University of the Built Environment
EST. 1919

Patron: His Majesty King Charles III

Horizons, 60 Queen's Road, Reading, RG1 4BS
ube.ac.uk | +44(0)118 921 4696 | enquiries@ube.ac.uk

University of the Built Environment
Institutional Research Repository

Title	Lectures (20 hours) to international students in 2023 for Ecole Supérieure des Professions Immobilières, Paris Campus.
Author(s)	David Hourihan, David Hourihan, David Hourihan and David Hourihan
ORCID	https://orcid.org/0000-0003-1405-3130; https://orcid.org/0000-0003-1405-3130; https://orcid.org/0000-0003-1405-3130; https://orcid.org/0000-0003-1405-3130
Type	Conference or Workshop Item
Publication title	
Publisher	
ISSN/ISBN	
Date	6 November 2023
Version	
DOI	
Repository link	https://ube.repository.guildhe.ac.uk/id/eprint/198/
Link to publication	
Notes	This publication version may differ from the final version

Copyright:
The University aims to make research outputs available to a broader audience via its digital Repository. Where copyright permits, full text material held in the Repository is made freely available.
URLs from GuildHE Research Repositories maybe freely distributed and linked to. Please refer to each manuscript for any further copyright restrictions.

Reuse: Copies of full items can be used for personal research or study, educational, or not-for-profit purposes without prior permission or charge provided that the authors, title and full bibliographic details are credited, a hyperlink and/or URL is given for the original metadata page, and the content is not changed in any way.

PROPERTY VALUATION

(BG3 ALT S6)

Section 8 –

Analysing Rental Evidence

Real Estate Business Management Program

Year 3 – Work study program

Présenter: David Hourihan MSc Prop Inv FRICS

7 November 2023

Property Valuation (BG3 ALT S6)

Agenda

1. What is comparable evidence?
2. Rental Analysis.
3. Application of rental evidence in a valuation.
4. Adjustment of rental comparables.
5. Adjustment of rent comparables: lease terms.
6. Adjustment of rental values for repairing and insurance obligations.
7. Repairing and insuring differences: Rule of thumb adjustments.
8. Repairing Covenant and insurance adjustment.
9. More rental adjustments for lease terms.
10. Lease terms adjustment: user clause and alienation.
11. Other lease terms and incentives.
12. Adjustment of rent comparables: the rental valuation.
13. Admissibility v Weight of evidence.
14. Best evidence.
15. Summary.

Property Valuation (BG3 ALT S6)

1. What is comparable evidence?

Details from recent market activity

- Market rent.
- Market value – sales/yields.

Range of subjective adjustments

- Lease terms.
- Tenant covenant.
- Size – IPMS or CoMP?
- Physical condition.
- Location etc.

Property Valuation (BG3 ALT S6)

2. Rental Analysis.

Annual rent / area = Rent per unit per annum.

Example:
Rent paid of £5,000 per annum.
1,000 square meters of space.
Rental rate = £5,000 / 1,000 sq m = £5 / sq m per annum.

Things to bear in mind:

- All measured areas should follow RICS/IPMS guidelines on measurement of useful space.
- Space in high street shops is zoned or weighted according to its relative value.
- Not all comparable rents will be perfect matches for the subject property, but they can still be used if the rent is adjusted for the difference(s).

Property Valuation (BG3 ALT S6)

3. Application of rental evidence in a valuation.

Example Question
Determine the Rental Value of an industrial property with a measured area (IPMS2) of 325 sq m.

A **comparable property**, (arm's length transaction, similar age, condition, location, lease structure and design) has an area (IPMS2) of 350 m2.

It was let on a new 15-year lease with 5-year rent reviews at a rent of £12,250.

No other adjustments required in this simple example.

Answer
Analysis of comparable
(analysis of a comparable to get rental rate per sq m).

Rental Value per m2 = rent / area
= 12,250 / 350.
= £35.00 per sq m.

Rental Valuation of subject property
Market Rental Value (MRV)=
area x rental value per sq m=
325 m2 x £35.00 per sq m=
£11,375 per annum.

Property Valuation (BG3 ALT S6)

4. Adjustment of rental comparables.

- The comparable will need to be adjusted to allow for differences in location, physical factors (including measurement) and lease terms.

- Procedure is to adjust the rent actually agreed to a rent that might have been agreed if the comparable was in same location, was similar physically and had been let on the same terms as those that are to be assumed for the property to be valued.

