Dear Sirs

International Valuation Standards Council (IVSC)
The Valuation of Trade Related Property
Discussion Paper

INTRODUCTION

In August 2012, IVSC published the above Discussion Paper, setting out a number of issues identified by the Board on which views were invited before 31 October 2012. This letter constitutes a personal response from Richard Hulyer of Taylors Business Surveyors and Valuers to the Discussion Paper. The Directors of Taylors have submitted their own independent response which I believe closely matches my own

PERSONAL BACKGROUND

After graduating with a Business degree, I qualified as an Associate (now referred to as Member) of the RICS in 1988 and was elected a Fellow in 1999. I have spent virtually my entire professional career specialising in the valuation of Trade Related Property (hereafter referred to as “TRP”) undertaking, I would estimate, more than 3,000 such valuations. I have worked with specialist business valuers Pinders and Taylors and was also a Director of Christie & Co and Savills, the latter within their Hotels Department.

In 2009 I was invited to become one of the inaugural members of the RICS Business Valuation Group (BVG) due to my extensive business valuation experience of individual operational TRP’s such as hotels, care homes, public houses etc. In recent times, due to the obvious cross over with the activities of the RICS Trade Related Property Group, both groups have been working more closely together.

I am aware that RICS will be submitting its observations on the Discussion paper and I have had the opportunity of expressing my views on this submission. However, I believe the final RICS submission to be a compromise between very many differing views within the two Groups and the result is that it is in parts confusing, contradictory and above all lacks clarity. There are large areas with which I disagree. The following comments therefore represent my own personal views.

RESPONSE TO THE DISCUSSION PAPER

The Discussion Paper highlights certain issues regarding the valuation of Trade Related Property (TRP) which appear to have culminated from the draft Guidance Note as IVS 232 Trade Related Property, which was intended to replace GN12 which became effective on 31 July 2007. IVS 232 was not approved for a number of reasons and responses are invited by IVSC to certain specific questions to which I would respond as follows:
Question 1

a) Are you familiar with the former GN12?

Yes.

b) Is GN12 used in the valuations that you provide or receive?

GN12 is not specifically referred to within my valuations, although the principles are followed.

c) If you have answered yes to either of the above, what are the elements of GN 12 that you find useful in either reporting or interpreting valuations?

GN12 identifies properties that change hands as fully equipped operational trading entities, where the profits method of valuation is adopted, unlike most other properties. It clearly explains the principles of the profits method in Section 5.3 and 5.4 and it also identifies that goodwill forms part of such a valuation, but only “transferable goodwill”.

I believe GN12 to be a fundamentally sound document, but requires further explanation of the difference between “personal goodwill” and “transferable goodwill” by adaptation of Section 5.5.

Question 2

Do you consider that it is a) practical and b) necessary to define a distinct category of real property for valuation purposes based on the degree to which the buildings or any other structures are specialised?

I believe the key issue in defining a distinct category of real property for valuation purposes in this regard is:

1. That it has been specifically adapted for its specialist use; and

2. It is an asset that normally changes hand as a fully equipped operational trading entity valued having regard to trading potential.

I believe that GN12 effectively fulfils its purposes as a detailed Guidance Note on the valuation of TRP, albeit with a few minor alterations necessary.

Question 3

If you have answered yes to Question 2, do you consider that the term “Trade Related Property” adequately conveys the particular characteristics that may lead a valuer to adopt a different valuation method as compared to other types of property?

I believe that the term TRP conveys the specialist characteristics separating the method of valuation from other types of property, although with some clarification needed.

Firstly, it is important that the term “Property” within the TRP asset base is stated as clearly relating to the fully equipped operational entity and not just the land and buildings element as otherwise this can lead to confusion. Further, it is necessary to explain that this can mean both freehold property interests and leasehold property interests, as any guidance needs to cover both scenarios.
A leasehold interest in a property can change hands as a fully equipped operational entity as well as a freehold interest including the freehold real property interest. Leasehold transactions form a major part of the current level of market transactions and these leasehold property interests are valued having regard to the same profits method of valuation explained within GN12. Current guidance both from IVSC and RICS is not clear in this respect and this is a key point that needs to be addressed.

**Question 4**

If you have answered yes to Question 2, please also indicate the types of real property that should be included in distinct category.

Section 1.1 of GN12 correctly lists an example of TRP’s, although there are very many other categories of properties which would fall within this category that are not mentioned. As a minimum, I believe that “care homes” should be included within the preliminary list. Comment should be made that this is but a very small proportion of types of legal interests in properties that change hands as fully equipped operational entities to which the Guidance Note applies.

**Question 5**

If you have answered no to Question 2, are there any other characteristics other than the specialisation of the buildings or structures that you believe may require Trade Related Property to be separately categorised from other real property for valuation purposes?

As mentioned above, the key element of a TRP is that it is a type of (legal interest in) property that is usually bought and sold in the market as a fully equipped operational trading entity.

**Question 6**

Are you familiar with the “profits method” as outlined above to value TRP? If so please indicate the types of real property where you are familiar with its application.

I am familiar with the “profits method” of valuation as outlined within GN12 and within paragraphs 8 to 12 of the IVSC Discussion Paper.

