Office Agency

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Department for Communities and Local Government

Department for Communities and Local Government  
Eland House  
Bressenden Place  
London  
SW1E 5DU  
Telephone: 030 3444 0000  
Website: [www.communities.gov.uk](http://www.communities.gov.uk)

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## Executive Summary

- This guidance updates the guidance published in 2005 to valuers of local authority property assets on the bases and methods of valuation for Housing Revenue Account assets for resource accounting. The guidance is appropriate for all Housing Revenue Account valuations from April 2010 and until further guidance is issued, following detailed review of the Major Repairs Allowance and updated guidance on the implementation of the requirements of International Financial Reporting Standards.
- It is intended that this guidance will be reviewed annually to take account of further amendments to International Financial Reporting Standards and their application in the public sector.
- There have been significant changes to both accounting and valuation standards and guidance since 2005. In summary, Financial Reporting Standards issued by the Accounting Standards Board have been replaced by International Financial Reporting Standards. The Value to the Business Model has been replaced by the Fair Value / Cost Model, definitions of Finance / Operating Leases have changed significantly, depreciation methodology / Major Repairs Allowance / componentisation is under consideration and the definition of Fair Value is also under consideration.
- This has resulted in new Valuation Guidance, interpretation and procedures. In addition, UK Valuation Standards (RICS Red Book) have started to merge with International Valuation Standards in terms of basis of valuation and definitions.
- It should also be noted that the Capital Charge is no longer appropriate in Local Authority Accounts.
- It has become apparent that valuers have been called upon to advise on a number of areas of concern (particularly componentisation and lease classification) that are really issues for the finance officer, not the valuer. CIPFA / RICS therefore issued a valuation information alert, Valuations for Capital Accounting (December 2009), to reduce the amount of concern that was becoming increasingly apparent within local authorities.
- The principles behind the valuation methodology remain the same as in the original guidance but an important change is the treatment of leasehold interests (finance leases which now also includes PFI and similar contracts) which are now valued to Fair Value of the underlying freehold interest, ignoring any leases or other occupational agreements.
- The adjustment factors have also been revised to take account of the significant changes in the residential housing market over the last five years. These will now be reviewed annually.
- Other changes are mainly to update valuation terminology and references to Government and other circulars.
- The basis of valuation for the bulk of the housing stock within the Housing Revenue Account is Existing Use Value for Social Housing (EUV-SH) as defined by the Royal

Institution of Chartered Surveyors Valuation Standards 6<sup>th</sup> Edition. It should be noted that any reference to Existing Use Value is not recognised under International Financial Reporting Standards and therefore the use of Existing Use Value – Social Housing or Fair Value (Existing Use Value assumption) is a departure from International Accounting Standards and should be noted as such in valuation reports where appropriate. This departure is in accordance with current CIPFA and Treasury guidance.

- One method of valuation was prescribed in the 2005 guidance to arrive at EUV-SH, based on the vacant possession value of the properties, adjusted to reflect the occupation by a secure tenant. (The Beacon approach). This updated guidance gives greater consideration of the use of Discounted Cash Flow as an alternative to the Beacon approach.
- The general principles and process to follow when using this method 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 Housing Revenue Account 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 Housing Revenue Account assets.
- Many of the accounting and valuation principles and assumptions are currently under review. Valuers must therefore be certain that they are up to date with current (valuation date) guidance and interpretation.
- Audit requirements are 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
- valuations
- the capital interest charge is no longer in use
- use of the guidance

## 1.1 Introduction

- 1.1.1 Resource accounting aims to show the resources consumed in delivering services. In the case of the Housing Revenue 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 Housing Revenue Account provides a financial framework which is intended to:
- encourage more efficient use of housing assets;
  - increase the transparency within the Housing Revenue Account;
  - assist authorities in planning their housing strategy;
  - bring Housing Revenue Account 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;
  - place an authority's Housing Revenue Account onto a more business-like basis.
- 1.2.2 This guidance seeks to ensure that these objectives continue to be met, post International Financial Reporting Standards.
- 1.2.3 The financial framework for the Housing Revenue Account, 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 Housing Revenue Account accounting process and to ensure consistency of approach, this guidance has been updated by the Department for Communities and Local Government (DCLG).

### 1.3 Capital Charge

- 1.3.1 Since 2006/07 local authorities have not been under a requirement to include a cost of capital charge in service expenditure.
- 1.3.2 Previously accounts included, as part of capital charges, a Capital Financing Charge, often referred to as notional interest and equating to the opportunity cost of capital assets used in the provision of a service.
- 1.3.3 From 2006/07 the Capital Financing Charge has no longer been made.
- 1.3.4 The cost of wear or deterioration of an authority's housing assets continues to be accounted for as a depreciation charge.

### 1.4 Valuation Background

- 1.4.1 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 Housing Revenue Account 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.
- 1.4.2 Part of the accounting framework is the element of subsidy, the Major Repairs Allowance, which represents the cost of maintaining the current condition of the stock. In the view of CIPFA/LASAAC Joint committee the Major Repairs Allowance, based on the annual cost of replacing individual building components as they reach the end of their useful life, is a reasonable estimate of the cost of wearing out (depreciation) of council dwellings – see Chapter 13, Depreciation of Assets.
- 1.4.3 The basis of valuation for accounting purposes will be Fair Value measured by the adoption of the special assumption of Existing Use Value for Social Housing. See Chapter 2 – Bases of Valuation for further details.

### 1.5 Use of the guidance

- 1.5.1 This guidance sets out the approach that authorities should adopt in preparing the Housing Revenue Account 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 16, Revaluations and Valuation Reviews. **For 2010-11, exceptionally, the Department recognises that some authorities may not be able to complete the five-year stock revaluation in time for the end-year accounts. In those circumstances it is recommended that the authority discuss the position with their auditor, but if the timetable cannot be met, an appropriate desk top exercise would be acceptable in 2010-11 with the more comprehensive stock valuation taking place in 2011-12.**

- 1.5.2 The guidance must be adopted for asset valuations for the Housing Revenue Account except in the case of Large Scale Voluntary Transfers of all of a local authority's stock. Where an authority has secured approval to take forward a transfer proposal to a tenant ballot or has secured a positive tenant ballot and is proceeding to complete a whole stock transfer transaction an asset revaluation can be based on a desk exercise review of the previous valuation. A full revaluation would be required if the proposed transfer did not take place as envisaged.
- 1.5.3 The aim of resource accounts in the Housing Revenue Account 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
  - The International Financial Reporting Standards based CIPFA Code of Practice on Local Authority Accounting in the United Kingdom
  - The Royal Institution of Chartered Surveyors (RICS) Valuation Standards 6th Edition in so far as they are consistent with the requirements and objectives of the Department for Communities and Local Government.
- 1.5.4 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.
- 1.5.5 Valuations should be carried out in accordance with the Royal Institution of Chartered Surveyors Valuation Standards except where they are varied by this Guidance to reflect the current policy requirements of DCLG.
- 1.5.6 The need for guidance on valuation methodology within the Housing Revenue Account arises from the various valuation techniques that are available for valuing social housing, and the need for consistency of approach between authorities.

## **1.6 Valuation Approach**

- 1.6.1 The two principal techniques currently used for valuing social housing are Discounted Cash Flow - a cash flow valuation, based on the income generated by the property, and an adjusted vacant possession valuation technique – the Beacon Method, based on the value of the property assuming vacant possession, with an adjustment factor to reflect occupation by a secure tenant.
- 1.6.2 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.
- 1.6.3 The Discounted Cash Flow method is widely implemented by investment surveyors but may be less familiar to the wider profession as a whole.
- 1.6.4 The Beacon method is used for no other purpose except the special circumstances of a Housing Revenue Account 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.

- 1.6.5 The Discounted Cash Flow valuation technique is universally adopted to arrive at Tenanted Market Value for the purposes of Large Scale Voluntary Transfer of housing stock by Local Authorities to Registered Social Landlords, and is the technique most commonly used in situations where the valuer has to arrive at Existing Use Value Social Housing - the specified valuation basis for the valuation of the Housing Revenue Account.
- 1.6.6 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.
- 1.6.7 The Discounted Cash Flow 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 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.
- 1.6.8 Discounted Cash Flow 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.
- 1.6.9 The Beacon method permits the disaggregation of valuation information for business and asset management purposes.
- 1.6.10 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.
- 1.6.11 When applying the Discounted Cash Flow 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.
- 1.6.12 Whilst Beacon values are firmly grounded in market evidence, to arrive at Existing Use Value-Social Housing 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.

- 1.6.13 Local authorities will need to bear in mind, if using the Discounted Cash Flow method, that it is dependent 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.
- 1.6.14 The Net Present Value which is the end product of the Discounted Cash Flow 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 Discounted Cash Flow 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.
- 1.6.15 It is for Local Authorities themselves, drawing on the expertise of their relevant professional advisers, to choose the method of valuation, whether Discounted Cash Flow or the Beacon approach. There may be circumstances where the Discounted Cash Flow method is appropriate. However, DCLG's view is that for the purposes of stock valuation for resource accounting, and for depreciation, the Beacon approach is likely to be more suitable for the purpose.

# Chapter 2 - Bases of Valuation

## Key points

- property classification
- valuation bases

## 2.1 Property Classification

- 2.1.1 Asset valuations are required for all properties held in the Housing Revenue Account. 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 Housing Revenue Account. 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 Housing Revenue Account, the matter should be raised with the Chief Finance Officer.
- 2.1.2 For International Financial Reporting Standards Accountancy purposes properties are required to be classified into one of the following groups :
- a) Property, plant and equipment (IAS 16)
  - b) Leases and lease type arrangements (IAS 17)
  - c) Investment property (IAS 40)
  - d) Assets held for sale / discontinued operations (IFRS 5)
- 2.1.3 Classification of assets is a matter for Directors of Finance who may require the assistance of the valuer.
- 2.1.4 De minimus levels for the Housing Revenue Account 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 basis of valuation under International Financial Reporting Standards is Fair Value and the existing use assumption is not recognised. However, CIPFA has given further guidance on the basis of valuation and this is detailed in Appendix 1.
- 2.2.2 Property, plant and equipment which would be expected to include most residential housing stock assets, shall be measured at Fair Value using the Existing Use Value-Social Housing assumption as defined in UK Practice Statement 1.13.
- 2.2.3 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 Fair 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 UK PS 1.3.

- 2.2.4 These valuation bases represent an entry value which is the cost to an authority, including acquisition costs, of acquiring an asset which will provide the same service potential as the existing property.
- 2.2.5 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. It is considered there will be few, if any, operational properties within the Housing Revenue Account which warrant a depreciated replacement cost approach.
- 2.2.6 Leases and lease type arrangements are accounted for in accordance with IAS 17 – see Chapter 8 Leasehold Housing Property and Chapter 11 PFI Schemes.
- 2.2.7 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.
- 2.2.8 Full definitions of Existing Use Value, Existing Use Value-Social Housing and MV as defined by the Royal Institution of Chartered Surveyors (RICS) Valuation Standards UK Practice Statements (PS) 1.3, 1.13 and PS 3.2 are reproduced in Appendix 1.
- 2.2.9 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 15, Valuation Reports.
- 2.2.10 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 depreciated replacement cost approach and should be carried out in accordance with the RICS Valuation Information Paper (VIP10), The Depreciated Replacement Cost Method of Valuation for Financial Reporting.
- 2.2.11 For completeness, the land and building component of the depreciated replacement cost valuation should be stated separately in the report, together with an assessment of the remaining life.
- 2.2.12 Assets “Held for Sale” 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 “Held for Sale”. The appropriate basis of valuation is Fair Value as represented by Market Value, less costs to sell.

# Chapter 3 - Beacon Approach to the Valuation

## Key points

- beacon principle
- 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 for resource accounting a vacant possession value, adjusted to reflect the continuing occupation by a secure tenant, is one method which could be adopted by authorities for the majority of their dwellings.
- 3.1.2 This approach will ensure that an auditable and consistent method is adopted by every authority in preparing Existing Use Value-Social Housing asset valuations. The method was adopted on the introduction of resource accounting in the Housing Revenue Account in 2000 and will continue to be included as an acceptable method in DCLG guidance.
- 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 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 establish the range of values, if any, from the beacon. 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% or +/- £5,000 of the beacon value, whichever is the greater, 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 20 per cent (i.e. lowest to highest values) or £20,000, whichever is the greater, 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 Valuation Standards 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

- 3.3.1 The accuracy of the beacon valuation together with the choice of beacon is a major factor governing the quality of the overall asset valuation.
- 3.3.2 The beacon valuation should assume that the property is vacant and that the current future use is for residential accommodation with no potential residential redevelopment of the site or intensification of use as a result of possible subdivision 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. Existing Use Value as defined in the RICS Valuation Standards at UKPS 1.3 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**

The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction, after proper marketing wherein the parties had acted knowledgeably, prudently and without compulsion, assuming that the buyer is granted vacant possession of all parts of the property required by the business and disregarding potential alternative uses and any other characteristics of the property that would cause its Market Value to differ from that needed to replace the remaining service potential at least cost.

No account should be taken of a bid by a prospective purchaser with a special interest, in particular a bid by an existing tenant and no account should be taken of any potential residential redevelopment of the site or intensification of use as a result of possible subdivision or extension of the property.

### **3.4 Vacant Possession Adjustment Factor**

- 3.4.1 The beacon value relates to 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 Existing Use Value-Social Housing 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; and where the tenants have additional rights including the Right to Buy, and where the Landlord has additional liabilities including insurance, repair and maintenance and statutory obligations. Therefore it is necessary to adjust the Beacon Value to reach Existing Use Value-Social Housing.
- 3.4.3 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 Existing Use Value-Social Housing.
- 3.4.4 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.

- 3.4.5 Appendix 4 gives details of the regional adjustment factors and the technical workings used to establish the adjustment factors.**
- 3.4.6 Valuers are not obliged to use the regional 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 Existing Use Value-Social Housing for the portfolio as a whole. This may arise where there are circumstances, particular to a local authority area not sufficiently reflected in the regional factor.
- 3.4.7** 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.
- 3.4.8 If the Valuer considers that the adjustment factor does not provide Existing Use Value-Social Housing 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.
- 3.4.9 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.
- 3.4.10** The reasons for departing from the factors provided in this guidance must be clearly stated in the 'beacon portfolio' sheets together with the methodology and sources of evidence adopted for preparing the alternative.

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

- 3.5.1** The Housing Revenue 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, including the beacon valuations should be retained in the suggested format as set out in the following chapter. The production of a beacon portfolio, in which every beacon property will be recorded together with a breakdown of the total valuation into smaller groupings will be a requirement of the valuation brief.

# 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. 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.
- 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 Chapters 8 -12.
- 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;
  - property archetypes - dwellings within an asset group which have a number of uniting 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><i>Key stage</i></b>	<b><i>Action</i></b>	<b><i>Paragraph Ref.</i></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 paragraph 4.4 and 4.11.
- 4.2.7 Open market sales are the best evidence for establishing vacant possession. 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.
- 4.2.8 **Valuers should not rely solely on Right to Buy information** if alternative market values are available.

## 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.
- 4.3.2 The valuer may find it useful to discuss the subdivision of the Housing Revenue Account portfolio into asset groups with the Chief Finance Officer. This will establish whether groupings already exist, for possibly different purposes, but which may be appropriate for this exercise.
- 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 included at the end of this chapter.
- 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;
  - property groupings used for stock condition surveys.
- 4.3.7 The number of asset groups within the Housing Revenue Account 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.
- 4.3.8 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;
- provide stock groupings which may be used for stock condition surveys.

4.3.9 Each asset group will be a collection of property archetypes (refer to fig 2 at end of the chapter).

#### **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". 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.

4.4.2 Set out below are examples of typical archetype groups within a housing estate asset group.

- 2 bedroom terrace.
- 3 bedroom semi-detached.
- Multi storey flats
- Unpopular housing.
- Sheltered houses.
- Lockup garages.
- Vacant property awaiting redevelopment.

4.4.3 These archetypes are not necessarily the same as those for the calculation of the Major Repairs Allowance, where the criterion is the cost of repair as opposed to range in value considerations. However some of the Major Repairs Allowance archetypes may be appropriate for this valuation exercise if the stock falls naturally into those specified types.

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 It is anticipated that range of value across the archetype should not exceed 30% (i.e. lowest to highest values) or £12,000, whichever is the greater, across the group as a whole. If, following a roadside inspection of the archetypes, it appears the value range across the type is in excess of these parameters, sub division of the archetype should be considered.
- 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, 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 paragraph 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 per cent and if this is the case the 'beacon record sheet' (see paragraph 4.7) should be noted with the reason for the range.
- 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 paragraph 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 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.
- 4.5.2 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 per cent in these cases and this fact, together with the reason for it, should be recorded on the beacon record sheet.
- 4.5.3 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 could be treated as variant from the beacon.

- 4.5.4 The range of value across the asset group/archetype for non-estate property may well exceed the 30 per cent or the £12,000 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 below).
- 4.5.5 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.
- 4.5.6 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.
- 4.5.7 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.
- 4.5.8 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.
- 4.5.9 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. Specific valuations may be required for these properties for business planning purposes.

## **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 paragraph 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 Internal inspections may not be necessary where the beacon has already been inspected by the asset valuer within the last three months. This situation may arise if the property has been valued for a Right to Buy application which has not resulted in a sale. If this approach is adopted it is recommended that a roadside inspection is carried out. Valuers must satisfy themselves that no material changes to the property have taken place, such as improvements carried out by the authority during the intervening period.
- 4.6.4 Details of the original inspection should be incorporated onto the beacon record sheet as detailed at 4.7 below.
- 4.6.5 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.
- 4.6.6 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 Standards PS 5.1).
- 4.6.7 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;
  - type: e.g. 1930's semi-detached;

- asset group;
- archetype group and number within the archetype;
- comparable evidence
- adjustments of comparables;
- valuation of beacon;
- percentage variation in value across the archetype.

4.7.3 The following information is not essential but may be useful to the authority:

- quality of comparisons [a scale is recommended to enable information to be analysed];
- quality of property [a scale is recommended to enable information to be analysed];
- quality of neighbourhood [a scale is recommended to enable information to be analysed].

