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Your Reference :
Our Reference : CE1/09/141
Please ask for : Geoff Scheers

Date : 2 September 2010

Dear Sirs,

**EXPOSURE DRAFT
PROPOSED NEW INTERNATIONAL VALUATION STANDARDS
IVS 303.04 – VALUATIONS OF TRADE RELATED PROPERTY**

The Valuation Office Agency (VOA) are, amongst other things, responsible for advising Her Majesty's Revenue and Customs (HMRC) on valuations of properties for tax purposes. Together with colleagues in HMRC we are currently in debate with the Royal Institution of Chartered Surveyors (RICS), the Chartered Institute of Taxation and others, on the approach and assumptions to be made when valuing Trade Related Properties for various tax purposes. We have, through our representative on the RICS Trade Related Valuation Group, contributed to the drafting of the RICS Guidance Note 1 on the 'The Valuation of Trade Related Properties', the Exposure Draft of which was published by the RICS in June this year.

We are keen to ensure clarity of understanding and consistency in valuations of trade related properties and with this in mind would like to make the following suggestions regarding the draft guidance in IVS 303.04. The following suggestions have been agreed with HMRC (Shares & Assets Valuation) and we hope provide greater consistency with the wording of the new draft GN1. We consider the amendments to paragraphs 6 and 7 to be most important.

1. Paragraph 3

Line 9 – delete 'will' and replace it with 'may also'.

2. Paragraph 5

Line 2 – after the end of the first sentence, insert a new sentence to say 'Within either approach it is common and useful to consider a profits methodology.'

3. Paragraph 6

Line 8 – after 'location' insert a new sentence to say 'Whilst analysis on a unit basis may assist (for example per bed space) it is essential due care and consideration are given to the range and impact of different factors affecting trading potential'.

Line 8 - after 'approach' delete 'is often' and insert 'may therefore be'.

4. Paragraph 7

Line 1 – at the start of the paragraph insert two new sentences to say:

‘Since trading potential is specific to individual property characteristics, and predominantly underlies value for this category of property, it is usual to consider some form of profits approach.

When considering the value of a trade related property for owner occupation the Fair Maintainable Trade (FMT) that could be generated at the property by a reasonably efficient operator (REO) will be estimated and an assessment made of the expected Fair Net Operating Profit which is then capitalised at an appropriate rate of return reflecting both the potential risks and rewards of the property (and its trading potential) by comparison to relevant analysis of comparable transactions.’

Line 1 – at the start of the existing first sentence delete ‘The income approach is applied to a trade related property by’ and insert ‘Where advice is required for rental or investment purposes, alternate consideration may be given to’.

Line 4 – delete ‘can’ and insert ‘may also’.

Line 5 – delete ‘interest’.

5. Glossary of Terms

Trade related property – after ‘designed’ insert ‘or adapted’ and in the last line, after ‘business’ insert ‘use’.

With regard to the suggested changes to paragraph 7 I would explain that our concern is that the current wording infers that a rental approach will arrive at the value for owner occupation when the market in fact transacts on a direct capitalisation of EBITDA/FNOP. We consider the most common approach for large sectors of property within this area (such as pubs, hotels and nursing homes) remains consideration of a direct capitalisation of an estimated EBITDA (of FNOP) and believe it important this remains the primary approach within this guidance along similar lines to the GN1.

In such circumstances adopting a rental approach involves making assumptions which are unnecessary if applying a capitalisation to FNOP by direct analysis. In summary our reservations about using the rental approach when valuing an owner occupied property are as follows:-

- a. In order to arrive at a capital value the method involves making difficult judgements not only about the FMT but the percentage of profits to adopt as the rental value and the appropriate investment yield, both of which can only be derived from comparison with lettings and sales of other properties at different dates, which significantly increase the scope for disputes over the analysis and comparability of the evidence.
- b. Much of the available comparable rental evidence will relate to new lettings of properties that are either new or have previously been vacant or rent reviews/renewals that disregard the occupation of the property by the tenant and predecessors in title in accordance with s.34 LTA 1954.
- c. Much of the comparable rental evidence will relate to lettings where the tenant has had to provide the chattels and the return on this capital and risk is reflected in the rents paid.
- d. The valuation using this approach represents the value of the property to an investor not an owner-occupier.

- e. The valuation produces a valuation of the property only to which it is then necessary to add a valuation of the chattels. It will not include the premium value to an occupier of acquiring the tangible assets together as a package with the enhanced trading potential due to the established trading history and the ability to continue trading from day 1. Isolating the bare property asset may unfairly apportion any premium or share of marriage value away and overstate the intangible elements.

We hope you are able to take on board the above suggestions and for ease of consideration attach a word document highlighting the relevant sections with our suggested amendments.

If you have any queries or would like to discuss the suggestions further then please let me know.

Yours faithfully,

Geoff Scheers

GEOFF SCHEERS
Head of HMRC Professional & Policy Support
Valuation Office Agency