The types of legal interest in property that are valued by the profits method include public houses, hotels, care homes, leisure properties, restaurants, petrol filling stations, children’s day nurseries, professional practices (veterinary surgeons, pharmacies, dental practices), general convenience stores and sub-Post Offices. In some of these instances, the freehold (real) property interest might be valued as a standard commercial property (i.e. offices/retail), whereas the leasehold interest in the fully equipped operational trading entity might be valued using the profits method (convenience stores, pharmacies, dental practices etc are a good example of this).

This again emphasises the point made in response to Question 3 above about the nature of the legal property interest being valued dictating the required approach to the valuation.

**Question 7**

What methods do you normally use to allocate value to the real property interest? Do you apply the same method regardless of the type of real property involved?

The true value of a TRP can only be the Market Value of the fully equipped operational entity. In considering an informal apportionment of land and buildings only, regard might be had to market evidence of sales of closed former TRP businesses or the value of the fully equipped operational entity, with adjustments then made to disregard goodwill, fixtures and fittings. This is done on a case by case basis. The resultant figure is an apportionment only and not a “value” and this need to be clearly stated within the report.
Question 8

In your experience what sources of data are available to support the use of either the profits method or an allocation to the real property from the value of the business in occupation? How reliable are these?

I am not aware of any data sources to assist in this respect.

Question 9

Do you consider that the general provisions in the IVSs concerning identification of the asset to be valued and clarification of the assumptions made about complementary or associated assets are sufficiently clear for application to TRP or do you believe that the IVSs should provide more specific guidance? If you believe that more specific guidance is required, please indicate the types of TRP where you believe that this is needed.

This is considered sufficiently clear.

Question 10

Please indicate any techniques with which you are familiar for ensuring that the value of the real property interest excludes any value attributable to other assets.

I am not aware of any such techniques other than as explained in the response to Question 7 above. The valuer needs to specifically state that the land and buildings apportionment specifically excludes those items relating to the in situ value of the trade fixtures and fittings and also excludes transferable goodwill.

Question 11

Please indicate for what purposes you consider that a valuation of a TRP should be made on the assumption that it is part of a going concern and for what purposes it should be made on the assumption that there is no business in occupation.

A TRP is a type of legal interest in an individual property that normally changes hands as a fully equipped operational entity. As such, if the business is trading, it should be valued as such using the profits method unless instructed to do otherwise.

If there is a required scenario for a trading entity that the valuation is required with “no business in occupation”, the valuation of the property element alone should be done by the utilisation of special assumptions, such as the business is closed, the trade inventory is removed, licences or certificates/consents are lost or in jeopardy or what other special assumptions the client might wish to instruct the valuer to assume. This is often a requirement of lenders who might wish to understand what their security might be worth in default/non-trading situations.

It is again critical that the recipient of the valuation report fully understands that an informal apportionment of the land and buildings element of a fully equipped operational entity is not necessarily the same as the valuation of the entirety subject to the special assumption that the business is closed.

Question 12

Do you agree that the value of the real property interest is affected by whether or not there is a business in occupation?

Yes. See the response to Question 11.
Question 13

If you are a user of valuation reports, in your experience, is the distinction between the business and the property interest normally clear from the reports that you receive?

Not applicable.

Question 14

If you are a provider of TRP valuations, what steps do you take to distinguish the business from the real property interest?

Firstly, the TRP is stated as being valued as a fully equipped operational trading entity and secondly, if instructed to do so, subject to special assumptions assuming the business is closed, no accounts are available, fixtures and fittings removed. These are usually the only two scenarios for which market evidence is available and for which market valuations can, therefore, be given. This again emphasises the need for the recipient of the valuation to fully understand that an informal apportionment of a global figure is not a Market Value.

GENERALLY - RESPONSE TO PARAGRAPHS 18 AND 19 OF THE DISCUSSION PAPER

I believe GN12 to be a fundamentally sound document which, in the main, adequately reflects the way in which the market operates and identifies correctly the principles required. Unlike the official RICS response, I do believe that a separate TRP guidance note/Standard is required.

IVS 232 confuses the issues in a number of ways and incorrectly infers at times that “trading potential” has some connection with the actual levels of trade undertaken by the business in occupation. The transferable goodwill element of a TRP does not ‘run’ with the property. Land and buildings can have trading potential but an additional element of goodwill can be created after a period of successful, sustainable, trading which is potentially “transferable goodwill”. Unfortunately, RICS appear to have followed the draft IVS 232 in spite of GN12 being the approved IVSC guidance on TRP valuation. I believe that RICS GN2 therefore creates the potential for great confusion.

I believe that further explanation needs to be made within GN12 as to the difference between “transferable goodwill” and “personal goodwill” with, otherwise, the document left fundamentally intact. The goodwill elements are correctly identified in paragraphs 3.3.2 and 3.3.3, although paragraph 5.5 needs to be expanded and the example given regarding a particular manager’s tax position, depreciation policy etc are irrelevant and should be removed. The profits method of valuation (as paraphrased in 5.3) disregards tax, depreciation and borrowing costs, although the lack of capital investment may adversely affect the EBITDA of a reasonably efficient operator.

I believe paragraph 5.5 should include better examples of cases of “personal goodwill” which a TRP value needs to disregard. For example, a restaurant operated by a TV chef might well produce higher levels of profit and EBITDA than in the hands of a reasonably efficient operator. The key to making the judgement of whether goodwill is transferable or not is in fully understanding the operation of the hotel/public house/care home etc business itself and the market within which it operates.

Yours faithfully

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