# Valuation of Social Housing

For Inclusion in Council's Financial Statements

# Current Guidance

## England & Wales

- Stock Valuation for Resource Accounting
- Guidance for valuers - 2010
- Department for Communities and Local Government
- DVS - Valuation Office Agency
- ***Recommends Beacon Method or DCF***

## Scotland

- Mandatory Guidance On The Valuation Methodology For Council Dwellings
- Endorses the DCLG Guidance, but
- ***Dictates Adoption of The Beacon Method***

# The Beacon Method

- Identify Typical Housing Types – The Beacons

- Value The Beacons using the Comparative Method
- Apply these Valuations to the Housing Portfolio
- Review and Refine
- Aggregate the Individual Values
- Apply "The Adjustment Factor"

# The Adjustment Factor

## An End Allowance Applied to Discount the Aggregate Value

**THE GUIDANCE STATES;**

"…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."

"….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."

"….A **net** yield of **4.75 per cent** was adopted for the private sector for all regions."

"…..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 "

"….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 "

"…..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."

# The Adjustment Factor

## A Simple Worked Example

| | Private Sector | | Council Housing | | Capitalised |
|---|---|---|---|---|---|
| **Type** | **Average Rent p.a.** | **Capitalise @ 4.75%** | **Average Rent p.a.** | **Capitalise @ 7.75%** | **% Difference** |
| **1 Bed** | £ 2,400 | £ 50,526 | £ 1,200 | £ 15,484 | 69.35 |
| **2 Bed** | £ 4,200 | £ 88,421 | £ 2,100 | £ 27,097 | 69.35 |
| **3 Bed** | £ 5,100 | £ 107,368 | £ 2,550 | £ 32,903 | 69.35 |
| **4 Bed** | £ 6,000 | £ 126,316 | £ 3,000 | £ 38,710 | 69.35 |

Deduct 69.35 % from Aggregate Value

# The Adjustment Factor

THE ISSUES

- There are no published Beacon Adjustment Factors in Scotland and the current guidance for England & Wales allows for valuer discretion in arriving at the appropriate adjustment factor.
- No valuation should be seen as a means to an end rather it should be based upon sound principles and transactional evidence. The guidance has not been updated since 2010 whilst the investment market is rarely static.
- EUV-SH, despite the relevant valuation assumptions, remains an opinion of market value and therefore should follow market practice.
- The yields suggested in the guidance for England & Wales do not appear to be supported by more recent transactional evidence.
- There is no rationale for the view that income from social rented stock is riskier than that from private rented stock.
- Determination of net rental income from either sector is fraught with difficulty and leads to an inconsistent approach.

# The Adjustment Factor

## What Does the Market Tell Us ?

There is a well established, mature market for let residential property investments, everything from single houses let on regulated tenancies to portfolios of thousands of properties. Experience shows that it is very difficult to determine a net yield, since there is no set standard for deductions as the circumstances of each landlord or investor are different. For that reason gross yields tend to be used for comparison given that rent and purchase price are known.

There is a considerable volume of transactions relating to social rented properties. In the main these are valued for loan security using investment valuation methodology. Socially rented properties are a pretty safe form of investment, but only of interest to investors who can both operate at a level of scale beyond the small scale Buy to Let investor and also are able to offer the level of service required by the housing regulator.

Private Rented Stock (PRS) currently trades at between 25% to 35% of Vacant Possession Value (VP) depending upon size, location and quality. Social Rented Stock(SRS) trades at between 35% to 45% of VP. The differential between PRS and SRS in this regard is accounted for by the ability of the purchaser to realise VP of PRS because of the lease structure e.g. AST against the regulated tenancy in the case of SRS.

# The Adjustment Factor

- It is clear that the risk profiles of Private and Social rental income are broadly similar.
- Yields can be adjusted for lot size and location
- The market consists of large scale investors looking for a long term return. Income rather than capital receipts is the key driver
- The valuation of social housing is a capitalisation of gross income
- The investor will always pay less than the aggregate of individual capital values as a discount is expected for a single portfolio purchase

# The Adjustment Factor

## VALUATION METHODOLOGY BASED UPON MARKET PRACTICE

### A SIMPLE WORKED EXAMPLE

| Rental | Gross Yield % | VP Value | Discount on VP % | Sale Date |
|---|---|---|---|---|
| £ 40,000,000 | 8.00 | £ 875,000,000 | 42.86 | 01 April 2013 |
| £ 68,000,000 | 9.44 | £ 1,350,000,000 | 46.67 | 01 November 2013 |
| £ 25,000,000 | 7.69 | £ 560,000,000 | 41.96 | 31 August 2012 |
| £ 56,000,000 | 8.62 | £ 1,150,000,000 | 43.48 | 01 June 2013 |

| Valuation Subject |
|---|
| £ 85,000,000 |
| 9.50% |
| £ 894,736,842 |
| £ 1,700,000,000 |
| 47.37 |

**Commentary**

The vendor is not in the business of selling individual units at VP. Therefore the willing seller and buyer as envisaged in the EUV-SH definition are the parties to these transactions. The sale price is largely driven by the investor's required return on their investment.

This arms length transactional evidence provides the capitalisation yield which can be adjusted by the valuer, which is standard practice in any investment approach.

The discount on VP derived from the market evidence informs the valuer as to the appropriate anticipated discount applicable to the subject portfolio which they are required to value and acts as a cross check of the capitalisation yield which they have adopted.

# The Adjustment Factor

PROPOSED VALUATION METHODOLOGY SHOULD;

Reflect Market Practice

Be Based Upon Transactional Evidence

Be Logical

Be Up To Date

Be Consistent

Lend Itself to Standardisation

# The Adjustment Factor

THE EXISTING APPROACH ;

- Is based upon a flawed perception of risk and return
- Produces an unreliable valuation
- Is out of date
- Involves imprecise analysis of rental information
- Is not in keeping with professional standards

# The Revised Adjustment Factor Methodology

## Matters to Address and Possible Answers

### Use of SRS sales transactions from England & Wales

- *An income flow is just that wherever it is based and the yield can be adjusted for any differences*
- *Also there is an abundance of PRS sales in Scotland therefore if the discount to VP is 35% for this stock, a judgement can be made by an experienced valuer as to the increment over 35% applicable to SRS in Scotland.*

### Use of Gross Rents and Yields Mask Stock Condition

- *Scottish Housing Quality Standard statistics provide detailed information on stock condition for each council area. This could be used to inform the valuer when adoption the appropriate capitalisation yield.*