4.7.4 Sample beacon record sheets are 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 of similar property should be regarded as a priority source, and to a lesser degree Right to Buy valuations and determinations. Although these valuations will relate to similar property types, they do not have the veracity of an open market sale and should be given a lesser weight 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 where there is a re-sale market, and make adjustments for the particular estate 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;
  - open market re-sales of similar Right to Buy properties on similar council estates.
- 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;
  - market sales from auctions, cash transactions and investment sales.
- 4.8.11 Details of individual transactions completed after 1st April 2000 are available from the Land Registry.
- 4.8.12 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;
  - 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 be no more than 15 per cent 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 cross 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 though 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 provided on the beacon record sheet showing the adjustment process and why this has been necessary.

#### **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 paragraph 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% or +/-£2,000 whichever is the greater, 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% / £2,000 band should capture the minor differences between properties such as presence / absence of a 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 (paragraph 4.4.4). 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 ;
  - 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 per cent (i.e. lowest to highest values) or £12,000, whichever is the greater across the group. 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 Housing Revenue Account 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 paragraph 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 of the number of variants and their addresses must 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% or +/- £2,000 whichever is the greater, of the beacon value, is the beacon value multiplied by the number of properties in the archetype.
- 4.12.2 Where the valuation approach is to ascribe a value to each individual property the beacon value should be recorded against each property within the archetype.
- 4.12.3 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.
- 4.12.4 Where the valuation approach is to ascribe a value to each individual property the beacon value and the variations should be recorded against each property where appropriate. The value of the archetype is the total of all these valuations.
- 4.12.5 In some cases, it may not be possible to identify the exact number of properties with each variant characteristic. In these cases a judgement will have to be made based on all available information as to how many properties within the archetype exhibit each variation. Once this has been established the same procedure as set above should be adopted.
- 4.12.6 The unit of valuation is the Housing Revenue Account 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.
- 4.12.7 The make up of the archetype valuation should be included on the beacon record sheet as it will form an essential piece of information in any subsequent valuation review. An example is shown on the beacon record sheet at Appendix 2. The adjustment factor as described below should then be applied to the total value of the archetype.

## **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 Existing Use Value-Social Housing. The adjustment factors will be adjusted annually 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 Existing Use Value-Social Housing 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 Existing Use Value-Social Housing 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 Existing Use Value-Social Housing 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 Housing Revenue Account, may require no further adjustment if occupation is not by means of a secure tenancy and the basis of valuation is Existing Use Value. These property types are dealt with in Chapter 9.

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

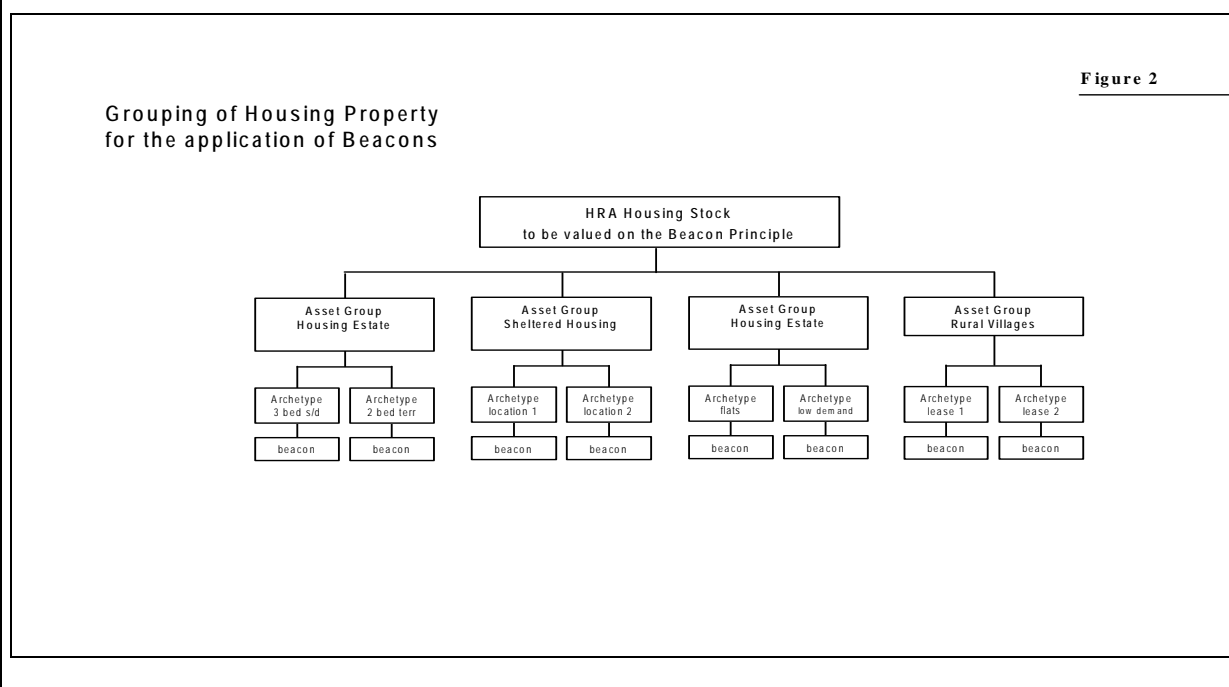
- 4.14.1 The value of each asset group is the total of all the property archetypes contained within the group. The make up of the asset group valuation should be recorded on an asset group schedule, an example of which is included at Appendix 2 and will form part of the beacon portfolio.
- 4.14.2 A summary of all the asset group valuations will form part of the valuation certificate and an example is included at the end of this chapter.
- 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 have 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.



**Figure 2: Grouping of Housing Property for the Application of Beacons**



**Asset Group Valuation Schedule - *operational property***

Name of Asset Group	Stock number	Unadjusted vacant possession value based on beacon values	Existing Use Value- Social Housing	Balance sheet	Note to accounts
Riverside Estate	1,000	£21,893,000	£11,158,000	£11,158,000	£21,893,000
Pinkie Estate	600	£32,972,000	£16,486, 000	£16,486, 000	£32,972,000
Summerston Estate	240	£10,781,000	£5,390,500	£5,390,500	£10,781,000

(see Appendix 2 for archetype groups within Riverside Estate) The valuations above have not been adjusted for directly attributable acquisition costs which are dealt with in Chapter 15.

# 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 part XV1;
  - properties are not a type sold for owner-occupation e.g. bed sit accommodation with shared facilities;
  - 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.
- 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 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.
- 5.2.5 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.
- 5.2.6 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. Where adjustments exceed 15% (Chapter 4 paragraph 4.9.3) the beacon record sheet should be noted accordingly.
- 5.2.7 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.
- 5.2.8 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;
  - 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. These property types should be categorised as non-operational and the correct basis of valuation will be Market Value (see Chapter 12).
- 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 will 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 Existing Use Value-Social Housing 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 would undervalue the asset.

- 5.4.3 It is a matter of valuer 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 Sources of information which may provide a comparison of market rents and affordable rents include the Housing Corporation *Guide to Local Rents Part 1: Cross Tenure Rents*, Rent Officer information and other sources such as local newspapers and local knowledge.
- 5.4.5 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.
- 5.4.6 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 paragraph 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.
- 5.4.7 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 per cent-40 per cent range may provide an unrealistic valuation.
- 5.4.8 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.
- 5.4.9 No adjustment factor is necessary in these situations as the beacon valuation will represent Existing Use Value-Social Housing.

## **5.5 Unpopular Housing Information**

- 5.5.1 To establish Existing Use Value-Social Housing 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;
- 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 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 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 paragraph 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 per cent range set out in Chapter 4 paragraph 4.4.2. The residential investment market is not as sensitive to variations in property type as the owner occupied market. Subject to valuer 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 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 paragraphs 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 would 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 may be so low as to make a sale unrealistic under the terms of Existing Use Value-Social Housing.
- 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 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 would 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, paragraph 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.
- 5.11.3 Sample beacon record sheets covering vacant houses and areas of vacant and let property are included in Appendix 2, beacon record sheets 2, 3 and 4.

## **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;
  - 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. These situations are dealt with in Chapter 8.

# 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 method of valuation produces an Existing Use Value-Social Housing 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 authority housing stock to Registered Social Landlords.
- 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 Discounted Cash Flow valuation to be undertaken for Housing Revenue Account purposes:

### Income

- Rental income flows reflecting Council 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 Right to Buy 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 Housing Revenue Account and this will necessitate close liaison between the valuer and the appropriate Council 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 etc 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, i.e. the Existing Use Value-Social Housing 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 Discounted Cash Flow 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 Existing Use Value-Social Housing of the entire stock.
- 6.4.2 Extensive, full internal inspections of individual Council dwellings, therefore, are not required.
- 6.4.3 If the Discounted Cash Flow 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 Discounted Cash Flow 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 Discounted Cash Flow may or may not be appropriate for these properties depending on the type of property and its' particular characteristics.
- 7.1.3 Under a Discounted Cash Flow 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 which represents the Existing Use Value-Social Housing of the property comprised in the Housing Revenue Account portfolio.
- 7.1.4 Four key stages are:
- assembly of information required from the local authority
  - selection of time period for Discounted Cash Flow valuation
  - analysis of information and estimation of future income flows
  - selection of discount rate

## **7.2 Discounted Cash Flow Valuation Spreadsheets**

- 7.2.1 Where a Discounted Cash Flow approach to valuation is the preferred methodology it will be clear that the valuer is heavily dependent upon Council sources for the detailed information which forms the basis of the Discounted Cash Flow 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 Discounted Cash Flow method will have access to a Discounted Cash Flow spreadsheet of which many models exist. Many such spreadsheets, designed for the Discounted Cash Flow 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 Discounted Cash Flow valuation to be undertaken for Housing Revenue Account 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 three years will be required together with anticipated rental income flows over the period of the Discounted Cash Flow 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 7.3.1 above.

- i. The Discounted Cash Flow calculation will not reflect any intention to create/acquire any new housing stock during the period of the Discounted Cash Flow valuation as the object of the exercise is to arrive at a valuation of the Housing Revenue Account 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 of rents to be charged for Council dwellings.
  - iii. The Government's current declared policy is for convergence to be achieved between Council rents and those charged by Housing Associations so that tenants of both types of social landlord will expect to pay similar rents for similar properties in similar areas.
  - iv. This policy underlies projected increases in Council rents to enable convergence to be achieved by 2015-16.
  - v. At the time of undertaking a Discounted Cash Flow 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 government policy and build into the Discounted Cash Flow formula the consequent anticipated increases in rents in this respect. The Council will need to consider the way forward in the light of the Government's proposals to reform the system of council housing finance and introduce "self-financing". This is expected to be introduced from April 2012 subject to Parliamentary approval.
- 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 – Council's will be able to provide this information.
  - Other Income. As stated in Chapter 6 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 Discounted Cash Flow 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 and expenditure streams etc lends itself to a Discounted Cash Flow 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 Discounted Cash Flow 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 registered social landlords 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 Registered Social Landlords are required to have a 30 year funding strategy in place. Local Authorities and their valuers will also need to consider compatibility with 30 year business plans under self-financing, assuming this is introduced as proposed.

## 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, 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 local authority 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 registered social landlord which has the capacity to raise funding in the private financial markets.
- 7.5.4 The stock is valued to Tenanted Market Value which is, essentially, the same Discounted Cash Flow method of arriving at Existing Use Value-Social Housing for Housing Revenue Account purposes.
- 7.5.5 Such valuations for stock transfer purposes, typically, adopt a discount rate in the range of 6 per cent – 7 per cent and this, together with the purchaser's level of borrowing costs provide a useful guide to the discount rate to be adopted in a Discounted Cash Flow valuation for Housing Revenue Account 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

- IAS17 Lease Assessments
- property leased by the authority
- property leased to the authority

## Key documents are:

- **Code of Practice on Local Authority Accounting** issued by CIPFA / LASAAC 2010/11.
- **International Accounting Standard 17 (IAS 17)**, which details how leases must be accounted for under International Financial Reporting Standards.
- **RICS Valuation Information Paper No. 9 (VIP 9)**, provides useful guidance on land and buildings apportionments for lease classification required under International Financial Reporting Standards. It is written specifically to address issues found in UK leasing practice and markets and in that context provides information on the application of International Valuation Application 1 (IVA 1) Addendum A (which is titled “Further Guidance on Lease Accounting”). VIP 9 (Chapter 3 Definitions) also contains useful definitions and commentary on some of the main accounting terms used in IAS17.
- The International Accounting Standards Board (IASB) new guidance ***Improvements to IFRSs – April 2009***. The land element of leases is not now automatically classified as an operating lease, as was previously the case [IAS17 para. 15 and VIP9 paragraph. 2.2 having been superseded by new IAS 17 paragraphs 15A, 68A & 69A].

## 8.1 Introduction

- 8.1.1 International Financial Reporting Standards introduces fundamental changes to the assumptions to be made when valuing leasehold interests and are mandatory for local and regional authorities with effect from 1 April 2010. Local authorities are required to follow the Code of Practice on Local Authority Accounting issued by CIPFA / LASAAC rather than following International Financial Reporting Standards directly. Currently the Code adopts IAS17 in full.
- 8.1.2 The traditional valuation approach for valuing leasehold interests is usually to value the “profit rent” element for the unexpired term of the lease. However, International Financial Reporting Standards requires the valuation of a finance lease to be of the underlying freehold interest (for operational assets), assuming vacant possession and ignoring any leases or other occupational agreements.
- 8.1.3 Prior to the valuation of the property there are several classifications or categorisations that need to be undertaken in order to determine which of the standards will apply. These assessments should be undertaken by the Authority’s Finance Director but the valuer may be asked to assist in the process. In essence,

this will involve consideration of IFRIC12 Service Concession Arrangements (see Chapter 11) and IAS40 Investment Property (see Chapter 9, paragraphs 9.3.8 & 9.3.9) to determine whether the leases should be treated in accordance with either of these Standards. If not then IAS17 will apply and the leases will need to be assessed as either operating leases or finance leases using the criteria set out in IAS 17. Section 8.2 below explains the process.

- 8.1.4 Clearly where the authority has numerous leases all made on the same terms it should not be necessary to carry out lease assessments for each lease individually and this is something that the Finance Director should agree with the Auditors. In summary these classifications will require the following valuations (the flow chart at the end of this chapter may assist in understanding the lease classification process and options):
- i. Operating leases where the authority is the lessee are “off balance sheet” and do not require a valuation.
  - ii. Operating leases where the authority is the lessor are “on balance sheet” and will require a valuation as (usually) an investment property (provided it meets the criteria set out in IAS 40). ***Note: - in practice it is very unlikely that any Housing Revenue Account properties could be properly classified as investment property.***
  - iii. Finance leases where the authority is the lessee are “on balance sheet” and will require a valuation (Fair Value – Existing Use Value assumptions) of the underlying freehold interest.
  - iv. Finance leases where the authority is the lessor are “on balance sheet” (as a *debtor only and therefore no property valuation is required of the leased asset*). It may be necessary to provide a valuation of the residual interest in the property, if material. (Fair Value – Existing Use Value assumptions)

## 8.2 Summary Provisions of IAS 17

8.2.1 IAS 17 replaces SSAP 21 (UKGAAP).

8.2.2 The main objective of IAS 17 is to ensure that entities account for the substance of any leasing agreement or hire purchase contract involving any asset, including property. It is not written from a purely property perspective and therefore can create difficulties in interpreting and understanding its provisions in a property context.

8.2.3 Note that IAS 17 shall not be applied as the basis of measurement for:

- property held by lessees that is accounted for as investment property (see IAS 40 Investment Property);
- investment property provided by lessors under operating leases (see IAS 40);

8.2.4 There are four main tasks which valuers may become involved with in connection with the asset valuation of a lease. These are:

- Lease classification (required on first occasion of the lease being accounted for under International Financial Reporting Standards)
- Assessment and capitalisation of minimum lease payments under any finance lease (required on first occasion of being accounted for under International Financial Reporting Standards)
- Valuation of any finance lease (required on the occasion of each revaluation)
- Valuation of qualifying tenants' improvements for Authorities as lessee (required on the occasion of each revaluation)

8.2.5 The objective of IAS 17 is to prescribe the appropriate accounting policies to apply in relation to finance and operating leases (i.e. on / off balance sheet and the resulting financial treatment; RICS Valuation Information Paper No.9 [VIP 9] provides a useful and brief summary). A lease is an agreement (*any agreement and not necessarily a lease in the legal sense*) whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time [IAS 17.4]; e.g. hiring agreements, licenses and tenancies will be classified as leases.

8.2.6 IAS 17 applies to all leases other than lease agreements for minerals, oil, natural gas, and similar regenerative resources. It does not apply to property that is accounted for as investment property for which the Fair Value model set out in IAS 40 is used.

8.2.7 A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. All other leases are classified as operating leases. Classification is made at the inception of the lease [IAS 17.4].

8.2.8 Whether a lease is a finance lease or an operating lease depends upon the substance of the transaction rather than the form. Situations that *could* ..... lead to a lease being classified as a finance lease include the following [IAS 17.10]:

- the lease transfers ownership of the asset to the lessee by the end of the lease term;
- the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than fair value at the date the option becomes exercisable that, at the inception of the lease, it is reasonably certain that the option will be exercised;
- the lease term is for the major part of the economic life of the asset, even if title is not transferred;
- at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- the lease assets are of a specialised nature such that only the lessee can use them without major modifications being made.

8.2.9 Other situations that might also lead to classification as a finance lease are: [IAS 17.11]

- if the lessee is entitled to cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- gains or losses from fluctuations in the fair value of the residual fall to the lessee (for example, by means of a rebate of lease payments); and
- the lessee has the ability to continue to lease for a secondary period at a rent that is substantially lower than market rent.

### **8.3 Interpretation and Amendments**

8.3.1 The above indicators may support a finance lease classification, but are not always conclusive. If it is clear from other features of the lease that substantially all the risks and rewards of ownership are not transferred to the lessee, then the lease is an Operating Lease. Examples of lease features that could prevent classification as a Finance Lease include contingent rents or if ownership transfers to the lessee at the end of the lease only on payment of an amount equivalent to the then Fair Value of the asset [IAS 17.12].

8.3.2 International Accounting Standards currently give little guidance on the application of the Standards, particularly on what weighting should be given to the various possible finance lease indicators. IAS 17 requires all leases to be classified as either a finance lease or an operating lease depending on the substance of the transaction, not its legal form. A finance lease is defined as 'a lease that transfers substantially all the risks and rewards incidental to ownership of the leased asset to the lessee' (IAS 17, paragraph 4). An operating lease is a lease 'other than a finance lease'.

8.3.3 The Royal Institution of Chartered Surveyor's Valuation Standards and VIP9 offer some examples of the process and calculations that may be necessary but not much other practical assistance.

