The capital and rental valuation of public houses, bars, restaurants and nightclubs in England and Wales
1st edition, guidance note

Public houses, bars, restaurants and nightclubs are among those types of property that are normally bought and sold having regard to their trading potential.

This guidance note provides more detailed guidance on this specific type of property in England and Wales. It deals with the following topics:

• a summary of the statutory issues that impact on the use of licensed property;
• an outline of the approach to market analysis, interpreting comparables and other factors affecting valuation;
• an explanation of the profits method of valuation;
• an outline of the approach to the assessment of market rent, with an indication of common lease terms, and the state of the market at the valuation date, which may need consideration;
• guidance on the tied lease market for public houses with specific reference to the landlord’s Code of Practice for the operation of its tied properties; and
• guidance on valuations for investment and secured lending.
The capital and rental valuation of public houses, bars, restaurants and nightclubs in England and Wales

RICS guidance note

1st edition (GN 67/2010)
RICS Valuations Standards (the ‘Red Book’)

RICS (Royal Institution of Chartered Surveyors) is the leading organisation of its kind in the world for professionals in property, land, construction and related environmental issues. As part of our role we help to set, maintain and regulate standards – as well as providing impartial advice to governments and policymakers.

To ensure that our members are able to provide the quality of advice and level of integrity required by the market, RICS qualifications are only awarded to individuals who meet the most rigorous requirements for both education and experience and who are prepared to maintain high standards in the public interest.

Members who qualify as valuers are entitled to use the designation ‘Chartered Valuation Surveyor’ and, in addition to compliance with the general rules of conduct applicable to all members, must also comply with the RICS Valuation Standards, generally referred to as the ‘Red Book’.

This guidance note describes the standard of work that is expected of a reasonable, competent valuer experienced in the subject to which this note relates.

RICS has in place a regulatory framework. Where a valuer undertakes work that has to comply with the Red Book that valuer is also required to register with RICS. Registration enables RICS to monitor compliance with the valuation standards and take appropriate action where breaches of those standards have been identified.

Acknowledgments

RICS would like to thank the trade related valuation group, supported by a working group of surveyors from across the industry, for its assistance in the development of this guidance note.
This is a guidance note. It provides advice to RICS members on aspects of their profession. Where procedures are recommended for specific professional tasks, these are intended to embody ‘best practice’, i.e. procedures which in the opinion of RICS meet a high standard of professional competence.

Members are not required to follow the advice and recommendations contained in the guidance note. They should, however, note the following points.

When an allegation of professional negligence is made against a surveyor, the court is likely to take account of the contents of any relevant guidance notes published by RICS in deciding whether or not the surveyor had acted with reasonable competence.

In the opinion of RICS, members conforming to the practices recommended in this guidance note should have at least a partial defence to an allegation of negligence by virtue of having followed those practices. However, members have the responsibility of deciding when it is inappropriate to follow the guidance. If it is followed in an inappropriate case, the member will not be exonerated merely because the recommendations were found in an RICS guidance note.

On the other hand, it does not follow that members will be adjudged negligent if they have not followed the practices recommended in this guidance note. It is for each individual chartered surveyor to decide on the appropriate procedure to follow in any professional task. However, where members depart from the good practice recommended in this guidance note, they should do so only for a good reason. In the event of litigation, the court may require them to explain why they decided not to adopt the recommended practice.

In addition, guidance notes are relevant to professional competence in that each surveyor should be up to date and should have informed him or herself of guidance notes within a reasonable time of their promulgation.
1 Introduction

1.1 Public houses, bars, restaurants and nightclubs are among those types of property generally referred to as trade related property. They are normally bought and sold having regard to their trading potential.

1.2 Guidance on the valuation of individual trade related properties in the RICS Valuation Standards (the ‘Red Book’) – GN2 under a revised system of numbering effective from spring 2011 – considers the criteria to be adopted by valuers when assessing Market Value (MV) or market rent for an individual trade related property. It relates to a wide range of trade related properties such as hotels, public houses, bars, restaurants, nightclubs, theatres or cinemas, and various other forms of leisure property.

