THE VALUATION PROCESS

To: **Governance & Audit Committee - 13 January 2011**

Main Portfolio Area: **Regeneration and Economic Development**

By: **Justin Thomson**

Classification: ***Unrestricted***

Summary: **At the meeting on the 28th September, the Committee was advised that a number of issues had been addressed, in relation to valuation. The Committee asked that a valuation officer be present at the next meeting.**

1.0 Introduction and background

1.1 Governance and Audit expressed interest in the purpose of property valuation, and how valuation operates at TDC.

1.2 This briefing note provides the information sought.

1.3 The Council's resources, like any other organisations' may be considered as;

- Cash
- Employees
- Property
- Equipment

1.4 TDC has a duty to ensure that it regularly monitors all of these assets to fulfil its statutory duty and shows residents that it is using resources effectively.

1.5 There are two sets of rules setting how property must be valued. These are:

i) Accountancy Regulations: CIPFA Code of Practice for Local authority Accounting; (IFRS) International Financial Reporting Standards

ii) Royal Institution of Chartered Surveyors Valuation Standards 6th Edition and Property Law

1.6 The s151 officer has a statutory duty to maintain the Council's asset register, together with accurate valuations of its property portfolio and to make sure that its financial accounts provide a fair and accurate representation of the Council's financial position.

1.6.1 The Council's portfolio has a total value of £69.3m, as at 31.3.2009. This is updated annually, on a rolling five year basis, at least 20% of the portfolio is valued each year.

2.0 Information

2.1 The Asset Management Strategy

All properties are entered on the Asset Register.

For each property the following details must be kept up to date.

- Valuation
- Repair/maintenance
- Rent reviews

Thanet had a backlog of incomplete records. In addition to this, it did not have up to date maintenance schedules for each property, could not ensure that it carried out rent reviews, within the prescribed time scale, under the terms of the lease (therefore risk of missing rent increases) and did not have up to date valuations on all property. Over the past three years these issues have been addressed.

2.2 Categories of Property

The level of income derived from a property will depend on its use. Broadly, retail premises attract the highest rents, followed by offices and industrial premises. There may be exceptions to this generalisation, which are affected by local market conditions. All properties on Thanet's Asset Register fall into one of the following categories.

i) Used for direct service delivery e.g. Margate Offices, Crematoriums etc.

ii) Leased to Thanet Leisure Force e.g. Winter Gardens, Swimming Pool etc.

iii) Commercial Properties e.g. industrial estates, the Port and Marina.

iv) Community facilities e.g. Sea Cadets, Age Concern etc.

v) Parks and Seafront promenades

2.3 Valuations

These must be carried out by appropriately qualified surveyors, with relevant professional experience, in accordance with CIPFA and RICS guidance. At TDC there are three appropriately qualified surveyors, one Fellow of the Royal Institution of Chartered Surveyors and two Members of the Institution; who, between them, have well over 40 years of experience. This has been gained in both the public and private sectors, covering the full spectrum of the different types of property, including port operations.

The process, for a traditional freehold investment valuation, is as follows:

1 Check the physical extent of the asset.

2 Establish the rental value

i) Even if the property is let and income producing, the rent payable may be below its market value, so the valuation will reflect the prospect of an increased rent from the next review date or next opportunity to increase the rent.

3 Determine the investment yield that should be adopted.

i) This is done to calculate a multiplier that reflects the security of the income stream generated from the property, the calibre of the tenant, position of the property, market trends and other sales or rental evidence.

ii) Investment yields have historically varied from sub 4% to around 25% and sometimes more. This is relevant because the lower the yield, the higher the multiplier and vice versa. A yield of 4% produces a multiplier of 25 and conversely, a yield of 25% produces a multiplier of 4. This multiplier is then used to capitalise the rental income.

A low yield demonstrates a good secure investment, secured by modern lease terms, with potential for regular income growth; a financially robust tenant, who is likely to want to continue trading in a prime location, which is in demand, such as the High Street of a good market town, which has no vacant units.