8.3.4 The International Accounting Standards Board (IASB) has recently issued new guidance *Improvements to IFRSs – April 2009*, which is applicable for annual periods beginning on or after 1 January 2010. One of the improvements concerns the classification of the land element in leases under IAS17. This has been adopted by the Code for 2010/11, although not yet adopted by the EU.

8.3.5 Prior to this amendment, leases of land were normally classified as operating leases unless the lessee was expected to acquire title to the land (e.g. at a favourable price). Under IAS17 [IAS 17.15], unless title to the land was expected to pass to the lessee, the lessee was not considered to receive 'substantially all the risks and rewards of ownership' of the land and the lease was classified as an operating lease. Paragraph 2.2 of VIP 9 also offered some supporting guidance on the classification of the land element of a lease.

- 8.3.6 The new amendment to IAS17 involves the deletion of existing paragraphs 14 & 15 and insertion of three new paragraphs (numbered 15A, 68A & 69A). Land which is subject to a lease still requires to be classified separately from any building element **but there is no longer a presumption that the land will have operating lease status**. Rather, the land element of the lease will be separately subject to the same lease classification tests (qualitative and quantitative) and procedures that are applied to the building element; i.e. have regard to IAS17 paragraphs 7 to 13.
- 8.3.7 IAS17 Paragraph 68A states that *“An entity shall reassess the classification of land elements of unexpired leases at the date it adopts the amendments referred to in paragraph 69A on the basis of information existing at the inception of those leases.”*

## 8.4 Summary

### 8.4.1 IAS17 looks at **the transfer of the risks and rewards of ownership**.

- It gives examples of finance lease indicators (paragraphs 10 – 11). **No single indicator is paramount or conclusive.**
- If there are contingent rents, the lessee may not have substantially all such risks and rewards of ownership (paragraph 12).
- The land element of leases is not now automatically classified as an operating lease, as was previously the case [paragraph 15 and VIP9 paragraph 2.2] having been superseded by new IAS 17 paragraphs 15A, 68A & 69A.

## 8.5 The Process to be adopted for Classifying Leases Under IAS 17

### 8.5.1 The lease assessment criteria set out in IAS17 criteria have been captured by a series of questions (Questions 1 – 15) contained in the “Qualitative Assessment Questionnaire”<sup>1</sup> which should be completed for each of the leases. The following process should be adopted as an appropriate methodology for assessing the leases:

- a) Read the lease (signed and dated copy of the lease and any subsequent deeds of variation). **Incomplete / unsigned leases are unlikely to satisfy audit requirements.**
- b) Assess whether the lease is standard for its market place and age, or does it have any unusual / uncommon (non-standard) lease clauses?
- c) If not, are there any other finance lease indicators? Assess the lease with regards to Preliminary Assessment Criteria (Part 1, Questions 1-10).
- d) Make an overall assessment of the nature of the lease i.e. operating or finance lease, having regard to the transfer of risks and rewards of ownership using IAS 17 paragraph 12. In essence, do the risks and rewards of ownership lie substantially with the lessor or with the lessee?
- e) If the conclusion is that the lease is an operating lease, provide the rationale and no further assessment is necessary.

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<sup>1</sup> See example in appendix 5



- f) If the classification is unclear, or if it is probably a finance lease, proceed to Part 2 (Qs 11 – 15) and undertake a “Quantitative Assessment”.
- g) Adopt the process for undertaking the Quantitative Test calculations set out in RICS – VIP 9 for both the land and building elements separately.
- h) Review lease terms (Qs 1 – 15 and “Quantitative Test”).
- i) Review the overall assessment of the nature of the lease(s) i.e. operating or finance lease having regard to the transfer of risks and rewards of ownership using IAS 17 paragraph 12. In essence, do the risks and rewards lie substantially with the lessor or with the lessee?
- j) Provide a conclusion with reasons.

## 8.6 Detailed Provisions of IAS 17 and Lease Classification

- 8.6.1 Prior to classifying their leases, the client must first identify which leases they actually hold and whether any contractual arrangements also contain lease type arrangements. Finance Directors are advised that their determination of whether an arrangement is (or contains) a lease should be based on the substance of the arrangement and requires an assessment by them of whether fulfilment of the arrangement is dependent on the use of a specific asset or assets, and whether the arrangement conveys the right to use the asset. IFRIC4 *Determining Whether an Arrangement Contains a Lease* provides the appropriate guidance. It will also be necessary to consider whether IFRIC12 Service Concession Arrangements or IAS40 Investment Property apply (see paragraph 8.1.3 above).
- 8.6.2 Once the client has identified their leases, all leases will be classified as either a finance lease or an operating lease. **Note that this classification exercise is undertaken at the date of lease inception and only needs to be undertaken once.**
- A finance lease is defined as a lease that transfers substantially all the risks and rewards incidental to ownership of an asset (IAS 17, paragraph 8). Title may or may not eventually be transferred.
  - An operating lease is defined as a lease other than a finance lease.
- 8.6.3 When assessing a lease, classification is dependent on the substance of the transaction rather than the form of the contract. For example, a series of transactions that involve the legal form of a lease is linked. The series of transactions should be accounted for as one transaction when the overall economic effect cannot be understood without reference to the series of transactions as a whole, reflecting the substance of the transaction.
- 8.6.4 Note that the relative values of the lessor’s and lessee’s interests are not a key factor in classification; it is whether the lessor has transferred substantially all the risks and rewards of ownership that is paramount.
- 8.6.5 **Why is classification important for lessees?**
- A finance lease will be treated as a “non-current asset” (the new term for “capital asset”) and this means it must be accounted for on the balance sheet as both an asset and a liability, and valued accordingly.

- An operating lease in contrast is not entered on the balance sheet. It's annual rent charge will simply be stated by the lessee on their profit and loss statement.

#### 8.6.6 **Who is responsible for lease classification?**

8.6.7 RICS VIP No. 9 states that it is the responsibility of Finance Directors and their accounting advisors to determine lease classification but advises that valuers may be asked to assist by:

- undertaking the classification tests (qualitative and quantitative), and by
- calculating the amount to be included on the client's financial statement.

8.6.8 Some clients may attempt to undertake these tests themselves while others will seek advice from the valuer on all the tests. Others may reach their own conclusions on the qualitative tests and seek valuer input only on the quantitative tests.

#### 8.6.9 **When is lease classification undertaken?**

8.6.10 As noted above, a lease has to be classified only once and the relevant date is the date of lease inception, not any particular asset valuation date.

8.6.11 International Financial Reporting Standards applies to leases retrospectively. This means that leases which are already in existence at the 1st April 2010 date of changeover from UKGAAP to International Financial Reporting Standards will have to be classified having regard to their date of inception, even although that may be many years ago. Going forwards, all new leases which are entered into will be classified as they arise at their inception date.

8.6.12 Local and Regional Government clients will need to classify all their leases in the months leading up to 1st April 2010.

### **8.7 Land and Lease Classification**

8.7.1 The land and building elements of a lease must be considered separately for the purposes of lease classification.

8.7.2 The land element is no longer automatically classified as an operating lease. Examples of when land and buildings may not be assessed separately are:

- Where the value of the land element is immaterial, treat the lease as a single unit for lease classification [*IAS 17, paragraph 17*]
- Where the lease payments cannot be allocated reliably between the land and building elements, the entire lease is treated as a single unit [*IAS 17, paragraph 16*]
- Where the lessee's interest in both land and buildings is classified as an investment property in accordance with IAS 40 [*IAS 17, paragraph 18, 19*]
- Where title of the land is expected to pass to the lessee by the end of the lease term (In which case the land will be treated as either an operating or finance lease reflecting the status of the building element).

## 8.8 Long Leases

- 8.8.1 Long leases of land such as ground leases of 125 years or more, at first glance, might be considered as instances where the lessor has transferred substantially all the risks and rewards of ownership. However this may not be the case and the appropriate “tests” should be applied. Please also note that whilst The RICS advises in Valuation Information Paper No. 9 [paragraphs 2.2 & 2.3] that:

“However long the lease term, it will be treated as a temporary arrangement for the use of the land” (subject to the bullet point exceptions listed above). This is a clear instruction within the Standard, in spite of the fact that substantially all the value of the land might pass to the lessee at the inception of a long lease.”

**IAS17 has now been amended by *Improvements to IFRSs – April 2009*.  
(See paragraph 8.3.6).**

- 8.8.2 Long leases will therefore need to be assessed as either operating or finance leases in accordance with the amended IAS17.

## 8.9 Assistance with Land Element Apportionment

- 8.9.1 An obvious difficulty lies in allocating the land and building rental elements of a property lease for classification purposes at the lease inception date. The process listed below for undertaking quantification test 10 (d) to determine the classification of the building element of a lease details the steps required to accurately apportion a lease rental between land and building. VIP No. 9 is also largely devoted to this question.
- 8.9.2 However the first point to bear in mind is that if it is clear that both elements (land and building) are operating leases from the outset, then no allocation exercise will be necessary.
- 8.9.3 Further assistance is provided by IVA 1 Addendum A, which is reproduced as Appendix 4.1 of the RICS Valuation Standards (6<sup>th</sup> Edition). This states that:
- Where a lease is of a self-contained plot of land and building, allocating the rent to each element can normally be undertaken reliably where there is an active market for land for similar development in the locality.
  - It will be comparatively rare for the buildings’ element to meet the criteria for classification as a finance lease and for the corresponding land element to not be clearly identifiable.
- 8.9.4 Where the lease in question is of part of a multi-let building with no identifiable land attributable to any particular lease, then a reliable allocation may be impossible.
- 8.9.5 Where a reliable allocation is not possible (for any reason), the Valuer should not attempt an allocation based on unreliable criteria but should advise that the allocation cannot be reliably made. IAS 17 paragraph 16 provides for the whole lease in these circumstances to be treated as “one lease without allocation” and then be judged as a whole as either being a finance or operating lease.
- 8.9.6 In practice (states IVA 1), leases of part of a multi-let building will normally be operating leases and the whole property will be classified as investment property by the lessor.

## 8.10 Buildings and Lease Classification

- 8.10.1 The building element will be classified as either an operating or finance lease after applying the classification test criteria in IAS 17, paragraphs 10 and 11. These comprise mainly qualitative tests and one quantitative test.
- 8.10.2 **No one test is necessarily conclusive (IAS 17, paragraph 12) or is designated as being paramount.**
- 8.10.3 There is no underlying decisive financial test. Despite answering “yes” to one or two of the tests, it may be clear from other features of the lease that there has not been a substantial transfer of the risks and rewards incidental to ownership. It is necessary to step back and take an overview. Look beyond the “form” to the party’s intentions and the substance of the agreement.
- 8.10.4 IVA 1 Addendum A (which is reproduced as Appendix 4.1 of the RICS Valuation Standards 6<sup>th</sup> Edition) states:
- ***“These are not absolute tests but illustrations. One or more may arise but the lease would still not be classified as a finance lease if it is clear from the overall context that substantially all the risks and rewards of ownership have not been transferred.”***
- 8.10.5 It is essential that each lease is considered on its own merits when classifying it. Close liaison and detailed discussions with the client will be essential during a classification exercise. The Valuation Office Agency has drawn up a template Lease Assessment Qualitative Questionnaire (which captures the assessment criteria in a series of structured questions) to help promote a consistent and auditable approach to information capture for this purpose. This is attached as Appendix 5.
- 8.10.6 Regarding the quantitative test, a worked example / template is also available, drawing on the guidance in RICS VIP No. 9 and the worked examples available in Section 13 of that document.

## 8.11 The Classification Tests

- 8.11.1 Paragraph 10 of IAS 17 lists four qualitative tests (a, b, c, e) and one quantitative test (d). It states that examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:
- a) the lease transfers ownership of the asset to the lessee by the end of the lease term;
  - b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
  - c) the lease term is for the major part of the economic life of the asset even if title is not transferred; [this is the quantitative test];
  - d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset;
  - e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

8.11.2 Paragraph 11 of IAS 17 lists a number of indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

- f) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- g) gains or losses from the fluctuation in the Fair Value of the residual accrue to the lessee (for example, in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and
- h) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

8.11.3 Regarding the test at paragraph 10 c, what is meant by "substantially all" (major part) is not defined in IAS 17 but it has traditionally, under the previous SSAP21 / Finance Leasing Manual – FLM4.29, been regarded as meaning 90 per cent or more. RICS VIP No. 9 notes that some auditors interpret "major part" and "substantially" to mean a lease term that is at least 75 per cent of the asset's remaining economic life at the inception of the lease. This will need to be discussed with individual clients and needs to be considered in the light of all the circumstances as no single test is conclusive.

8.11.4 Undertaking the full quantitative test at paragraph 10 d will involve detailed calculations and can be time consuming. However the RICS and IVA offer the following advice regarding lease classification:

- RICS VIP No 9, paragraph 2.4: "Classification of the buildings element is not straightforward but it is often possible to determine it is an operating lease at a qualitative level without performing detailed calculations."
- RICS VIP No. 9 paragraph 2.11 states: "If the qualitative tests indicate an operating lease, and a preliminary (non-detailed) consideration of the quantitative test (IAS 17 paragraph 10 d) does not suggest otherwise, then no further analysis is required."
- RICS VIP No 9 paragraph 2.9 provides the following guidance regarding the qualification test "major part of asset's economic life" at ISA 17 paragraph 10 c). "There is no definition of what is meant by "the major part of the asset's economic life". ..... The standard offers no further guidance on this. Building lives are a matter of judgment, so this test (10c) is unlikely to be conclusive in isolation"
- RICS VIP No. 9 paragraph 2.11. "If the qualitative tests are not conclusive, then separate valuations of the land and buildings under the lease, and an apportionment of the rent, will be required to carry out the (*full quantitative paragraph 10d*) test, and to determine the figures to be included in the financial statements."

- RICS VIP No. 9 paragraph 2.10. The test at IAS 17 paragraph 10 d) is the quantification test and first requires you to split out the building rental element from the land rental element at lease inception. *“There is no definition of what is meant by “substantially all” of the fair value. The company directors and their accounting advisers will need to interpret this test in the context of the advice provided to them by the valuer. .... Certainly, if the value of the lease interest in the buildings comes close to 90% of the freehold value, or more, then it is likely that the lease would be classified as a finance lease, unless there is persuasive evidence to the contrary.”*
- IVA 1 (reproduced at Appendix 4.1 of the RICS Valuation Standards 6<sup>th</sup> Edition) states: “Occasionally leases that are not clearly structured as finance agreements may meet some of the criteria of a finance lease, for example, where the rental payments do not reflect the underlying value of the property. In those cases a more detailed analysis of the value of the risks and benefits transferred may be required in order to confirm or rebut their classification.”
- IVA 1 Addendum A (reproduced at Appendix 4.1 of the RICS Valuation Standards 6<sup>th</sup> Edition) notes that in most property leases:
  - the interest in the land and buildings is not distinguishable
  - the interest in both normally reverts to the lessor at the end of the lease
  - there are often provisions for the rent to be reviewed periodically to reflect changes in the Market Value of the property
  - there is often an obligation on the lessee to hand the buildings back to the lessor in good repair.

And concludes that: “These are all considered to be clear indicators that the lessor has not transferred substantially all the risks and rewards of ownership of either the buildings or the land to the lessee. Consequently, finance leases of real property will generally arise only where the lease is clearly designed as a way of funding the eventual purchase of the land, buildings or both by the lessee, often by means of an option to acquire the lessor’s interest for a nominal sum after the rental payments have been made.”

- RICS VIP No. 9 at paragraph 9.2 provides advice on those leases which have a rent review clause that permits the rent to rise or fall at review, as opposed to an upwards only review clause. As this makes the entire rent after review contingent, which impacts on the level of the Minimum Lease Payment calculation, the RICS guidance states: “In practice, a lease with regular upwards or downwards rent reviews cannot be a finance lease because the lessor retains the risk of rental value changes”.

8.11.5 The above guidance notwithstanding, it remains the case that each lease must be considered on its own merits when being classified.

## **8.12 Undertaking the Quantitative Test:**

8.12.1 After applying the qualitative tests and a preliminary (non-detailed) consideration of the quantitative test, it may be clear that the land and building parts of the lease are operating leases. If however this is not clear and there are indications that it might be a finance lease, it will be necessary to fully apply the quantitative test to help inform the classification assessment.

8.12.2 RICS VIP No. 9 from Section 4 onwards provides guidance on undertaking the quantitative test. The information which the valuer will be involved in producing in order to:

- a) complete the quantitative test, and
- b) subsequently determine for any finance lease the asset and liability figures to be shown in the accounts, may include the following:
  - The freehold value of the asset that has been leased, split between the building and the land
  - The value contained within the lease, split between the building and the land
  - An allocation of the Minimum Lease Payments under the lease between the building and the land.
  - The Test: “at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset”.

8.12.3 The difficulty is that because land and buildings are classified separately, the test has to be applied not to the lease as a whole but to the land and building elements separately of both the lease payments and the Fair Value.

8.12.4 In carrying out the test, the Minimum Lease Payments (including any lump-sum upfront payments) therefore are required to be allocated between the land and the buildings elements in proportion to the relative Fair Values of the leasehold interests in the land element and buildings element of the lease at the inception of the lease. *[IAS 17, paragraph 16]*.

8.12.5 The weighting of the apportionment must reflect the lessee’s leasehold interest in the land and the buildings; i.e. they are weighted to reflect their role in compensating the lessor, and not by reference to the relative Fair Values of the land and buildings. (The principle underlying this is that it is considered reasonable to expect that the lease payments relating to the building element would be set at a level that enabled the lessor not only to make a return on initial investment, but also to recoup the value of the building used up over the term of the lease.)

8.12.6 First, it is important to consider what is meant by Minimum Lease Payments. Minimum Lease Payments are defined (in IAS 17) as those payments over the lease term that the lessee is required to make, excluding contingent rents. This includes any amounts guaranteed by the lessee (or a party related to the lessee). For example, Minimum Lease Payments will include any premium paid as consideration for the granting of the lease.

8.12.7 Contingent Rents are defined (in IAS 17) as that portion of the lease payments that is not fixed in amount or can be quantified absolutely at lease inception (e.g. future changes in market rents, future price indices, percentage of future sales, etc). It flows from this that if there is an “upward or downward” review, then the entire rent after the review date is treated as contingent. In practice, as the lessor then retains the risk of rental value changes such a lease cannot be a finance lease (RICS VIP No. 9 paragraph 9.2). If the rent cannot reduce on review, then the initial rent is used in the calculation until the end of the lease term (or earlier expected determination).