- Must also consider type of transaction:
  - new letting.
  - rent review.
  - lease renewal.

5. Adjustment of rental comparables: lease terms

The lease terms that are likely to impact on the rent a tenant would offer include:

- **Lease length**: may not have an enormous effect unless very different e.g., 1 year v 25 years.
- **Repair obligations and insurance responsibility**: the more a tenant has to pay for repairs the less they can afford to pay in rent.
- **User clause/restrictions**: in general, the greater the restriction on user the lower the rental value.
- **Review pattern/frequency/basis**: in general, the longer the period between rent reviews, the more the tenant will offer.
- **Rent free periods, premiums and other lease incentives**: trying to estimate effective rent from headline rents of comparables.
- **Security of tenure** provisions.
- Additional Benefits e.g., parking.

Property Valuation (BG3 ALT S6)

6. Adjustment of rental values for repairing and insurance obligations.

Full Repairing and Insuring (FRI) is the benchmark structure for most leases.

- So, adjustments are needed for leases not on those terms - Internal Repairing and Insuring (IRI) and Internal Repairing only (IRO).
- Which do you think would be the highest rent for the same property – FRI or IRI or IRO?
- If you're not sure think about it another way -would you expect to pay more rent if you had other costs, such as repairs, to pay?
- Parties need to be aware of terminology used in repairing covenants as 'put', 'keep', 'maintain' and 'return' have significant implications.
- Note, the order and method which you use to apply adjustments will affect the answer. There is limited guidance on what is 'correct'.

Property Valuation (BG3 ALT S6)

7. Adjustment of rental values for repairing and insurance obligations: Rule of thumb adjustments.

Rational economic tenant:

Where tenant is responsible for fewer outgoings they will be prepared to pay a slightly higher rent. So, the rent for IRI and IRO leases are higher than the rent for a FRI lease.

Sample adjustments: to adjust IRI and IRO :

- IRI to FRI deduct cost of external repairs (say 5%) of rent.
- IRO to FRI deduct 7% of rent (= 5% for cost of external repairs and 2% for insurance cost).
- IRO to IRI deduct cost of insurance (say 2%) of rent.

The adjustments above are ‘rules of thumb’ and do depend on the type, age and condition of the property.

For example, older properties may cost more to repair and may represent a higher % of the rent.

Property Valuation (BG3 ALT S6)

8. Repairing Covenant and insurance adjustment.

Example

For the renewal of a shop lease, the tenant has proposed that the repairing covenant be changed from an FRI to an IRI basis.

What would the proposed rent be on the new terms if the estimated market rent on FRI terms is £340,000 p.a.?

The tenant will be prepared to pay a higher rent as they no longer have an obligation for the external repairs.

Rent

Rent on FRI terms	340,000 p.a.
plus allowance for external /struct repairs @ 5% of rent	17,000
Rent on IRI terms	357,000 p.a.

Property Valuation (BG3 ALT S6)

9. More rental adjustments for lease terms.

IRO to **IRI**

IRO rent of £5000 per annum.

Less 2% for insurance.

= IRI equivalent.

IRI = £5000 x 0.98.

IRI = £ 4900 pa.

IRO to **FRI**

IRO = £ 5000.

less 7% for insurance and external repairs.

= FRI equivalent.

FRI = £ 5000 x 0.93.

FRI = £ 4650 pa.

These are subjective opinions.

In practice different adjustments may be made.

You should always consider the circumstances.

Property Valuation (BG3 ALT S6)

10. Lease terms adjustment: user clause and alienation.

Think about these scenarios:

Shop 1 with an open user clause has been let at £20,000 pa.

Shop 2 is virtually identical and is held on the same lease terms with the exception of the user clause which is limited to the use of sale of shoes, sandals, boots and handbags only. Shop 2 is undergoing a rent review.

Would the rent for Shop 2 be likely to be **Higher** or **Lower** than the rent for shop 1?

Shop 3 is virtually identical to Shop 1 and is held on the same lease terms with the exception of the alienation clause. Shop 1 has an open alienation clause whereas Shop 3 allows assignment only subject to landlord's consent.

Would the rent for Shop 3 be likely to be **Higher** or **Lower** than the rent for shop 1?

11. Other lease terms and incentives.

Different Rent Review Patterns

- The presumption is that a tenant will offer a different amount depending on the frequency of the rent reviews.
- In general, the longer the period between rent reviews, the more the tenant will offer as an initial rent.
- If my comparable has 5 year rent reviews but the property I am valuing has 3 year rent reviews I will need to adjust the comparable rent - how do I do this?