1.3 This guidance note provides more detailed guidance to valuers with regard to the valuation of a specific group of trade related property, that being pubs, bars, restaurants and nightclubs (licensed properties) that are occupied and trading. It has been written specifically with regard to the law and practice in England and Wales. It refers to valuation methodology in section 5 and provides a practical approach to the assembly and interpretation of relevant information.

1.4 In the case of properties that are economically capable of occupation as licensed properties but are vacant, the same principles and approach should be applied, with appropriate adjustments and weighting attached to the various factors affecting value.

1.5 A trade related property is usually valued by treating the physical property, the trading equipment (often referred to as trade inventory) and the market’s perception of the trading potential for a business use as a single entity. It is the potential income from the operational entity that is the primary concern of a purchaser and, hence, also the valuer.

1.6 The valuer needs to be actively involved in the market for this class of property as a practical knowledge of the trading aspects of a trade related property is fundamental to the analysis of the property’s existing operation and trading potential.

1.7 This paper also addresses the widely differing trading characteristics that licensed properties have; hence the sector is divided into a number of submarkets. Valuers should be fully conversant with the requirements of operators within these submarkets.

2 Terms used in this guidance note

2.1 The terms used in this guidance note may have different meanings when used by other professional disciplines.

Adjusted net profit

2.2 The valuer’s assessment of the actual net profit of a currently trading operational entity. It is the net profit that is shown from the accounts once adjustments for abnormal and non-recurring expenditure, finance costs and depreciation relating to the asset itself, as well as rent where appropriate, have been made. It relates to the existing operational entity and gives the valuer guidance when assessing the fair maintainable operating profit (FMOP).

Earnings before interest, taxes, depreciation and amortisation (EBITDA)

2.3 A term that relates to the actual operating entity and may be different from the valuer’s estimated FMOP.

Fair maintainable operating profit (FMOP)

2.4 The level of profit, stated prior to depreciation and finance costs relating to the asset itself (and rent, if leasehold), that a reasonably efficient operator (REO) would expect to derive from the FMT based on an assessment of the market’s perception of the potential earnings of the property. It should reflect all of the costs and outgoings of the REO and an appropriate annual allowance for periodic expenditure such as decoration, refurbishment and renewal of the trade inventory.

Fair maintainable turnover (FMT)

2.5 The level of trade that an REO would expect to achieve on the assumption that the property is properly equipped, repaired, maintained and decorated.

Market rent

2.6 The estimated amount for which a property would be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm’s-length transaction after
proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. Whenever market rent is provided the 'appropriate lease terms' which it reflects should also be stated.

**Market Value**

2.7 The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

**Operational entity**

2.8 Usually includes:

- the legal interest in the land and buildings;
- the trade inventory, usually comprising all trade fixtures, fittings, furnishings and equipment; and
- the market’s perception of the trading potential, together with an assumed ability to obtain/renew existing licences, consents, certificates and permits.

Consumables and stock in trade are normally excluded.

**Personal goodwill (of the current operator)**

2.9 The value of profit generated over and above market expectations that would be extinguished upon sale of the trade related property, together with financial factors related specifically to the current operator of the business, such as taxation, depreciation policy, borrowing costs and the capital invested in the business.

**Reasonably efficient operator (REO)**

2.10 A concept where the valuer assumes that the market participants are competent operators, acting in an efficient manner, of a business conducted on the premises. It involves estimating the trading potential rather than adopting the actual level of trade under the existing ownership, and it excludes personal goodwill.

**Tenant’s capital**

2.11 May include, for example, all consumables, purchase of the inventory, stock and working capital.

**Trade related property**

2.12 Any type of real property designed for a specific type of business where the property value reflects the trading potential for that business.

**Trading potential**

2.13 The future profit, in the context of a valuation of the property, that an REO would expect to be able to realise from occupation of the property. This could be above or below the recent trading history of the property. It reflects a range of factors such as the location, design and character, level of adaptation and trading history of the property within the market conditions prevailing that are inherent to the property asset.