8.12.8 Where the lessee has an option to purchase at a price (sufficiently lower than Fair Value) that makes it reasonably certain, at lease inception, that the option will be exercised, then the Minimum Lease Payments will be the (non-contingent) rent payable up to the date the option can be exercised, plus the value of any option payment (*IAS 17, paragraph 4*).

8.12.9 In summary (VIP No. 9 provides more detail), the steps are as follows:

- a) Calculate the freehold value of the asset (land and building combined) at the date of lease inception (Market Rental Value multiplied by an appropriate market derived YP in perpetuity).
- b) Calculate the value of the lease at lease inception (the Minimum Lease Payment figure as defined above, multiplied by an appropriate YP figure for the lease term or to any earlier anticipated expiration date).

Note: the two calculations above consider the property as a whole rather than separating out the land and building elements, as is required at the next steps. However before proceeding further, it can be useful to consider the relationship of these two figures, one to another, to see what clues they give as to the likely status of the lease; in effect a preliminary (non-detailed) quantitative test or “testing of the waters”. It may be quickly very clear that the “substantially all” measure in the test is highly unlikely to be met.

- c) Subtract the result of b) above from the result at a) above to obtain the total residual value. As stated at *RICS VIP No. 9, para 2*, mathematically what is left will be that part of the freehold value that is not dependent on the contractual rents payable under the lease,
- d) Apportion this residual value between land and building. This can be done by the following process:
  - a): calculate the building's depreciated replacement cost at the lease inception date
  - b): assess the remaining economic life of the building at lease inception
  - c): assess the anticipated remaining life of the building at the end of the lease
  - d): calculate: 
$$\frac{\text{depreciated replacement cost} \times \text{Rem. life at lease end}}{\text{Rem. economic life at inception}}$$

Note: this calculation is assuming straight line depreciation over the expected economic life and features the application of a depreciation factor which is proportionate to the relative durations of the lease term and the economic life.



- e): calculation d) gives the estimated residual value of the building at the end of the lease.
  - f): the Present Value of this residual building element figure will now be calculated, using the interest rate implicit in the lease. In the RICS examples, this is noted as being exactly the same as the property yield because the calculations have all been predicated on the yield and no external adjustments (such as applying a known land value) have been made.
  - g) Subtract this “Present Value of building residual figure” from the building’s “depreciated replacement cost at lease inception figure”. The result is a figure which represents the “building value under the lease”; i.e. how much of the building’s “value” is within the “total lease value” figure calculated at 2: above.
- 8.12.10 Apportion the freehold value of the asset (figure at step 1 above) between land and building. While a direct land value could be applied for this analysis, it, the already calculated “depreciated replacement cost figure at lease inception” for the building (step 4a), can be used as the building apportionment.
- 8.12.11 Calculate the percentage relationship between the “building value under the lease” figure at step 4g above and the “depreciated replacement cost figure at lease inception” (step 4a). This will show what percentage of the present value of the building element is included in the value of the lease.
- 8.12.12 You know the Fair Value of the whole leasehold asset (at step 2) and the value within that of the building element (at step 4g). Simple subtraction of the building figure from the Fair Value of the lease will give you the value of the land element within the lease. The value of these building and land elements can be stated as percentages of the (step 2) Fair Value of the leasehold asset.
- 8.12.13 Now apply that same percentage split to the Minimum Lease Payment rental figure to determine how much of the initial rent (i.e. the Minimum Lease Payment) is attributable to the land element and how much to the building element. This figure will be needed if either of the lease elements proves to be a finance lease and the client requires a capitalisation of the Minimum Lease Payment for balance sheet (liability) purposes.
- 8.12.14 It is possible to compare the building element rental allocation to the freehold value allocated to the building and consider the income rate of return which that shows. Then do the same for the land element rental allocation, comparing it with the freehold value allocated to the land and consider the income rate of return which that shows. The levels of return and particularly any clear discrepancy between the returns on the building and the land (e.g. a much higher return on the building) may suggest an operating lease. Alternatively, where the payments apportioned to the land appears to give a realistic return, for example perhaps similar to the building return, it is more likely that the building classification test would suggest it is held as held under a finance lease, although it should be remembered that no one test is conclusive.
- 8.12.15 It is recommended that valuers study RICS VIP No. 9 and its worked examples in detail to obtain further insights into applying the procedure in practice.

### 8.13 Accounting Treatment of Leases

8.13.1 The treatment of operating and finance leases differs between lessors and lessees. VIP 9 Chapter 1, Introduction: The Accounting Principles gives a useful summary. The main points for the valuer to note are:

- Lessor's Operating Lease - The asset will be held on balance sheet usually as an investment property and IAS 40 will apply. (Note – this may not always be the case for Housing Revenue Account properties where leases may be associated with service delivery).
- Lessor's Finance Lease - is recognised on the balance sheet (*as a debtor only and therefore no property valuation is required of the leased asset*) representing the right to receive lease payments and the entity's interest in the residual value of the property, if material. (Fair Value – Existing Use Value assumptions). Rental income is recognised in the income statement over the lease term and depreciation may be charged against the asset.
- Lessee's Operating Lease - The asset is not recognised on the balance sheet
- Lessee's Finance Lease - The asset is recognised on the balance sheet initially at an amount equal to the lower of its fair value or the present value of the minimum lease payments. A liability to make future payments, equal to the lower of the fair value of the asset or the present value of the minimum lease payments, is recognised on the balance sheet. Lease payments paid are recognised in the income statement over the lease term. The asset will be depreciated.

### 8.14 Valuation of Lessee's Interest in a Finance Lease

8.14.1 Where a finance lease is identified, the split of rentals between land and building which was used to assist with the classification process (specifically, the quantitative test) will now be used to help calculate the amounts to be included in the various parts of the lessee's financial statements.

8.14.2 IAS 17 paragraph 20 states:

*"At the commencement of the lease term, lessees shall recognise finance leases as assets and liabilities in their balance sheets at amounts equal to the Fair Value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease."*

8.14.3 CIPFA and The Treasury agree that for Local and Central Government accounting purposes the Fair Value currently to be reported in this context is **the value of the underlying freehold interest**, assuming vacant possession and ignoring any leases or (at initial recognition only) the PV of the Minimum Lease Payments whichever is the lower.

- 8.14.4 For finance leases, the valuer must therefore establish the value of the underlying freehold interest in the lessee's interest in the asset (note that the asset will be both the land and the building part of the lease if both qualify as finance leases). This calculation will, on the first valuation of the lease under International Financial Reporting Standards, be required both at:
- a. the date of lease inception (to assist with the initial asset & liability entries to the balance sheet), and
  - b. also at the date of valuation.
- 8.14.5 At subsequent revaluations, this valuation will only be required as at the date of revaluation.
- 8.14.6 As for lease classification, the initial valuation of any finance lease under International Financial Reporting Standards must be undertaken as at lease inception, retrospectively if necessary. Where a revaluation is undertaken at a subsequent date, the lease inception figures will remain on the balance sheet but there may be a value to be separately included by the client.
- 8.14.7 In many instances, it is anticipated that the market value of the lease interest held by the lessee will be nil as there will be no profit rent where the property is let at a full rental value.

## **8.15 Accounting Definitions**

- 8.15.1 VIP 9, Chapter 3 Definitions, contains definitions of the principal accounting terms used in IAS17 together with some useful commentary. However, it may be useful to include here some further explanation of "Lease Term".
- 8.15.2 *Lease Term* is defined at paragraph 4 of IAS 17 as the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option. It should be noted here that it is usually assumed that break clauses will be exercised by the lessee if, in the particular circumstances, it is reasonable to make such an assumption (i.e. there are no particularly onerous penalties attached to exercising the break option).
- 8.15.3 The Primary Lease Term - "Lease Term", also referred to sometimes in this context as primary lease term, can therefore comprise two elements:
- i. The contractual term of the lease still remaining at the valuation date.
  - ii. Any further period of occupancy envisaged after expiry of contractual term provided that it is reasonably certain that, at the inception of the lease, the lessee intends to exercise the option to remain in occupation.

- 8.15.4 Regarding this “potential further period of occupancy”, the lease itself may contain an “option to renew” clause. Alternatively there is in England a statutory right of renewal (subject to certain exceptions) for a period equal to the length of the original contractual term subject to a maximum of 15 years, assuming the parties have not elected to opt out. At the end of each renewal period, the statutory extension provisions can be reapplied, giving the possibility of a primary lease term approaching or equal to the physical life of the building in some cases.
- 8.15.5 Difficulty can be encountered in determining what the lessee's intentions towards continued occupation were at the inception of the lease. In some instances, it may be clear that a building will no longer be needed for operational purposes when the contractual term expires because a new facility is being constructed or a service relocated. The authority may also state that it does not intend to remain in occupation of a particular property. Where the authority is unable to clarify its intentions one way or the other with regard to any leased property, the assumption by default - in the absence of any contrary information – will be that the occupation will continue with statutory rights being invoked.

## **8.16 Types of Leases in the Authority's Portfolio**

8.16.1 The Authority may hold several types of Leasehold interests including:

- ground leases where the authority is lessee;
- property leased by the local authority to other housing organisations/charities;
- individual properties leased to the authority in order to meet local housing needs;
- leases / licences / agreements between departments within the authority. As these are internal arrangements to the authority these would not be classed as leases and IAS17 does not apply. However, the valuer may be requested for a valuation for internal accounting purposes but these are not “leased” assets in the Housing Revenue Account.

8.16.2 Properties held on ground leases normally fall to be valued by the beacon approach as the houses will be in a defined location and of a uniform type. The houses should form either an archetype within an asset group or, in cases where there are substantial numbers and range of types, a separate asset group. Local authority housing subject to ground leases will not be common in many areas of the country, and unless advised to the contrary, it should be assumed that all the properties are freehold.

8.16.3 Other types of leased properties may be less uniform in nature, and often scattered throughout the authority. A more individual approach may be necessary for establishing the valuations in these cases.

8.16.4 The *Code of Practice on Local Authority Accounting and International Financial Reporting Standards* require leases to be classified as either finance leases or operational leases. Where a lease is operational no fixed asset will be entered on the balance sheet of the lessee. Where a lease is classified as a finance lease the asset and the outstanding liability will be recorded on the lessee's balance sheet and the rental payments under the lease will be apportioned between a finance charge and the principal repayment of the outstanding liability.

## **8.17 Ground Leases**

- 8.17.1 Ground leases will cover a discrete number of identifiable properties, often whole estates or pockets of properties within defined boundaries. In the case of whole estates the beacon approach described in Chapter 4 should be adopted and the estate split into property archetypes. The beacon valuations will need to reflect the following:
- the Fair Value of the underlying freehold interest
  - any restrictive covenants that may be attached to the freehold interest;
- 8.17.2 Any legal requirement for the authority to purchase the freehold or extend the lease at a revised ground rent should be noted as this may require separate accounting treatment.
- 8.17.3 It may not therefore be necessary to have a separate beacon valuation for the leasehold properties.
- 8.17.4 Some ground leases may be for non-estate properties scattered across a locality and it may be impractical, in terms of materiality to the overall accuracy of the valuation, to have beacons for each property.
- 8.17.5 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 to arrive at Existing Use Value-Social Housing as this would potentially understate the value of the property.

## **8.18 Property Leased by the Authority (Authority as Lessor)**

- 8.18.1 Although these leased properties will usually be of an individual nature, it should not be necessary to inspect each property internally and externally. A sample inspection of a typical property should be carried out and a roadside inspection of the remaining should be sufficient where properties are of a similar type and let under a similar types of lease.
- 8.18.2 Operating Leases: These assets are leased to other organisations for the delivery of a service that would otherwise be provided by the authority (and therefore have not been classified as investment properties). These properties are valued to Fair Value having regard to the current income and any reversionary value. This figure will need to be adjusted by the appropriate factor (if housing) for the authority, to provide Existing Use Value-Social Housing.
- 8.18.3 Finance Leases: The asset is recognised on the balance sheet as a debtor (no valuation is required) representing the right to receive lease payments and the entity's interest in the residual value of the property (valuation may be required). Reversionary values that are material should be based on freehold vacant possession value, taking into account any improvements that should be carried out under the terms of the lease. This figure will need to be adjusted by the appropriate factor for the authority, to provide Existing Use Value-Social Housing, and deferred for the period remaining on the lease.

8.18.4 Individual property valuations should be prepared and included in a separate property schedule, except where streets/groups of houses have been let on identical leases. In cases where there are a number of properties let on similar terms, the value of the total number of units should be based on the value of a single property and reported accordingly on the schedule. Sample schedules are included at the end of this chapter but the exact format required should be discussed with the Finance Director.

## **8.19 Properties Leased to the Authority (Authority as Lessee)**

8.19.1 Authorities may require additional property to meet local housing needs and lease accommodation from third parties. If the leases are classified as finance leases these properties should be valued (underlying freehold assumption with vacant possession), and where the leases are of an individual nature, each property should be valued. The approach to inspections is the same as at 6.3.4, having regard to valuer judgement and the effect on the overall accuracy of the valuation.

8.19.2 The asset is recognised on the balance sheet initially at an amount equal to the lower of its Fair Value or the present value of the minimum lease payments. A liability to make future payments, equal to the lower of the Fair Value of the asset or the present value of the minimum lease payments, is recognised on the balance sheet. Lease payments paid are recognised in the income statement over the lease term. The asset will be depreciated.

8.19.3 Subsequent valuations are to Fair Value.

<b>Housing Revenue Account Asset Valuation - 1 April 2010</b>					
CHAPTER 8 SCHEDULES - LEASES BY THE AUTHORITY (authority lessor)					
<b>Ref No.</b>	<b>Address</b>	<b>Description</b>	<b>Fair Value £'s</b>	<b>length of lease remaining years</b>	<b>Remarks</b>
1	3,5,7 Victoria Road	3 terrace properties leased to a housing association	180,000	20	30 year leases from 2000 at £5,000 per annum per property.  Operating lease but used for service delivery.
2	15 The Rowans	Semi-detached property leased to a charity to accommodate people with learning difficulties	50,000	5	15 years from 2000 at £5,000 per annum.  Operating lease but used for service delivery.

## Housing Revenue Account Asset Valuation - 1 April 2010

### CHAPTER 8 SCHEDULES - LEASES TO THE AUTHORITY (authority lessee)

Ref No.	Address	Description	Fair Value £'s	length of lease remaining years	Remarks
1	1,3,5 Brown Crescent	3 terrace properties leased from private sector to meet demand	250,000	20	30 year leases from 2000 at £10,000 per annum per property  Assessed as a Finance lease and valued to Fair Value
2	15 The Square	Semi-detached property leased from private sector to meet demand in rural area	65,000	25	30 years from 2005 at £7,500 per annum  Assessed as a finance lease and valued at PV minimum lease payments.

The valuations are not adjusted for directly attributable acquisition costs which are dealt with in Chapter 15.

## DETERMINING THE VALUATION TREATMENT FOR HOUSING REVENUE ACCOUNT PROPERTIES

Accounting Standard and Interpretation	Consideration	Y	N
1. Does IAS16, Property, Plant and Equipment apply?	Is the property held for use in the production or supply of goods and services, for rental to others, or for administrative purposes, and expected to be used during more than one period?	IAS16 applies, but see 2 below.	See 5 below
2. Adaptation and interpretation for the public sector context	<p><b>The Code para. 4.1.1.6.</b> The following adaptations of IAS 16 for the public sector context apply. Is a) or b) appropriate?</p> <p>a) 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.</p> <p>b) All other classes of asset shall be measured at fair value. The fair value of council dwellings shall be measured using existing use value–social housing (EUV–SH).</p> <p>If there is no market-based evidence of fair value because of the specialist nature of the asset and the asset is rarely sold, authorities may need to estimate fair value using a depreciated replacement cost approach.</p>	<p>Valuation not required</p> <p>See 3 below</p>	<p>See 2 b)</p> <p>N/A</p>
3. Does IFRIC 12 or IFRIC 4 apply?	<p>Is the property subject to:</p> <p>a PFI or similar arrangement (IFRIC12 Service Concession Arrangements)? Service concession arrangements are arrangements whereby a government or other body grants contracts for the supply of public services, e.g. roads, housing, prisons, hospitals etc. to private operators.</p> <p>or</p> <p>a service concession arrangement (IFRIC4 Determining Whether an Arrangement Contains a Lease) e.g. outsourcing arrangements that do not take the legal form of a lease but which convey rights to use assets in return for a payment or series of payments.</p>	Does IAS17 apply? See 4 below	Does IAS17 apply? See 4 below
4. Does IAS17 apply?	If the property is subject to a lease or lease type agreement then an assessment will be required using the criteria set out in IAS17 unless IAS40 applies (See 6 below).	Carry out IAS17 Finance / Operating Lease assessment. See chart below	Does IAS40 apply? See 6 below.
5. Does IFRS5 apply?	Is the property classified as “Non-current Assets Held for Sale and Discontinued Operations” in accordance		



with IFRS5 and section 4.9 of the Code?

4.9.2.12 of the Code - An authority 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 continued use. It must satisfy all the criteria set out in para. 4.9.2.12 of the Code.

Assets held for sale should be measured at the lower of carrying amount and fair value less costs to sell

Does IAS40 apply? See 6 below.

4.9.2.4 of the Code - Discontinued operation is an activity of an authority that must cease completely. 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 etc.

Valued to fair value which (for land and buildings) is to be interpreted as the amount that would be paid for the asset in its existing use.

Does IAS40 apply? See 6 below.