Rent Free Period

A difficult area - various approaches.

Remember we are trying to find the rent that the tenant would have paid if they had not agreed a longer than normal rent-free period.

Property Valuation (BG3 ALT S6)

12. Adjustment of rent comparables: the rental valuation.

We now need a technique that enables us to take the information from the comparables and form an opinion of value.

Most valuers will go through a subjective thought process.

‘I think the property I am valuing (A) is better than comparable B because it (A) is newer than B’.

‘A is not as good as C because C has Air Con and A does not’.

To help with this a comparable grid or matrix might be used which might involve ranking.

Property Valuation (BG3 ALT S6)

12. Adjustment of rent comparables: the rental valuation.

Comp	Adjustments	Agreed Rent	Adjusted Rent	Rent per Sq.m.
A	Rent agreed one year ago, increase by 10%	20,000	22,000	120
B	One year rent free period	30,000	27,000	100
C	No adjustment	25,000	25,000	115
D	3 year review pattern	37,000	38,000	130
E	No adjustment	45,000	45,000	112

Property Valuation (BG3 ALT S6)

12. Adjustment of rent comparables: the rental valuation.

Comp	Attributes	Rent per Sq.m.
B	You could have several columns one for each of the main attributes that you consider are significant determinants of value	100
E	The Table could be set out with columns and rows swapped from this example.	112
C		115
A		120
D		130

Property Valuation (BG3 ALT S6)

12. Adjustment of rent comparables: the rental valuation.

Analysis Table:

Table 5.3 Comparison valuation using quantitative and qualitative approaches.

	Comp A	Comp B	Comp C	Comp D	Comp E	Subject Property
Market Rent (£)	£67,000	£75,000	£66,000	£80,000	£83,200	–
Elements:						
• NIA (m^2)	100	90	95	115	130	125
• MR/m^2	£670	£830	£694	£609	£640	
• Management costs	–	–5%	–5%	–	–5%	
• Repair liability	–	–5%	–10%	–	–5%	
• Insurance liability	–	–2.5%	–	–	–2.5%	
• Age allowance	+5%	–5%	–	–	–5%	
Net quantitative adjustment to market rent (MR)/m^2	+5%	–17.5%	–15%	–	–17.5%	
Adjusted MR/m^2	£704	£685	£590	£696	£528	
• Condition	Ave	Ave	Ave	Ave	Ave	Ave
• Ratio of parking space to NIA	Ave	Ave	Ave	Poor	Good	Good
• Location	Superior	Inferior	Ave	Superior	Inferior	Superior
Net qualitative adjustment	**–ve**	**+ve**	**–ve**	**–ve**	**+ve**	**–**

The example in Table 5.3 would require a detailed narrative below to outline the assumptions and adjustments.

Example from Wyatt (2013) Property Valuation, chapter 10.

Property Valuation (BG3 ALT S6)

13. Admissibility v Weight of evidence.

Some evidence may not be admissible e.g. ‘hearsay’. Evidence which is closest to the subject property in terms of comparability will carry the greatest weight.

Best comparable evidence is:

- ❑ Recent
- ❑ Nearby
- ❑ Similar use
- ❑ Similar size
- ❑ Same type of tenure
- ❑ Similar covenant
- ❑ Similar condition
- ❑ Open market transaction

Example from Wyatt (2013) Property Valuation.

Property Valuation (BG3 ALT S6)

14. Best evidence.

Rental

- Settled in court.
- Settled by arbitrator.
- Settled by expert.
- Open market letting.
- With incentives.
- Without any incentives.

Sales

- Auction.
- Tender.
- Open market.

Property Valuation (BG3 ALT S6)

15. Summary.

- In order to value using the rental method, relevant evidence of market rental value must be sought.
- It may be necessary to make adjustments to the rents in order to bring them to ‘rents on the same terms as the subject property.
- It may also be necessary to adjust the comparable evidence to reflect the physical nature of the subject property, e.g. poor quality or different location.
- The creation of a basket of evidence is crucial when looking at rental evidence and making adjustments.
- Remember that the extent of these adjustments reflect the valuer’s opinion of value, not fact.
- The results of any analysis using adjusted rents must be set against each other for comparison.
- Weight must be attached to each piece of evidence, depending on how reliable it is.
- Then conclusions can be drawn as to what is a reasonable and supportable opinion of market rental value for the property.

Next Lecture

Section 9 – Valuation Formula