Taking an example from the Thanet portfolio:

2.4 **Former Marks and Spencers Store, High Street, Margate**

As has been recently publicised, Margate has the highest retail vacancy rate in the Southeast, which is reflected in the value of the property. At the peak of the market, the value of the M&S store might have attracted a yield in the region of 4%, giving a multiplier of 25. However, in the most recent valuation, the multiplier used was significantly below that figure and has more than halved i.e a much higher investment yield was adopted to reflect the lack of tenant and general uncertainty.

The reason for this is twofold:

1 There has been a large decline in values in the High Street, which has affected yields generally.

2 The store is no longer occupied or income producing and the rental value is now estimated to be half what it was, when let.

In this sort of situation, it is therefore necessary to make a judgement as to when the building might become income producing. So, the estimated rental value is deferred for that period. In this case, it has been estimated that the building would not be income producing for 2 years, so the multiplier has been deferred for that period to reflect that judgement. That further reduces an already reduced multiplier.

Therefore, considering the two main elements in the valuation; both the rent and the appropriate multiplier have been drastically reduced, to reflect:

1 Property is vacant and deterioration of the High Street
2 Rents have declined severely

3 The calibre of a future tenant's covenant that might be attracted
4 The relative insecurity of the potential income
5 The lack of current income and likely void before income could be expected
6 Costs of holding the property whilst vacant

This therefore has a triple negative impact on value. Firstly, the estimated rental value has fallen sharply. Secondly, that income stream will not be received immediately and therefore needs to be deferred. Third, the yield has also increased significantly to reflect these uncertainties, which results in a much lower multiplier. The current value is therefore significantly below what it was at the peak.

2.5 **Specialised Properties**

The rules of the Royal Institution of Chartered Surveyors stipulate that surveyors carrying out asset valuations need to be professionally qualified. Of equal importance, they are also required to have relevant, recent experience of valuing the types of property under consideration.

So, for example, the Port of Ramsgate requires periodic valuation, as with the rest of the portfolio. This consists of a lot of specialised structures, such as the pontoons and breakwaters, which require specialist valuers, to carry out the valuations. The Valuation Office has specialist building surveyors who are experienced in this type of work. They have therefore been instructed to carry out the current port valuation, in so far as this cannot be done 'in house'.

2.6 **Rental Income**

Over the last three years, rental income has remained relatively static, in spite of the worst recession for 70 years, at just over £1.1million p.a.This does not include income from property in the 'new port', to the west of the Royal Harbour.Two large lettings have been documented over the last year, which together, will add £163,000 p.a of income, when fully implemented towards the end of next year. Significant progress has also been made towards letting or selling long leases at the Eurokent Business Park, which is helping to maintain income.

In the current economic climate, it is difficult to predict the future, particularly as the recent public sector cuts that have been announced are likely to have an impact on the economy but this will take some time to be reflected in economic activity and gauge what effect they will have. In the last year more vacancies have occurred in our property but new lettings have also been achieved.

During this period, the Estate Department has also been able to catch up with outstanding rent reviews, which has helped to offset reductions that might have arisen due to vacancies. All of these factors, together are helping to maintain income against a background of very poor economic conditions. Further port related lettings are also anticipated, in the short term.

This emphasises the need to keep up to date with rent reviews and achieve lettings of vacant property, to take opportunities to increase income from the portfolio.

2.7 **Conclusions**

Significant progress has been made in bringing records up to date. These have been computerised, which makes the task of monitoring and entering any changes much easier. As has been demonstrated, good accurate information is a basic element of good estate management and providing accurate valuations. This practice needs to continue.

In tandem with this, more control has been introduced into the rent review process, to enable all available income to be assessed and documented. As has been shown, income received bears a direct relationship to value and therefore it is imperative that good records are maintained and that rent reviews are implemented when they are due, so that values can reflect the maximum rents available.

3.0 Options

3.1 This report is for information.

4.0 Corporate Implications

4.1 Legal

The valuation process needs to be undertaken on an annual basis by qualified staff, to-ensure the section 151 officer's statutory obligations are fulfilled.

4.2. Corporate

4.2.1. This process is consistent with effective asset management.

4.4. Equity and Equalities

There are no implications to be considered under this heading.

6.0 Decision-making Process

There are no decisions required.

Contact Officer: Justin Thomson, Tel: (01843) (57)7053