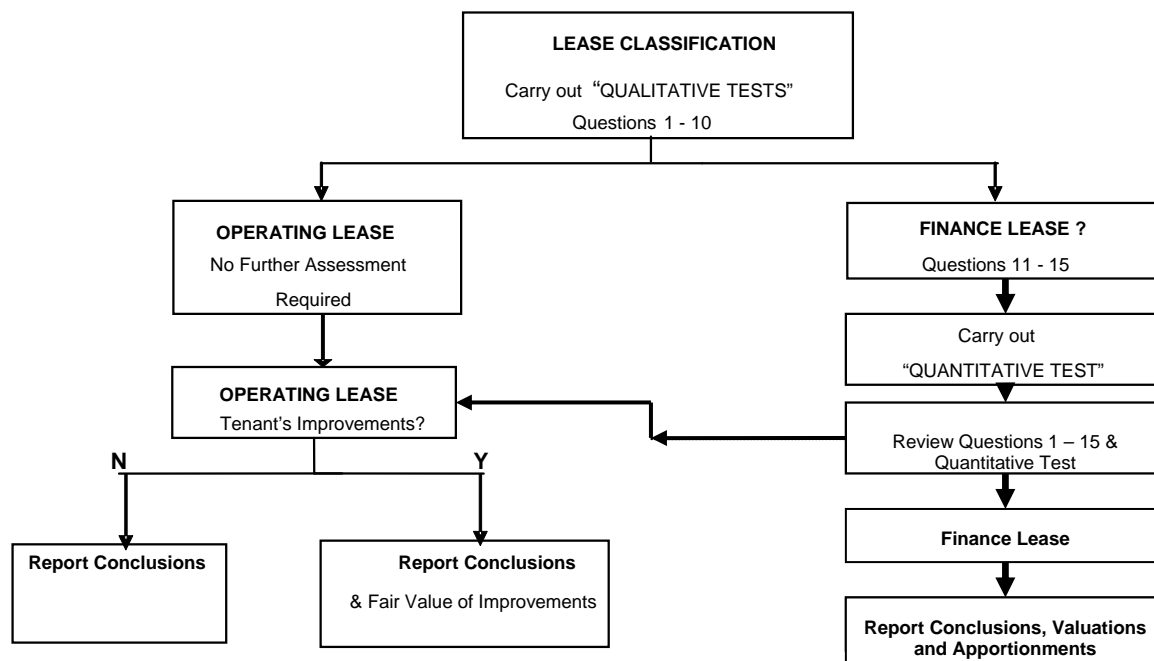
6. Does IAS40 apply?

An investment property is one that is held solely to earn rentals or for capital appreciation or both. Property that is used to facilitate the delivery of services or production of goods as well as to earn rentals or for capital appreciation does not meet the definition of an investment property under IPSAS 16 4.4.1.3. The Code requires investment property to be accounted for under the fair value model.

Valued to Fair Value (Market Value assumptions).

Discuss property classification with Finance Director

## Overview of the IAS17 OPERATING / FINANCE Lease Classification Process



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

### Key points

- categorisation of assets
- basis of valuation
- types of property
- report schedules
- contamination/radon/mining subsidence

### Key documents are:

- Department of Environment Circular 8/95.
- Code of Practice on Local Authority Accounting 2010/11 (previously known as the SORP)

### 9.1 Introduction

- 9.1.1 Although the Housing Revenue Account 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 Housing Revenue Account assets. Non-housing property may include lock-up garages let exclusively or mainly to Housing Revenue Account tenants. These will normally be considered part of the Housing Revenue Account although where an authority has a policy of letting of garages, on a long-term basis, to people who are not Housing Revenue Account tenants, it may be more appropriate to account for them in the General Fund.
- 9.1.2 Other likely operational assets are play areas, grassed areas and gardens, community centres, shops and council offices. The decision as to whether costs for these assets should be charged to the Housing Revenue Account is for the authority to make in the light of local circumstances and the use made of the assets. **Guidance is in DOE Circular 8/95 which may be revised following proposals to reform the Housing Revenue Account (currently going through the consultation process).**

## 9.2 Classification of Assets

9.2.1 The classification of Housing Revenue Account assets is a matter for the Chief Finance Officer, with assistance from the valuer. There is no fixed rule based on property type, as categorisation is dependent on the function of the asset within the authority.

9.2.2 It is necessary for all properties to be identified and classified. The final valuation report will require the value of the non-housing assets to be stated separately from the value of the dwellings.

9.2.3 Property assets are to be classified into one of the following groups (UK Appendix 1.5 Para.2, and Section 4.1 of The Code):

- Property plant and equipment

Authorities shall account for all tangible fixed assets in accordance with IAS 16 Property, Plant and Equipment, except those more specifically listed below or where the Code has detailed interpretations or adaptations to fit the public sector.

- Leases and lease type arrangements

Authorities shall account for leased assets in accordance with IAS 17 Leases, except where the Code has detailed interpretations or adaptations to fit the public sector.

- Investment property

Authorities shall account for investment property in accordance with IAS 40 Investment Property, except where the Code has detailed interpretations or adaptations to fit the public sector.

- Assets held for sale

Authorities shall account for assets held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, except where the Code has detailed interpretations or adaptations to fit the public sector.

9.2.4 Although there is no requirement to do so in the Code, the authority may wish to divide the classifications into further groups and the valuer will report accordingly.

## 9.3 Basis of Valuation

9.3.1 Infrastructure, community assets and assets under construction (excluding investment property where the Fair Value can be reliably determined) shall be measured at historical cost and the option given in IAS16 Property, Plant and Equipment to measure at Fair Value is withdrawn. Examples of this category of asset are given in the annexe to UK Appendix 1.5.

- 9.3.2 All other assets in this category shall be measured at Fair Value. The separate valuation requirements that apply to leases, investment property, assets held for sale and depreciation are dealt with in paragraphs 4 to 7 of UK Appendix 1.5.
- 9.3.3 Pending the formal clarification by IASB on the application of Fair Value to property the Code requires the following values to be reported:
- For land and buildings, Fair Value is to be interpreted as the amount that would be paid for the asset in its existing use. This requirement is met by providing a valuation on the basis of Existing Use Value in accordance with UKPS 1.3; and, where significantly different;
  - The Fair value (market value - that is, the valuation does not disregard alternative uses). A statement should be made that no account has been taken of issues such as reducing the service potential, or disruption, and the associated costs that would be incurred in achieving that alternative use.
- 9.3.4 Authorities will use the Existing Use Value in the financial statements of the authority. The Fair Value (market value) will be used to inform the asset management plans/strategies of authorities.
- 9.3.5 The use of depreciated replacement cost is recognised in appropriate circumstances. The valuer must have regard to the requirements of PS 6.6, depreciated replacement cost in the public sector, and PS 6.7, Comparison of depreciated replacement cost valuations and alternative market values. In addition, Valuation Information Paper 10, The Depreciated Replacement Cost Method of Valuation for Financial Reporting, contains detailed information on the use and application of depreciated replacement cost when valuing for financial statements.
- 9.3.6 The Fair Value of council dwellings shall be measured using Existing Use Value—Social Housing (as defined in UKPS 1.13).
- 9.3.7 The valuation of leases should follow the procedure set out in Chapter 8 of this guidance.
- 9.3.8 Investment property, i.e. the property is used solely to earn rentals or for capital appreciation or both, shall be accounted for in accordance with IAS 40 at Fair Value (market value). The Code requires the valuer to provide the Fair Value of the property reflecting any current leases, current cash flows and any reasonable assumptions about future rental income or outgoings.
- 9.3.9 The Fair Value of investment property held under a lease (that is, where the authority is the lessee) is the lease interest itself, not the underlying Fair Value (Market Value) of the freehold property.
- 9.3.10 The authority is required to identify, and separately account for, assets where they meet the strict criteria for classification of assets as held for sale, as set out in the Code (also see IFRS 5 and Chapter 12 of this Guidance).
- 9.3.11 Assets held for sale may be included at Fair Value (market value) less costs to sell (if lower than the carrying amount of the asset). Where the valuer makes an adjustment for the costs to sell this must be made clear in the report to avoid double counting.

## **9.4 Information**

9.4.1 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

## **9.5 Property Types**

9.5.1 The following types of property may be included within the Housing Revenue Account. 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;
- offices (possibly shops depending on categorisation);
- hostels/sheltered housing;
- meeting halls/community centres (usually classed as specialised properties);
- shared ownership schemes.

## **9.6 Open Spaces/Play Areas/Allotments**

9.6.1 Areas of landscaping and communal gardens included within the Housing Revenue Account 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 do not require to be valued. (see Annex to UK appendix 1.5). Where, however, the asset is included in the Housing Revenue Account and is not classed as a community asset, a valuation on the basis of Fair 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.

9.6.2 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.

9.6.3 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.

## **9.7 Lock up Garages**

- 9.7.1 The valuer should consult the Finance Director about the appropriate accounting treatment and whether IAS40 or IAS17 should apply (see paragraphs 9.3.7 and 9.3.8 above).
- 9.7.2 As these properties are of similar design a beacon approach to the valuation is probably the most appropriate.
- 9.7.3 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.
- 9.7.4 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.
- 9.7.5 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).
- 9.7.6 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.
- 9.7.7 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.

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

- 9.8.1 The valuer should consult the Finance Director about the appropriate accounting treatment and whether IAS40 or IAS17 should apply (see paragraphs 9.3.7 and 9.3.8 above).
- 9.8.2 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.
- 9.8.3 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.

## **9.9 Hostels/Sheltered Housing**

- 9.9.1 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;
  - various types of sheltered accommodation.
- 9.9.2 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 Fair Value (Existing Use Value).
- 9.9.3 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. Fair Value (Existing Use Value).
- 9.9.4 Where there are a significant number of these properties it may be appropriate to adopt a beacon approach to arriving at a typical Fair 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 Housing Revenue Account. It is not envisaged that all these properties should be inspected internally and a roadside inspection may be sufficient.
- 9.9.5 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 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 Fair Value (Existing Use Value).
- 9.9.6 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 Existing Use Value-Social Housing 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.



- 9.9.7 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.

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

- 9.10.1 The approach to the valuation for specialised properties is depreciated replacement cost in accordance with the RICS Valuation Standards PS 6.6 and VIP 10. 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 the RICS Valuation Standards PS 6.6.
- 9.10.2 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.
- 9.10.3 It will be necessary to provide an indicative Fair Value (Market Value assumption) where this is materially different from the depreciated replacement cost.

## **9.11 Shared Ownership**

- 9.11.1 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.
- 9.11.2 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.

## **9.12 Reporting Schedules and Procedures**

- 9.12.1 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).
- 9.12.2 Sheltered accommodation which is more akin to general purpose housing as described at paragraph 9.9.6 and shared ownership schemes should also have a beacon record sheet.
- 9.12.3 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 Fair Value), and remarks.

9.12.4 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.

9.12.5 It is recommended that houses valued to Existing Use Value as detailed in paragraph 9.9.4 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.

### **9.13 Depreciation**

9.13.1 To allow for any depreciation calculation the land and building elements of the valuations for properties not covered by a Major Repairs Allowance should be provided, together with the remaining life of the asset. Further guidance on depreciation is included in Chapter 13.

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

9.14.1 The same standard approach should be adopted for these environmental issues as in Chapter 4, paragraph 4.15.

## Housing Revenue Account Asset Valuation - 1 April 2010

### SCHEDULE 9 - OPERATIONAL PROPERTY NON-HOUSING

UPRN	Address	Description and Area	FV (EUV) £'s	DRC £'s	land apportionment £'s	building apportionment £'s	Remaining life estimate	Remarks
1	2 Smith Court	Ground floor office in multi storey block extending to 50 sq m used as advice centre.	10,000		2,500	7,500	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 200 sq m built in 1955 on a 0.2 ha site		110,000	20,000	90,000	20	Open market value £50,000 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	10,000		6,000	4,000	10	new playground for use by tenants on the estate
4	1 Clover Row	Shop extending to 30 sq m in parade of 5 on large estate. Leased for 15 years from 1/4/98, FRI at £3,000 per annum	30,000		8,000	22,000	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 15

## Housing Revenue Account Asset Valuation - 1 April 2010

### SCHEDULE 9 - OPERATIONAL PROPERTY SPECIAL HOUSING

UPRN	Address	Description and Area	FV (EUV) £'s	DRC £	land apportionment £	building apportionment £	Remaining life estimate	Remarks
1	4 The Square	Three storey terrace house with 8 bed sits with shared kitchen and bathrooms and welfare support	150,000		52,000	98,000	45	value assumes VP as a dwelling house. No secure occupation
2	St Martin's Hall	500 sq m former YMCA hostel now adapted and used as accommodation with additional welfare support		375,000	50,000	325,000	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	150,000		50,000	100,000	40	value has regard to private residential home market
4	1,3,5,7 Castle Mains Cottages	Shared Ownership Scheme	50,000		10,000	40,000	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 15.

# 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 Standards, UK Appendix 1.2 et al.
- 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 Housing Revenue Account 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 Housing Revenue Account. 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;
- redevelopment/refurbishment schemes of existing property.

### **10.3 New Build Schemes**

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:

## **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 Existing Use Value-Social Housing of the property is £17,500 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 £500,000.

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 Housing Revenue Account 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.

## 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.

6.1.1 Housing Revenue Account Asset Valuation - 1 April 2010							
SCHEDULE 10 - LAND AND BUILDINGS IN THE COURSE OF DEVELOPMENT / REFURBISHMENT							
Ref No.	Address	Description and Area	land and buildings excluding contract work £	Land £	Retained buildings £	Contract work to valuation date £	Remarks
1	1-4 The Cedars	Four new houses in a rural location		14,000	n/a	100,000	new development on greenfield site
2	East Court	100 flats Multi-storey block of flats undergoing complete redevelopment	1,750,000 (inc land)			500,000	retained buildings valued to EUV-SH



# Chapter 11 PFI Schemes - Assets Covered by Housing Revenue Account Private Finance Initiative Schemes

## Key Points

- service concession
- basis of valuation

## Key documents are:

- IFRIC 12.
- Code of Practice on Local Authority Accounting 2010/11 (previously known as the SORP)
- The International Accounting Standards Board (IASB) new guidance ***Improvements to IFRSs – April 2009***. The land element of leases is not now automatically classified as an operating lease, as was previously the case [IAS17 paragraph 15 and VIP9 paragraph 2.2] having been superseded by new IAS 17 paragraphs 15A, 68A & 69A.

## 11.1 Introduction

11.1.1 Section 4.3 of the Code applies to PPP and PFI arrangements (as defined in paragraphs 4.3.1.4 and 4.3.1.5) 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. 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 It is anticipated that more properties will appear on authorities' balance sheets under these provisions than was the case under the previous provisions which applied prior to 1 April 2010; indeed, most properties are now 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 Housing Revenue Account asset valuation and valued in accordance with this Guidance as set out in Chapter 4.

11.1.4 Where Housing Revenue Account dwellings are not included in the authority's balance sheet for the period of a private finance initiative contract, the authority will

need to consider (in line with paragraph 4.3.2.5 of the Code of Practice) 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 follow the guidance set out in 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. In these circumstances, authorities may need to account for the reversionary interest in accordance with paragraph 4.3.2.6 of the Code of Practice.

## 11.2 Interpretation

- 11.2.1 Under UKGAAP pre International Financial Reporting Standards, 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.
- 11.2.2 The new accounting arrangements under International Financial Reporting Standards are very different, both in their scope and the approach required. International Financial Reporting Standards also requires authorities to break their PFI transactions down into a number of component elements, with each then being accounted for in a different manner. HM Treasury finalised the PFI approach for the UK public sector in late spring 2008, establishing that it be consistent with private sector companies through application of the principles of IFRIC Interpretation 12 (IFRIC 12).
- 11.2.3 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.
- 11.2.4 **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.
- 11.2.5 **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 2.1 of *Accounting for PFI under IFRS* examines what constitutes a service concession. Section 2.2 considers which service concessions then require to be accounted for under IFRIC 12; the answer is most of them.

11.2.6 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

11.2.7 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”.

11.2.8 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.
- 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.

11.2.9 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.

11.2.10 **Which service concessions are within the scope of IFRIC 12?** Section 2.2 of “Accounting for PFI under IFRS” considers which service concessions require to be accounted for under IFRIC 12; the answer is most of them. 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?

- 11.2.11 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.
- 11.2.12 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. 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. 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.
- 11.2.13 It is expected that most PFI schemes will be recognised as 'on-balance sheet' under International Financial Reporting Standards, and indications are that auditors are indeed requiring that most PFI contracts considered to date be classified in this way.

### 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 The Authority is required to recognise the infrastructure as its own asset, together with a corresponding liability to pay for it. The asset will be recognised and measured 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. **Therefore the figure which the client will normally require from the valuer is the fair value of the asset assuming vacant possession and ignoring any leases or lease type arrangements.**
- 11.3.3 Fair value is measured as the market value subject to the assumption of continuance of the existing use. Where the asset is a specialised asset and the Fair 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. The fact that the asset is being maintained to a specified contractual requirement does not negate the need to depreciate it.

- 11.3.4 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.**
- 11.3.5 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. See Chapter 13, Depreciation of Assets.
- 11.3.6 Following initial measurement, the asset will be treated as any other item under IAS 16 and its Fair Value will need to be kept up to date by the Authority.
- 11.3.7 Where an indication of impairment occurs, it should be subject to an impairment review.
- 11.3.8 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 International Financial Reporting Standards**

- 11.5.1 PFI schemes that existed off-balance sheet prior to the introduction of International Financial Reporting Standards 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 Fair 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.

# Chapter 12 – Discontinued Operations 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 15.

## 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” re 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 (paragraph 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 (paragraph 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 (paragraph 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 (paragraph 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 Valuation 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 Standards, Practice Statement 4.1.). 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-operational 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 Standards, Practice Statement 3.2 Commentaries 3,4 and 5 on Synergistic / Marriage / Hope Value etc.). 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 Standards, Practice Statement Appendix 2.3).
- 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.

## 12.12 Negative Values

- 12.12.1 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.
- 12.12.2 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. (RICS Valuation Standards, Practice Statement 6.8)
- 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.

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

- 12.13.1 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.
- 12.13.2 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, any known risks associated with any of these factors.**

## 12.14 Valuation Report

12.14.1 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.

## 12.15 Report Schedules

12.15.1 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.

Housing Revenue Account Asset Valuation - 1 April 2010					
NON-OPERATIONAL PROPERTY					
Ref No.	Address	Description and area	FV (MV) £'s	FV (MV) special assumptions £'s	Remarks
1	1 1-21, 2-20 Cedar Street	40 houses awaiting demolition	150,000	200,000	FV assumes redevelopment potential for housing. FV special assumption assumes planning permission obtained
2	Vacant site at Cross Street	0.5 ha site for housing development	125,000		site has planning permission for residential development
3	Red Court	Multi storey block awaiting demolition	(100,000)		Council decision to demolish no demand for residential development, demolition costs exceed site value
Total Positive Value - £275,000					
Total Negative Value - (£100,000)					

These valuations are not adjusted for directly attributable selling costs which are dealt with in Chapter 15.

# Chapter 13 - Depreciation of Assets

## Key Points

- Depreciation
- The Major Repairs Allowance
- Review of the Major Repairs Allowance
- Depreciation of assets covered by the Major Repairs Allowance
- Major Repairs Allowance basis and assumptions
- Depreciation of assets not covered by the Major Repairs Allowance
- International Financial Reporting Standards asset componentisation, and depreciation
- Categories of Building Components
- Investment property
- Discontinued operations".
- Property 'Held for Sale'

## Key documents are:

- CIPFA / RICS Valuations for Capital Accounting (December 2009) – this valuation information alert offers interim guidance to valuers specifically on depreciation and componentisation.
- LAAP Bulletin 86 Componentisation of Property, Plant and Equipment under the 2010/11 International Financial Reporting Standards-based Code, June 2010
- *Major Repairs Allowance* (DCLG covering financial year 2001-02) – sets out the basis of the calculation of the Major Repairs Allowance and assumptions.
- *Review of the Major Repairs Allowance* (DCLG July 2009)
- RICS VIP 10, Chapter 9 Assessing Depreciation – outlines some methods of depreciation and what needs to be considered.

## Purpose

The accounting practice for depreciation is set out in the Code of Practice on Local Authority Accounting, and additional guidance on the accounting treatment in the English Housing Revenue Account is given in the Guidance Notes for Practitioners, published by CIPFA. The purpose of this chapter is to provide the valuer with background knowledge as to how depreciation may affect valuation requirements.

## 13.1 Depreciation

- 13.1.1 The fundamental objective of depreciation is to reflect in the revenue account the cost of using the asset i.e. in this case, the amount consumed in providing the service of social housing. This cost of use includes the wearing out, using up or other reduction in the economic life of a tangible fixed asset. This may arise through use, the passage of time or obsolescence or through changes in technology or demand for the goods and services produced by the asset
- 13.1.2 In accordance with the Code of Practice on Local Authority Accounting, depreciation should be provided for on all fixed assets with a finite useful life. Subsequent expenditure that maintains or enhances the previously assessed standard of performance of an asset does not negate the need for depreciation. Enhancements will also depreciate and their consumption over time should be reflected in the revenue account.
- 13.1.3 In 1999, FRS15 Tangible Fixed Assets introduced component accounting. Component accounting means that where a tangible fixed asset comprises two or more major components with substantially different useful economic lives, each component should be accounted for separately for depreciation purposes. The purpose of component accounting is to ensure revenue accounts are charged with an appropriate amount for the consumption of assets in the year, and that the balance sheet values of the assets held are materially correct.
- 13.1.4 This Stock Valuation Guidance focuses on the use of the Major Repairs Allowance as a proxy for component accounting and depreciation for their dwelling stock, although other approaches may be appropriate. If using the Major Repairs Allowance for component accounting and depreciation, local authorities will need to demonstrate the appropriateness of this approach in their financial reporting. Authorities should note previous guidance, which allowed for the Major Repairs Allowance to be used as a suitable proxy for depreciation as long as local authorities were able to demonstrate that this was not materially different from the actual charge. If a local authority has been able to demonstrate appropriateness of Major Repairs Allowance previously, the Department's view is that this should not be a problem in the future, and should not need to change on the transition to International Financial Reporting Standards.
- 13.1.5 However, authorities are free to use alternative, including more traditional, component accounting and depreciation methods if more appropriate, and are required to do so in respect of Housing Revenue Account assets that do not form part of the dwelling stock.
- 13.1.6 **This Chapter should be treated as interim guidance. As part of the Government's proposals for the major reform of the system of council housing finance, the Major Repairs Allowance within the Housing Revenue Account subsidy system would go. A revised basis for the calculation of depreciation beyond 2011-12 is currently being developed by CIPFA on behalf of DCLG. Further valuation guidance will be issued in due course, but for the time being it is envisaged that the methodology as detailed below should be followed.**

## 13.2 The Major Repairs Allowance

### Review of the Major Repairs Allowance

- 13.2.1 A review of the Major Repairs Allowance was commissioned by DCLG and the findings and recommendations are contained in the Building Research Establishment Ltd (BRE) document *Review of the Major Repairs Allowance* July 2009. These findings are currently under consideration by DCLG.
- 13.2.2 DCLG is working on the detail of the Government's proposals to reform the system under which the Housing Revenue Account subsidy system would be replaced with one of local authority self-financing. The existing system is expected to continue for at least the next financial year (2011 / 2012).
- 13.2.3 **Authorities should therefore continue to use the existing arrangements for the Major Repairs Allowance for the time being.** This Guidance will be revised to include changes that need to be taken into account.

## 13.3 Depreciation of Assets Covered by the Major Repairs Allowance

- 13.3.1 A detailed description of the calculation of the Major Repairs Allowance is included in the DCLG document *Major Repairs Allowance* (2001). A summary of the calculation process is set out below.
- 13.3.2 In brief terms, the Major Repairs Allowance is the annual cost of maintaining the property over a thirty-year period. The costs are based on replacing some key components of a property (e.g. bathrooms, kitchens, heating / CH boilers etc.) as and when they reach the end of their useful economic lives.
- 13.3.3 Under the Code of Practice on Local Authority Accounting, the depreciation method adopted by an authority should be the one most appropriate to the type of asset. It will be for local authorities to demonstrate to their auditors that whatever approach they adopt is reasonable, including the use of the Major Repairs Allowance as a proxy. In carrying out a valuation of the land, houses and other property within the Housing Revenue Account, authorities are required by The Housing Revenue Account (Accounting Practices) Directions 2010, issued under sections 78 and 87 of the Local Government and Housing Act 1989, to follow the guidance in this publication.



13.3.4 Where the Major Repairs Allowance is adopted as the most appropriate measure of depreciation, the valuer will not be required to provide assessments of remaining life or residual values for the assets covered by the Major Repairs Allowance, although it is recognised that in practice this information may be needed to establish appropriateness of the Major Repairs Allowance for depreciation (see paragraph 13.3.6 below). It would, however, be open to the Chief Finance Officer to adopt one of the more traditional methods of depreciation – or to use one of the more traditional methods to carry out a simple test of a Major Repairs Allowance-based depreciation charge. For this, it would be necessary to calculate the amount to be depreciated (normally, the current value of the asset less its residual value) and allocate this over the useful remaining economic life of the asset. Because land is not depreciated, (in most circumstances land is assumed to have an unlimited life – see IAS16 paragraph 58) the residual value will normally be the building value. The Chief Finance Officer would therefore need to consider whether to instruct the valuer to provide land values separately and assess useful remaining economic life.

13.3.5 It should be possible to carry out some fairly simple calculations to estimate residual lives and land values at the global stock level. This would typically include:

- assessing the useful economic remaining life of the asset (for example producing a weighted average remaining life of the whole stock assuming a total design life of the property of 60 to 80 years, but with possible adjustments to reflect major modernisation);
- establishing the depreciable amount of the asset typically by deducting the value of land from the total value of the asset (this could be done adequately by using regional information on land values as a proportion of vacant possession values which is widely available); and
- allocating the depreciable amount as fairly as possible over the useful economic life of the asset (usually in equal amounts per year).

13.3.6 Therefore, it is unlikely that valuers will be required to provide an assessment of remaining economic life and land values for individual beacon properties. However, if the Chief Finance Officer does require such information, then valuers need to have regard to this requirement when selecting beacon properties to represent asset groups.

## **13.4 Major Repairs Allowance Basis and Assumptions**

13.4.1 The Housing Revenue Account is a record of revenue expenditure and income relating to an authority's own housing stock. The Major Repairs Allowance represents the capital cost of keeping stock in its current condition. Where local authorities are able to demonstrate the reasonableness of this approach, the Major Repairs Allowance, based on the annual cost of replacing individual building components as they reach the end of their useful life, could be used as a proxy for depreciation.

13.4.2 The Major Repairs Allowance reflects the cost of keeping stock in its current condition, i.e. the expenditure required to fund 'newly arising needs'. The Major Repairs Allowance is calculated by estimating the annual cost of replacing

individual building elements as they reach the end of their useful life. The Government calculates this on the basis of information from the English House Condition Survey (EHCS), by:

- a) establishing at the national level (using EHCS data), likely timings and costs of replacement of building elements for 13 building archetypes;
- b) summing the anticipated required capital expenditure over the next 30 years to replace these building elements for each archetype and converting this into an annual average amount;
- c) calculating each authority's Major Repairs Allowance by multiplying the national average archetype cost by the number of eligible dwellings of that archetype in the authority's stock and applying a regional cost compensation factor.

13.4.3 A more detailed note of how Major Repairs Allowance is calculated is at Appendix 7.

### **13.5 Depreciation of Assets Not Covered by the Major Repairs Allowance**

13.5.1 All assets have to be depreciated. Non-housing Housing Revenue Account assets (e.g. shops) are not eligible for the Major Repairs Allowance. The use of the Major Repairs Allowance as a proxy for dwellings depreciation, can not be applied to other non-residential assets, such as lock up garages, offices and other miscellaneous assets.

13.5.2 These assets should be relatively few in number and low in value in relation to the total value of the Housing Revenue Account portfolio. The resources devoted to preparing the necessary information for depreciation calculations of these properties should have regard to the materiality of the effect of these calculations on the overall accounts.

13.5.3 The approach to adopt is to undertake a valuation of the land value and the buildings. The depreciable amount is then calculated on a systematic basis over the useful economic life of the asset.

13.5.4 For practical purposes it may be appropriate for the valuer to make a judgement of the percentage of the asset's value which is representative of the value of the site. This will lessen the resources required for providing additional land valuations, with no significant effect on the accuracy of the overall calculation in the accounts. If a percentage approach is adopted, it must nonetheless be related to local land values and building replacement costs. This might be achieved by valuing land / buildings for a sample of the properties and applying the resulting calculated apportionments (percentages) to the remainder of the properties.

13.5.5 The reporting schedules for those categories of properties should include the appropriate columns for the apportionment of the land and buildings and the assessment of the useful remaining life.

13.5.6 There will be operational assets, usually bare land held freehold, for which no depreciation is appropriate.

13.5.7 For all assets where authorities have chosen not to rely on the Major Repairs Allowance as a proxy for depreciation, authorities will need to have direct regard to the requirements of the International Financial Reporting Standards.

### **13.6 International Financial Reporting Standards and Componentisation, and depreciation**

13.6.1 International Financial Reporting Standards is clear that component accounting should be applied and this approach should apply to accounting within the Housing Revenue Account as far as possible. It is expected that many authorities will adopt the Major Repairs Allowance as an estimate measure of depreciation for achieving the aims of IAS 16, where they are able to demonstrate that this is a reasonable approach. The following guidance applies where authorities are not permitted or have chosen not to use the Major Repairs Allowance approach. IAS 16 paragraphs 43-47 require that each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item, and with a significantly different useful economic life, should be depreciated separately, but those with the same useful lives and depreciation methods may be grouped for depreciation purposes.

13.6.2 The Department for Communities and Local Government does not envisage that **this need be an onerous task**, and expects that for non-specialised buildings minimal componentisation should will be required. However, it is for the individual local authority to decide what its material components are. Traditionally (i.e. pre International Financial Reporting Standards UKGAAP) the minimum requirement has been for the building itself although in some instances this may also have included some of the following:

- plant and equipment
- external works
- building services

It is therefore essential that the valuer discusses with the authority the approach to componentisation. Not all assets will need to be split into components.

13.6.3 The DVS Building Surveying team has developed a 26 point elemental breakdown (under 6 headings) for Depreciated Replacement Cost (DRC) valuation purposes and this could be used as a basis for componentisation (see examples in 13.7.3 & 5). However, this level of detail is unlikely to be necessary and a minimal approach is recommended wherever possible. The final decision will rest with the client after discussion with their auditors.

## **13.7 Categories of Building Components**

13.7.1 The following is offered to identify the possible extremes of componentisation so that, if required, the valuer can offer some alternative approaches for discussion with the Finance Director.

13.7.2 In deciding the degree to which a structure should be broken down into its component parts for depreciation purposes, the matter of materiality, i.e. the extent to which the additional componentisation will impact on the actual depreciation charge, needs to be considered. If the impact is minimal then the extra work involved in breaking down the structure into 10 or 20 component parts is unlikely to be justified. The Department's view, in discussion with CIPFA, is that it should be possible for a fairly pragmatic approach to be taken. The RICS / CIPFA issued a valuation information alert in December 2009, Valuations for Capital Accounting, which offered interim / transition guidance to valuers. CIPFA have now issued LAAP Bulletin 86 Componentisation of Property, Plant and Equipment under the 2010/11 IFRS-based Code, June 2010.

13.7.3 Full componentisation, following the example of a depreciated replacement cost approach to the valuation of operational assets might consider the following components (clearly the components could differ depending on the type of building):

- Substructure
- Frame
- Upper Floors
- Roof
- Stairs
- External Walls
- Windows and External Doors
- Internal Walls and Partitions
- Internal Doors
- Wall Finishes
- Floor Finishes
- Ceiling Finishes
- Fittings
- Sanitary Appliances
- Services Equipment
- Disposal Installation
- Water Installation
- Heat Source
- Space Heating and Air Treatment

- Ventilating Systems
- Electrical Installation
- Gas Installations
- Lift and Conveyor Installations
- Protective Installations
- Communications Installations
- Special Installations

13.7.4 A description of what is included under each of these headings is included in Appendix 6. These headings are consistent with those set out in Annex B to DCLG's paper *The Major Repairs Allowance*.

13.7.5 However, authorities may want to use a small number of components which are normally in any household the most expensive items to replace, eg kitchens, central heating boiler systems, bathrooms, roofs. In deciding this, authorities should have regard to the nature and degree of specialisation of the building, materiality and practicality. This should enable the authority to reduce the number of components to, for example, no more than half a dozen.

13.7.6 There may be circumstance where this can be further reduced, particularly with regard to materiality (e.g. internal finishes) – indeed some health sector bodies are generally using four components.

13.7.7 Under International Financial Reporting Standards componentisation is mandatory. However, the decision on the degree of componentisation to be used in individual cases and the recognition of depreciation is a matter for the authority and, depending on the circumstances, may not be necessary beyond the basic land and buildings apportionment.

## **13.8 Investment Property**

13.8.1 Investment property, as classified in IAS40 is land or building(s) or both held to earn rentals or for capital appreciation or both, rather than for:

- (a) Use in the production or supply of goods or services or for administrative purposes; or
- (b) Sale in the ordinary course of operations.

13.8.2 In accounting terms investment properties are, therefore, by definition “non-operational”. Valuers may come across situations where land and / or buildings are leased to third parties and for valuation purposes are treated as investments. In some instances these properties might be classified as operational and therefore cannot be classified as investment properties under IAS40.

13.8.3 Investment property is measured to Fair Value (IAS 40, paragraphs 33 to 55), effectively Market Value. It will reflect any current leases, current cash flows and any reasonable assumptions about future rental income or outgoings.

13.8.4 The table at paragraphs 1.7 of RICS VIP 9 states that where a body is the lessor of an operating lease, the asset will “usually” be classified as an investment property. However use of the word “usually” is misleading when the public sector is involved because there will be many occasions when a public sector body holding a property as lessor is doing so primarily for policy reasons rather than for rental or capital appreciation purposes.

13.8.5 It is the responsibility of clients to determine the classification of their assets and advise the valuer (see IAS 40 paragraphs. 14).

13.8.6 If the property is held as an investment under IAS40, depreciation of the asset would not be required as the depreciation is reflected in the Fair Value (market value). Annual revaluation may be needed, but the only requirement is that the value is not materially out of date.

13.8.7 If the asset is used in the business for service delivery then the lease classification process under IAS17 needs to be undertaken and associated figures provided as described in Chapter 8.

## **13.9 Discontinued Operations / Abandoned Assets But Not Qualifying as Assets “Held for Sale”.**

13.9.1 An authority shall not classify as “held for sale” a capital asset that is to be abandoned (use ceases but not “held for sale” as defined under IFRS5). This is because its carrying amount will be recovered principally through continuing use.

13.9.2 IFRS 5 permits only an asset that is to be sold to be classified as held for sale. Assets to be abandoned are classified under ‘non-operational’ and thus are depreciated.

13.9.3 Capital (non-current) assets to be classified under 'non-operational' include capital assets that are to be used to the end of their economic life and capital assets that are to be closed rather than sold.

### **13.10 Property “Held for Sale”**

13.10.1 IFRS5 states that:

- “6. 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.
- 7. 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.
- 8. 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.”

13.10.2 From a valuer's point of view, property that is classified as “held for sale” is valued to Fair Value having regard to its Market Value including potential for alternative use, with due allowance for any costs associated in achieving that alternative use. If there is no demand in the market for the use for which the property is designed then any specialised features which it may have will either be of no value or have a detrimental effect on value as they represent an encumbrance. Assets held for sale are included in the Balance Sheet at the lower of fair value (less costs to sell) or existing carrying amount, but this is a matter for accountants.

13.10.3 Land and/or buildings that cease permanently to be used for “service delivery” purposes by an authority become classified under the heading of ‘non-operational’. The valuer will need to establish in discussion with the authority whether the property has been declared as “held for sale” by the authority either individually or grouped with other assets or whether it is correctly classified as a surplus asset.

- 13.10.4 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.
- 13.10.5 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 'non-operational'.
- 13.10.6 A property is not subject to depreciation if it qualifies as "held for sale" under IFRS5.



# Chapter 14 - Impairment

## Key points

- background
- impairment
- measurement of impairment
- impairment within the Housing Revenue Account

## Key documents are:

- IAS36 - Impairment of Assets
- IPSAS21- Impairment of Non-Cash-Generating Assets
- The Code, Chapter 4.7 – Impairment of Assets

### 14.1 Background

14.1.1 Impairment is a reduction in the value of fixed assets below the carrying amount in the balance sheet. Where there is reason to believe that a reduction in value is material, the carrying value should be adjusted accordingly. The Code of Practice on Local Authority Accounting provides all the necessary detail on the accounting treatment of impairment. The purpose of this chapter is to provide the valuer with background knowledge as to how impairment affects valuation requirements.

14.1.2 Paragraph 4.7.1.1 of The Code states that: “Authorities shall account for impairments in accordance with IAS 36 Impairment of Assets, except where interpretations or adaptations to fit the public sector are detailed in the Code. The objective of the standard is to ensure that assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the standard requires the recognition of an impairment loss.”

### 14.2 Impairment

14.2.1 IAS 36.6 contains the following definitions:

- a) Impairment: an asset is impaired when its carrying amount exceeds its recoverable amount
- b) Carrying amount: the amount at which an asset is recognised in the balance sheet after deducting accumulated depreciation and accumulated impairment losses
- c) Recoverable amount: the higher of an asset's fair value less costs to sell (sometimes called net selling price) and its value in use

- d) Fair value: the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties
- e) Value in use: the discounted present value of the future cash flows expected to arise from: the continuing use of an asset, and from its disposal at the end of its useful life

14.2.2 Impairment is defined in IPSAS 21 (19) as :

“a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation (amortization). Impairment, therefore, reflects a decline in the utility of an asset to the entity that controls it.”

14.2.3 IPSAS21 (22) requires that:

An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

1. External sources of information

(a) Cessation, or near cessation, of the demand or need for services provided by the asset.

(b) Significant long-term changes with an adverse effect on the entity have taken place during the period or will take place in the near future, in the technological, legal or government policy environment in which the entity operates.

2. Internal sources of information

(c) Evidence is available of physical damage of an asset.

(d) Significant long-term changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, or plans to dispose of an asset before the previously expected date.

(e) A decision to halt the construction of the asset before it is complete or in a usable condition.

(f) Evidence is available from internal reporting that indicates that the service performance of an asset is, or will be, significantly worse than expected.

14.2.4 IPSAS21 (25) states that::

There may be other indications that an asset may be impaired. The existence of other indications may result in the entity estimating the asset's recoverable service amount. For example, any of the following may be an indication of impairment:

(a) During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use; or

(b) A significant long-term decline (but not necessarily cessation or near cessation) in the demand for or need for services provided by the asset.

14.2.5 Clearly several of these indicators are specific to the authority and outside the general knowledge of the valuer. Therefore impairment should be considered by the valuer in the context of evidence of physical damage and market value decline. Other reasons for impairment are a matter for the client authority to consider.

14.2.6 Impairment is also covered in Chapter 4.7 of The Code and includes interpretation in the public sector context, definitions of terms and refers to IAS36 and IPSAS21 as above.

### **14.3 Summary of Impairment**

14.3.1 Impairment occurs because something has happened to the fixed assets themselves or to the economic environment in which the fixed assets are operated. In the case of the Housing Revenue Account assets, changes that indicate impairment may have occurred include (The Code, 7.4.2.11):

- a significant decline in the demand for social housing;
- evidence of obsolescence or physical damage to the asset;
- a significant adverse change in the statutory or other regulatory environment in which the authority operates;
- a commitment by the authority to undertake a significant housing reorganisation.

### **14.4 Measurement of Impairment**

14.4.1 Impairment is measured by comparing the carrying value of the fixed asset in the balance sheet with its current value. Where current value is less than the value in the balance sheet, impairment has occurred. From a valuation perspective, in the case of the Housing Revenue Account assets, impairment occurs where there is a reduction in Existing Use Value-Social Housing.

14.4.2 It is not always practicable to carry out individual property valuations to establish whether there has been a reduction in the carrying value and this is certainly the case for Housing Revenue Account property. Valuations for impairment within the Housing Revenue Account should be carried out on groups of properties, and the appropriate groupings in most cases will be the asset groups, which are also the groups to be adopted for the annual desk top reviews.

## **14.5 Impairment and the Housing Revenue Account**

- 14.5.1 The Code of Practice on Local Authority Accounting requires impairment reviews where there are 'trigger events' which suggest a change of value may have occurred and examples of these events are set out in this Guidance at para. 14.3.1.
- 14.5.2 As the Housing Revenue Account housing assets are depreciated it is unlikely that impairment will occur unless there are external events or changes in circumstances which cause a sudden reduction in value. This is because impairment caused by wearing out of the asset is already accounted for. In the case of Housing Revenue Account assets, impairment reviews will form part of the annual desk top reviews which are covered in detail in Chapter 16.
- 14.5.3 When carrying out the annual reviews in accordance with Chapter 16, it is important to look at all sources of information to establish whether there have been any "trigger events" which may indicate falls in value. This information and its effect on values should be incorporated into the index which is applied to revise the asset group valuation. Chapter 16 provides details of the methodology behind the annual review valuations.
- 14.5.4 Impairment reviews are particularly important where authorities have decided that no depreciation charge is made on the grounds that it would be immaterial, or even when depreciation is charged where the remaining life of the assets is in excess of fifty years. Reviews are considered necessary in these cases, even in the absence of trigger events, because year on year depreciation may lead to impairment which is not fully recognised.
- 14.5.5 If there has been a reduction in value the remaining life and the residual value should also be reviewed and revised, where necessary, if that method of depreciation has been adopted.

## **14.6 Valuation Requirements for Housing Revenue Account assets**

- 14.6.1 The annual desk top reviews and rolling programmes of revaluations, which are described in full in Chapter 16, will cover all the requirements for carrying out impairment reviews. These annual reviews will capture not only any material increases in value in an asset group, but also any material falls in value, i.e. impairment. No additional valuations are required for impairment reviews other than the annual desk top valuations.
- 14.6.2 Where under the annual review the asset group value has been impaired, the valuer must make a note in the report of the amount of the loss and the reason for the reduction in value resulting from the impairment. The accounting treatments are explained in the Code of Practice on Local Authority Accounting, Chapter 4.7.

## **14.7 Reporting**

14.7.1 The annual review schedules as detailed in Chapter 16 will incorporate all the information resulting from any impairments that have been recognised.

14.7.2 Valuers should note the changes since SORP 2009 as set out in paragraph 4.7.6 of The Code.

14.7.3 The Code requires that an annual assessment shall take place as to whether there is any indication that an asset may be impaired. If any indication exists, the recoverable amount shall be estimated. There is no longer a specific requirement to undertake an impairment assessment of assets when either:

- a) no depreciation charge is made on the grounds that it would be immaterial or
- b) the estimated remaining useful life of the fixed asset exceeds 50 years.

In addition IAS 36 does not exempt non-depreciable land from impairment reviews and IAS 36 makes no distinction between impairments due to the clear consumption of economic benefit and other impairments (ie general fall in prices specific to the asset).

# Chapter 15 - Valuation Reports

## Key points

- valuation report and property schedules
- notional costs of acquisition and disposal
- beacon portfolio

## 15.1 Introduction

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

- a valuation report;
- a beacon portfolio.

## 15.2 The Valuation Report

15.2.1 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 Housing Revenue Account assets. The minimum content of valuation reports are set out in the Red Book (PS 6.1).

15.2.2 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 Discounted Cash Flow approach if appropriate). The incorporation of these schedules will allow a reader of the report to follow the make up of the final valuation.

15.2.3 The exact format of the report is the responsibility of the valuer subject to the requirements of the RICS Valuation Standards PS 5.1. The valuer responsible for undertaking the valuation must sign the report and any subsequent valuation reviews.

15.2.4 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.

## 15.3 Notional Directly Attributable Acquisition and Disposal Costs

15.3.1 UKPS 1.7 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.

- 15.3.2 For the Housing Revenue Account 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 (Existing Use Value) should be made.
- 15.3.3 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 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 Standards 6th Edition UKPS 1.7 the deduction for these costs must be shown separately from the actual valuations.

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

- 15.4.1 In addition to the balance sheet valuation (Existing Use Value) 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.

#### **15.5 The Beacon Portfolio**

- 15.5.1 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 should be grouped into asset groups and indexed, for ease of use.

## Chapter 16 - Revaluations and Valuation Reviews

### Key points

- purpose and approach
- commissioning of valuation services
- requirements and methodology
- treatment of improvements, assets in course of development, leases
- valuation timetable

### 16.1 Purpose and Approach

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

- the Housing Revenue Account 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.

16.1.2 IAS16 (para.31) states that: "valuations 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."

16.1.3 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.

16.1.4 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.

16.1.5 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.

16.1.6 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 (paragraph 4.1.2.35 of The Code). **However, the Code does not specify how the revaluation should be done, and, exceptionally for 2010-11, an appropriate desk top exercise would meet the requirements with the more comprehensive valuation taking place in 2011-12.**



16.1.7 Possible approaches include:

- a full revaluation every five years with desk top reviews in the other four years;
- a full revaluation of 20 per cent of the stock every year with a desk top review of the remainder, informed by the results of the revaluation;
- a full revaluation of a varying percentage of the stock over the five years with desk top reviews for the remainder, informed by the results of the revaluation.

16.1.8 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 Housing Revenue Account 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.

## **15.6 Commissioning the Valuations**

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

16.2.2 The valuations should be carried out by a qualified internal or external valuer, with no necessity for review of full revaluations by an external valuer if the internal valuer is used. This position 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.”

16.2.3 The CIPFA Code of Practice on Local Authority Accounting states that “where assets are re-valued (i.e. the carrying amount is based on Fair Value), valuations shall be carried out at intervals of no more than five years. Valuations may be carried out on a rolling basis or once every five years. (4.1.2.35)”.

16.2.4 The Fair Value of land and buildings shall be undertaken by professionally qualified valuers. (4.1.2.36)

16.2.5 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. (4.1.2.12). This definition of qualified (internal or external) valuer should be followed when commissioning the valuations.

16.2.6 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.

## **16.3 Minimum Requirements for the Review**

16.3.1 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.

## **16.4 Annual Review Methodology**

16.4.1 The approach should be based on a desk top review of the Discounted Cash Flow 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
- changes in rental levels, investment yields and property management costs

16.4.2 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 desk top valuations and so it is important to consider the possibility that downward movements in value may have taken place.

16.4.3 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. Chapter 14 gives a more detailed explanation of impairment.

16.4.4 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.

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

16.4.6 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.

- 16.4.7 As these assets are expected to form a small part of the Housing Revenue Account 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 Housing Revenue Account asset value. In some cases movements in value may not be material and if this is the case the existing valuations should be adopted.
- 16.4.8 However there will be circumstances where it is appropriate to update values of these non-housing and non-operational assets and the recommended approach is the use of an index, based on market evidence within that property sector. This index, after allowing for disposals, could be applied to the respective total values i.e. land and buildings as reported in the original asset valuation or the previous update.
- 16.4.9 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. 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.
- 16.4.10 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.

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

- 16.5.1 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;
  - review other categories of properties.

## **16.6 Annual Review Inspections**

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

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

16.7.1 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 desk top review should include a statement to this effect.

16.7.2 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;
- details of any development/refurbishment schemes either still in progress or initiated since the last valuation.

16.7.3 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.

## **16.8 Treatment of Improvements**

16.8.1 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 Housing Revenue Account assets.

16.8.2 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 desk top

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.

- 16.8.3 The approach in 16.8.2 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.
- 16.8.4 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.
- 16.8.5 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.
- 16.8.6 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.

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

- 16.9.1 New build schemes in the process of construction at the date of review should be included in accordance with Chapter 10 para 10.3.
- 16.9.2 Category A schemes will be reviewed automatically as part of the asset group review as any work will be already reflected in the valuation.
- 16.9.3 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.

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

- 16.10.1 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.
- 16.10.2 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;

- the remaining properties should be indexed having regard to indices used for other assets in the portfolio.

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

16.11.1 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.

## **16.12 Method of Reporting Annual Reviews**

16.12.1 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 with authorities to meet their particular reporting requirements.

16.12.2 When preparing the report for the desk top 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.

16.12.3 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.

## **16.13 Timetable**

16.13.1 Annual reviews, re-valuations and/or rolling programmes of revaluations should be carried out in line with this guidance on an annual basis. The valuation date is 1 April in each year.

# Appendix 1 - Valuation Bases

## 1. Introduction

- 1.1 The basis of financial reporting and asset valuations for financial statements has changed considerably over the last five years and it is important that the valuer understands the current situation and what could change following further review.
- 1.2 International Financial Reporting Standards replaced UKGAAP (FRS and SSAP) in Central Government with effect from 1 April 2009 and in Local & Regional Government with effect from 1 April 2010.
- 1.3 In summary, this has required a fundamental re-assessment of the basis of asset valuations, definitions and assumptions to be made resulting from the change to International Financial Reporting Standards and the resulting need for RICS definitions and guidance to match both International Financial Reporting Standards and International Valuation Standards definitions,
- 1.4 The UKGAAP basis of valuation for financial reporting, Existing Use Value, is not a recognised valuation basis under International Financial Reporting Standards accounting and there is ongoing international debate on the exact definition to be used.
- 1.5 International Financial Reporting Standards International Accounting Standard 16: Property, Plant & Equipment (IAS16) requires asset valuations to be to Fair Value, which is recognised in the accounting standards as being an exit value - effectively the Market Value which may be realised on disposal. **Fair Value** is defined in IAS16 as the amount for which an asset could be exchanged between knowledgeable, willing parties in an arms length transaction and IAS 16 states that this is usually determined from market based evidence by appraisal. This figure reflects any potential alternative uses which may give a higher value than the existing use. Such an interpretation ties in with the IVSC's IVA 1 paragraph .4.1 (reproduced as Appendix 4.1 of the RICS Valuation Standards).
- 1.6 The Financial Reporting Advisory Board (FRAB) and HM Treasury decided in Summer 2009 that for "in use" non-specialised assets held by the UK central government public sector, Fair Value under IAS 16 will be interpreted from 2009/2010 forwards as being restricted to the market value for existing use. This special assumption effectively means a continuation of the former Existing Use Value basis when assessing Fair Values for these properties.
- 1.7 The Treasury FReM for 2009/10 has been revised to accomplish this, and section 6.2.5 of it now states: "For 'in use' non-specialised property assets Fair Value should be interpreted as **market value for existing use.**" This means potential alternative uses will not be reflected.

- 1.8 Despite this the term “Existing Use Value” (EUV) should not be referred to in reports as it no longer exists as a valuation basis and references should be made to Fair Value but in the following terms:

*"Fair Value, which is the Market Value on the assumption that the property is sold as part of the continuing enterprise in occupation".*

possibly abbreviated to Fair Value (Existing Use Value) pending further guidance.

- 1.9 This qualification reflects the requirements of FReM 6.2.5 and uses the wording found in the RICS Valuation Standards at PS 6 Appendix 6.3 paragraph 8(a). For all practical purposes this is equivalent to Existing Use Value as it disregards potential alternative uses. This is the figure which will be used by the client to arrive at the depreciable amount for the balance sheet.
- 1.10 Where the valuer is aware that the asset may have a higher value for alternative use, this should be additionally brought to the attention of the client, just as in the past. This may take the form of just flagging up that the value for a potential alternative use may be significantly higher, or if the client requires it, providing an additional figure based on Fair Value (i.e. unrestricted market value). This is an additional "for information figure" however, not the figure for balance sheet use.
- 1.11 The situation in Local & Regional Government was equally uncertain and resulted in an “Exposure Draft” revising RICS Valuation Standards UKPS1.12 and UK Appendix 1.5 pending development of the CIPFA International Financial Reporting Standards based Local Authority Accounting Code.
- 1.12 The CIPFA/LASAAC Local Authority Code Board has released the 2010 Code Exposure Draft and Invitation to Comment for public consultation. The 2010 Code, which is the first to be prepared under International Financial Reporting Standards (IFRS), applies to accounting periods starting on or after 1 April 2010.
- 1.13 Chapter 4 , Property Plant & Equipment of the CIPFA/LASAAC Code 2010 contains the following definitions:

**4.1.2.8 Existing Use Value – Social Housing (EUV-SH)** is the estimated amount for which a property should exchange, on the date of valuation, between a willing buyer and a willing seller, in an arm’s-length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion, subject to the following further assumptions that:

- the property will continue to be let by a body and used for social housing
- 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 relet them, rather than with vacant possession
- any subsequent sale would be subject to all of the above assumptions.



4.1.2.9 For this section of the Code, **Fair Value** (for land and buildings) is to be interpreted as the amount that would be paid for the asset **in its existing use**. This requirement is met by providing a valuation on the basis of existing use value (EUV) in accordance with UKPS 1.3 of the RICS Valuation Standards.

- 1.14 For reporting purposes and to avoid the need to explain the absence of an Existing Use Value definition and usage, it may be useful to adopt a temporary abbreviation of Fair Value (EUV) for Fair Value, continuing enterprise in occupation.
- 1.15 How Fair Value may be interpreted from 2011/2012 remains fluid. RICS Valuation Standards Appendix 6.3 makes reference to the IASB undertaking a project to review the principles and several draft proposals have been circulating over the last year. The IASB is likely to issue a revised Fair Value standard towards the end of 2010 if agreement is reached between their working party and stakeholders. When revised guidance appears, Treasury has stated that it will consider the Fair Value issue afresh with FRAB.

## 2. Current Interpretation

- 2.1 The RICS has published an exposure draft of UKPS 1.12 Local Authority Asset Valuations and the associated Appendix 1.5 so that practitioners are prepared for the introduction of CIPFA's International Financial Reporting Standards based Code of Practice on Local Authority Accounting. The accounting concept of Fair Value is interpreted for the various different types of asset encountered in Local Authorities, viz:

"Subject to any assumptions that the Code requires, Fair Value is the same as market value.

For further guidance on Fair Value see PS 4.1 & 4.3, Appendix 4.1 and Appendix 6.3 (UK App 1.5 paragraph 1.6)

- 2.2 "For land and buildings, **Fair Value is to be interpreted as the amount that would be paid for the asset in its existing use**. This requirement is met by providing a valuation on the basis of existing use value in accordance with UKPS 1.3; and, where significantly different, the Market Value (that is, the valuation does not disregard alternative uses). A statement should be made that there is no account of issues such as reducing the service potential, or disruption, and the associated costs that would be incurred in achieving that alternative use (see UKPS 1.4)." (UK Appendix 1.5 paragraph 3.3)
- 2.3 UK Appendix 1.5 paragraph 3.6 covers the Fair Value of council dwellings and states this DCLG guidance 'may be followed'. This wording is expected to change following the 2010 review of DCLG guidance.
- 2.4 **Existing Use Value for Social Housing (EUV-SH)** as defined in the RICS Valuation Standards (6<sup>th</sup> edition) UK PS 1.13 is:

“The estimated amount for which a property should exchange, on the date of valuation, between a willing buyer and a willing seller, in an arm’s-length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion, subject to the following further 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 assumptions.”

**2.5 Market Value (MV):** as defined in the RICS Valuation Standards (6<sup>th</sup> edition) at PS 3.2 is:

“The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.”

**2.6 Depreciated Replacement Cost (DRC) approach:** For certain properties no Existing Use Value or MV can be determined, owing to their specialised nature and because they are rarely sold on the open market, except as part of a sale of the business or entity of which they are part. Such specialised properties are likely to be rarely found in the Housing Revenue Account; they are valued using a depreciated replacement cost, defined 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”. (RICS Valuation Standards (6<sup>th</sup> edition) Glossary)

**2.7** UK Appendix 1.5 paragraph 3.5 directs the valuer to use depreciated replacement cost where appropriate.

The valuer must have regard to the requirements of PS 6.6, *depreciated replacement cost in the public sector*, and PS 6.7, *comparison of depreciated replacement cost valuations and alternative MV’s*. In addition, Valuation Information Paper 10, *The depreciated replacement cost method of valuation for financial reporting* contains detailed information on the use and application of depreciated replacement cost when valuing for financial statements.

**2.8** Early and ongoing dialogue with the client is vital. RICS guidance is not tightly prescriptive regarding aspects of asset valuation methodology, particularly at the

detail level of depreciated replacement cost. Within their confines, many subtle variations in approach or interpretation are possible and these can have a significant impact on the resulting figures produced. An instruction which simply asks for an asset valuation to be undertaken in accordance with RICS Red Book will be insufficient to ensure that the entity receives a common result and consistency of approach over time, regardless of which valuer is used. Discussion between entity and valuer about the exact nature of the entity's bespoke requirements and how these can best be fulfilled is essential. Sufficient details about the exact approach employed must be captured for the benefit of future valuations, when it is likely that there will have been a change of valuer.

## Appendix 2 - Sample Beacon Record Sheets

### Beacon Record Sheet Number 1

Address	15 Smith Road, Townley YY3 2PX
Date of Inspection	1st May 2010
Valuation date	1st April 2010
Accommodation	kit, Lr, 2 beds, bath, w/c
Floor area	optional
Type	1930's semi detached
Asset Group	Riverside Estate
Archetype	2 bed semi
Number within Archetype	500 (includes 10 linked properties)

Comparable evidence (exact address should not be quoted, but sufficient information on location to allow an assessment of the quality of the comparable)

Open market sales on adjacent estate within last 6 months at:

- A) £55,000 for 3 bed semi with new kitchen and bathroom
- B) £45,000 for 2 bed semi similar condition
- C) £40,000 for 3 bed terrace poorer location

Adjustment to comparable

Comparable A deduct £5,000 for bedroom, £5,000 for kit and bath £45,000

Comparable B deduct £2,000 as better location than beacon £43,000

Comparable C add £7,000 as poorer location than beacon and terrace, deduct £5,000 for extra bedroom £42,000

Beacon Value	% variation across	Variants	Remarks
£43,000	40,000-£45,000	10 units at £40,000	

Quality Indicator Box	V Good	Good	Adequate	Limited/Poor
Comparables	**			
Condition of Beacon		**		
Quality of locality		**		

### Archetype Valuation

Property types	No	Value of Beacon Property	VP of group based on beacon assumptions	Adjustment Factor 40% to EUV-SH
beacon properties	490	£43,000	£21,070,000	£8,428,000
variant 1	10	£40,000	£400,000	£160,000
<b>Total value of archetype</b>			£21,470,000	£8,588,000

Variants are located at 1-19 John Street

### Beacon Record Sheet Number 2 (final stages of decline)

Address	Deanside Square properties
Date of Inspection	1st May 2010
Valuation date	1st April 2010
Accommodation	250 flats with kit, l/r, 2 beds, bath and w/c
Floor area	Optional
Type	Five 1960's 10 storey tower block
Asset Group	Riverside Estate
Archetype	vacant property (Deanside Square)
Number within Archetype	250

### Comparable evidence

No owner-occupied sales, no Right to Buy sales or applications, properties not being re-let, 95 per cent properties vacant, remaining tenants on transfer list, likely to be declared surplus and demolished within next three years but no definite plans. Lifts need replacing.

- a) cash sales for terrace houses nearer centre of town with letting demand £3,000 per unit
- b) nearest flats with owner occupied market half a mile away market sell for £25,000 for 3 bed

### Adjustment to comparable

Comparable sales are for properties where there is an identifiable demand. Subject properties so poor and in poor location that no letting demand.

Beacon Value	% variation across the archetype	Variants	Remarks
Value of whole archetype is NIL	N/A	N/A	

### Adjustment to comparable

Quality Indicator Box	V Good	Good	Adequate	Limited/Poor
Comparables			**	
Condition of Beacon				**
Quality of locality				**

### Archetype Valuation

Property types	No	Value of Beacon Property	VP of group based on beacon assumptions	Adjustment Factor 50% to EUV-SH
vacant properties	250	Nil	Nil	N/A
<b>Total value of archetype</b>			Nil	Nil

### Beacon Record Sheet Number 3 (second stage of decline)

Address	5 Charles Square
Date of Inspection	1st May 2010
Valuation date	1st April 2010
Accommodation	3 bed semi detached
Floor area	Optional
Type	1970s terrace and s/d houses
Asset Group	Riverside Estate
Archetype	difficult to let property (Charles, Russell and James Square)
Number within Archetype	100

### Comparable evidence

No owner occupied sales, no Right to Buy sales or applications, estate of last resort for tenants on waiting list, used as temporary accommodation in emergency re housing cases, tone of rents equivalent to private sector, long term voids in excess of 40%. Anticipated that unless major regeneration of the area takes place all the properties will be empty in medium term (3-5 years). Current rents average £1500/unit per annum

### Valuation

Gross Rent	£150,000
voids 60%	£90,000
management	£22,500
repairs	£22,500
Total Outgoings	£135,000
Net rent	£15,000
YP 5 yrs 16%	3.2
Valuation	£48,000 (£1,200 per occupied unit)

Beacon Value	% variation across the archetype	Variants	Remarks
Value of whole archetype is £48,000	N/A	N/A	

Quality Indicator Box	V Good	Good	Adequate	Limited/Poor
Comparables				**
Condition of Beacon				**
Quality of locality				**

### Archetype Valuation

Property types	No	Value of Beacon Property	VP of group based on beacon assumptions	EUV-SH Adjustment Factor 45%
difficult to let	100	N/A		N/A
<b>Total value of archetype</b>			<b>£48,000</b>	<b>£48,000</b> (see record sheet for valuation)

### Beacon Record Sheet Number 4 (first stage of decline)

Address	15 Meadowburn Crescent
Date of Inspection	1st May 2010
Valuation date	1st April 2010
Accommodation	3 bed semi detached
Floor area	Optional
Type	1950 two and three bed terrace and s/d houses
Asset Group	Riverside Estate
Archetype	difficult to let property (Meadowburn Rd, Cres and Square)



Number within Archetype	150
-------------------------	-----

### Comparable evidence

No owner occupied sales, no Right to Buy sales or applications, one of the less attractive estates for tenants on waiting list but properties re-let although slower than for better estates. Characterised by pockets of boarded up units awaiting re-let. Group will remain as part of authorities lettable stock and in long term envisaged refurbishment may take place. Private sector rents and affordable rents show little difference in tone.

- a) cash sales for terrace houses nearer centre of town with letting demand £5,000 per unit
- b) ex-council house sold as investment on adjacent estate for £3500
- b) nearest council property with owner occupied market half a mile away market sell for £22,000 with VP for 2 bed house

Adjustment to comparables/valuations

Comparable investment sales suggest £3,000-£5,000 a unit for similar accommodation  
Letting demand unlikely to improve but stable over last two years  
Long term the estate will have a future following refurbishment

### Valuation

150 units	150
letting units	150
value/unit	£2,500 (to allow for longer void periods than with comparables)
Valuation	£375,000

Beacon Value	% variation across the archetype	Variants	Remarks
Value of whole archetype is £375,000	N/A	N/A	

Quality Indicator Box	V Good	Good	Adequate	Limited/Poor
Comparables				**
Condition of Beacon				**
Quality of locality				**

### Archetype Valuation

Property types	No	Value of Beacon Property	VP of group based on beacon assumptions	EUV-SH Adjustment Factor 45%
difficult to let	100	£2,500		N/A
<b>Total value of archetype</b>			<b>£375,000</b>	<b>£375,000</b> (see record sheet for valuation)

### Asset Group Valuation Sheet

#### Asset Group - Riverside Estate

Archetype	VP of group based on beacon assumptions	Stock number	Valuation EUV-SH
2 bed semi	£21,470,000	500	£8, 588, 000
Vacant properties (Deanside Square)	Nil	250	Nil
difficult to let (Charles, Russell, and James Square	£48,000	100	£48,000
difficult to let (Meadowburn Rd, Cres and Square	£375,000	150	£375,000
<b>Total</b>	<b>£21,893,000</b>	<b>1,000</b>	<b>£9,011,000</b>

## Appendix 3 – Departures from the RICS Valuation Standards 6<sup>th</sup> Edition and Assumptions and Limitations in the Valuation Report

### 1. Departures from the RICS Appraisal and Valuation Standards 6<sup>th</sup> Edition

#### 1.1 Additional Fair Value: Valuations for Housing Revenue Account Assets

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

Where there is a significant difference between either Existing Use Value, Existing Use Value-Social Housing and the depreciated replacement cost approach and Fair Value a valuation on the basis of Fair value (Market Value) must also be prepared and the report state the reasons for the difference.

RICS Appraisal and Valuation Standards,

PS 6.7: When reporting a *valuation* which has been estimated by using *depreciated replacement cost* methodology, the valuer must state in the report:

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

and

UK PS 1.4.:Where there is a significant difference between the Existing Use Value and *MV* of the same property the valuer must provide an opinion on both bases and explain the reasons for this in the *report*. Any published reference to the must refer to the on both bases, except where the difference has no material effect on the aggregate value of the entity's *properties*.

##### ***Departure***

Unless specifically required by the authority, Fair Value for properties affected by the above are not required.

##### ***Reason for Departure***

The beacon approach/Discounted Cash Flow has been adopted for the majority of the properties in the Housing Revenue Account and therefore the valuation approach is not site specific. An alternative use value for these properties that form the bulk of the assets in the Housing Revenue Account is of little value.

## **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 in their existing state at date of valuation; RICS Valuation Standards UK Appendix 1.2.

### ***Departure***

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 Departure***

To avoid the necessity for local authorities to identify the costs of every refurbishment programme, however small.

## **1.3. Existing Use Value**

### ***Existing Standard***

The definition of Existing Use Value assumes that vacant possession will be provided on completion of the sale of all those parts of the property occupied by the business.

### ***Departure***

Housing Revenue Account properties have been valued subject to the terms of the occupational agreements.

### ***Reasons for Departure***

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.

## **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***

An inspection and investigations must always be carried out to the extent necessary to produce a valuation which is professionally adequate having regard to its purpose. RICS Valuation Standards PS 5.1.

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

An inspection of the beacon property is considered adequate for the valuation of the Housing Revenue Account residential assets.

Inspections and investigations on properties not valued on the beacon approach should have regard to RICS Valuation Standards 6<sup>th</sup> Edition, PS 5.1. and 5.2.

### ***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 valuation which is professionally adequate for its purpose. RICS Valuation Standards, PS 5.2.

### ***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 Standards, PS 5.2.

### ***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 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 Standards Appendix 6.3, paragraph 9).

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 Standards UKGN 1, paragraph 2.

### ***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

Existing Use Value - Social Housing (EUV-SH) is to be used for inclusion in Financial Statements for housing stock held for social housing. UKPS 1.13 defines Existing Use Value-Social Housing as

*“Existing Use Value for Social Housing is the estimated amount for which a property should exchange, on the date of valuation, between a willing buyer and a willing seller, in an arm’s-length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion, subject to the following further 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 assumptions.”*

In the case of local authority 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.

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.

The adjustment factors provided in the previous guidance for valuations carried out in 2005 have been reviewed given the significant changes in the housing market over the last five years. Over the period there has been significant growth in vacant possession values, falling yields in the private rented market and continued rent restructuring in the public sector.

As explained in the main body of this report (Chapter 3, paragraph 3.4) the revised adjustment factors are based on the ratio of private and public sector rents and yields. The workings behind the rental, yield and resultant adjustment factors are explained below.

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 LHA Direct. 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.

Information on yields has been derived from the RICS, Building Society, Chartered Surveyor firm publications, and government publications. A net yield of 4.75 per cent was adopted for the private sector for all regions. There was insufficient research available to support any material regional variations in private yields.

With regards to 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 evidence on these yields. The lack of evidence in respect of public yields has led to the need to apply professional judgement for this variable, and an adjustment of 3 per cent\* from the private sector evidence has been adopted, to produce a yield of 7.75 per cent for the socially rented sector.

*\* unattractive investment features such as sub-market rents and additional management liabilities are already accounted for in the calculation, which takes account of actual net rents.*

Three per cent was the consensus view of chartered surveyors consulted on this aspect.

Based on the above information capital values for each sector were calculated on a regional basis for each type. The resulting ratios for each region were averaged with appropriate weighting\* given to the proportion of types.

*\* a greater regard was had to the ratio generated by the dwelling type which had the most evidence. For example in Yorkshire and Humber 42% of private rents were in respect of 2 bed properties, and 9% in respect of 4 bed properties.*

**The resultant adjustment factors are as detailed in the schedule below.**

There is a material change in adjustment factors from 2005 and this is mainly due to the difference in the yields, in 2005 a 1 per cent difference between the private and public sector was used. However this is no longer considered to accurately reflect the additional risk and liability the public sector landlords undertake when compared with private sector investors.

Results typically show a 13 per cent drop in the adjustment factor from 2005 levels. This will increase the discount to be applied to the Beacon Value when calculating Existing Use Value-Social Housing.

Evidence suggests that an exercise based upon on the yields adopted in 2005 (5 per cent private; 6 per cent public) would produce an across board reduction of c2-3% in adjustment factor, with exception of 1 region.



<b>Adjustment Factors for England</b>	
<b>Region</b>	<b>Adjustment Factor</b>
North East	37%
North West and Merseyside	35%
Yorkshire and the Humber	31%
East Midlands	34%
West Midlands	34%
Eastern	39%
London	25%
South East	32%
South West	31%

The adjustment factor is applied to the total vacant possession valuation based on the beacon valuation. For example, if the vacant possession value of an estate in the West Midlands based on the beacon valuations is £500,000,000 , the Existing Use Value-Social Housing is £170,0000 (i.e. £500,000,000 x 34% = £170,000,000)

# 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			Clause / Ref. Number:  Comments

	value at the time of the sale? [17/10(b)]			
3	Is the lease term for the major part of the asset's economic life even if title is not transferred? [17/10 (c)]			<p>Clause / Ref. Number:</p> <p>Comments</p>
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)]			<p>Clause / Ref. Number:</p> <p>Comments</p>
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)]			<p>Clause / Ref. Number:</p> <p>Comments</p>
	<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)]			<p>Clause / Ref. Number:</p> <p>Comments</p>
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)]			<p>Clause / Ref. Number:</p> <p>Comments</p>
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?			<p>Clause / Ref. Number:</p> <p>Comments</p>
10	Does the lease contain a payment structure derived from specific interest rates or rates of			<p>Clause / Ref. Number:</p>

	return which would be required by a lender?			Comments
<p><b>ONLY NECESSARY TO CONTINUE IF ANSWERS ABOVE ARE INCONCLUSIVE</b></p>				
	<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

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**CONCLUSIONS AND RATIONALE:**

**DATE OF QUALITATIVE ASSESSMENT:**

**Name**

**Date**

# International Accounting Standards

## IAS 17 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:

	Information required:	Response	Comments / source of data
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		
	Information required:	Response	Comments / source of data
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**

See also VIP9.

UPRN / Property Code Number:

### **PROPERTY ADDRESS**

Valuation Date (lease inception)

01/01/2000

Construction date

01/01/1990

Original life of building

60

years

Life of building at lease inception

50

years

Length of lease

25

years

Building NIA

1,000

sq.m

Site area

0.1

hectares

Lease Rent

£100,000

p.a

Rate of return

7.00%

Residual Value

£263,213

### **1 ASSESS THE FREEHOLD VALUE**

#### **Valuation of freehold interest**

Initial lease rent

£100,000

YP in perpetuity, S.Rate

14.2857

Fair Value

**£1,428,571**

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

#### **(Deduct land or buildings value)**

Fair Value

£1,428,571

less residual value

£263,213

**Fair Value within Lease**

**£1,165,358**

### **3 APPORTION FREEHOLD VALUE BETWEEN LAND AND BUILDINGS**

Fair Value

£1,428,571

Replacement cost of building (depreciated) at lease inception

£1,000,000

**70%**

Land Element

£428,571

**30%**

**£4,286,000**

### **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

**Buildings value within lease**

**£854,537**

### **5 APPORTION THE VALUES UNDER THE LEASE**

Fair Value within Lease

£1,165,358

less Buildings value within lease

£854,537

0.73328

**land element within lease**

**£310,821**

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

Full componentisation, following a depreciated replacement cost approach to the valuation of Housing Revenue Account assets might consider the following components (clearly the components could differ depending on the type of building).

### **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**

Load-bearing 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, gantries, 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.

## Appendix 7 – Calculations for The Major Repairs Allowance

The Major Repairs Allowance is calculated on the basis of information from the English House Condition Survey. The English House Condition Survey is a national survey which collects detailed and consistent information on the condition and age of individual dwelling elements in all tenures, by way of physical inspections of dwellings by building surveyors. The English House Condition Survey is currently used in the construction of the stock condition indicators within the Generalised Needs Index and Housing Needs Index.

The English House Condition Survey is not large enough to be able to predict directly expenditure requirements for each local authority robustly and accurately. Instead, the English House Condition Survey is used to estimate the national average expenditure required on newly arising need for dwellings of 13 different types (the "national average Major Repairs Allowances").

Major Repairs Allowance allocations for each authority are derived by applying the national average Major Repairs Allowances to the number of eligible dwellings of each type owned by an authority. This means that stock information is the only information required from authorities in order to calculate their Major Repairs Allowance: this is submitted by authorities through the Housing Revenue Account Subsidy Base Data Return each year. Regional differentials in the costs of renovation work are applied, in the same way as currently within the GNI, based on data from the Building Cost Index Price Indices for Public Sector Housing.

By calculating separate national average Major Repairs Allowance weights for different dwelling types within the local authority sector, the methodology recognises that all dwellings within the local authority stock are not currently in the same condition and do not have the same requirements for expenditure to meet the costs of newly arising needs. Dwellings of different construction types, age and size have different expenditure requirements.

Information on elemental lifetimes and replacement costs for each of the archetypes is provided by the Valuation Office, following consultations with a group of building professionals, including representatives from Local Authorities. The assumptions behind these formed part of the consultation in November 1999.

The DCLG paper on the Major Repairs Allowance contains more detailed explanations on methodology, assumptions and adaptations for local circumstances.

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