3 **Statutory issues**

3.1 When licensed properties are sold as fully equipped operational entities, the new owner normally expects to obtain/renew the licences and consents that are necessary for the operational entity to continue. The new owner also expects to take over the benefit of existing approvals, certificates and permits together with any future bookings which are an important part of the ongoing business.

3.2 In the UK such statutory licences, consents, certificates and permits, include the premises’ licences under the *Licensing Act 2003* and fire risk assessment.

3.3 Other statutes and regulations that may be relevant include the following:

- *Transfer of Undertakings (Protection of Employment) Regulations 2006*;
- *Food Act 1984* (as amended);
- *Food Safety Act 1990* (as amended);
- *Equalities Act 2010*, which largely replaced the *Disability Discrimination Act 1995* and *2005* on 1 October 2010; and
- gas and electrical regulations in relation to the trade inventory.

Whilst this list highlights issues for the valuer to consider, it should not be regarded as exhaustive.

3.4 Other matters on which enquiries may be made are whether:
• the property is subject to any outstanding notices under environmental health and food safety in relation to the *Food Safety Act 1990* and the *Food Hygiene Regulations 1970 and 1990*;

• the premises have the relevant planning permission under the *Town and Country Planning (Use Classes) Order 1987* (as separately amended in England and Wales) and whether there are any future highway, infrastructure or development proposals that may have either a positive or negative effect on the business and its trading potential;

• the premises benefit from means of escape provisions; and

• the property is within a conservation area or is an historic listed building.

3.5 Where it is not possible to inspect the licenses, consents, certificates and permits relating to a property, or other information cannot be verified, the assumptions should be identified in the report, together with a recommendation that all information should be verified by the client’s legal advisers.

3.6 The valuer will also need to point out that the value could be reduced if such an assumption is not validated, or if the licences are lost or in jeopardy. If the granting authorities or police have indicated that they intend to impose conditions or refuse or oppose a renewal, this should be mentioned and due weight given to it in the valuation.

3.7 When valuing a portfolio it may not be practical, or necessary, for the valuer to investigate and address all matters. The valuer may state explicitly that the portfolio owner’s records have been relied upon, that licences exist and meet a specified minimum scope and standard, and that there are no existing conditions that would materially affect the trading potential of the premises being valued.

4 Market analysis, comparables and factors affecting valuation

4.1 Freehold and leasehold interests in licensed properties are freely bought, sold and let in the open market, either as fully equipped operational entities offered with vacant possession, or as investments.

4.2 Public houses are typically viewed under one of six broad types:

• town centre: circuit bar (including chameleon bar);

• town centre: traditional pub (either food or wet led);

• community: urban;

• community: suburban;

• community: rural; and

• food led: destination.

They are typically operated in one of four ways:

• under direct management;

• by a lessee, occupying by way of a full repairing and insuring lease;

• by a tenant, occupying under the terms of an internal repairing short term agreement; and

• by individuals as owner/occupiers.

4.3 The public house market is further complicated by the specific submarket relating to tied leases and tied tenancies, whereby brewers or public house operating companies (pubcos) own the freehold or leasehold interest but grant a lease or tenancy to an operator with detailed requirements relating to terms of business. This usually includes some form of supply tie, and some leases also oblige the tenant to restrict certain gaming machines to specific suppliers on terms whereby the landlord shares in the profits. Section 7 addresses this in more detail.

4.4 The restaurant market has evolved enormously in recent years. Historically, it was made up of two sectors, the traditional a la carte restaurant that had been developed in character property – for example, a small country house, barn, watermill, etc. – and the high street restaurant. The branded restaurant sector in particular has developed and matured, giving rise to a considerable number of outlets that are often taken as developer’s shell units.

4.5 The franchised restaurant market is effectively split into two types: those that include a property interest and those that do not. Where there is a property interest, this can be in the name of the franchisor, with a sublease to the franchisee, or the
franchisee can itself be the head lessee. Either way, any franchised restaurant is subject to a ‘franchise agreement’, which is a personal agreement between the two parties.

4.6 A franchise agreement is generally transferable to purchasers that meet certain qualification criteria. A well drafted franchise agreement will set out those qualification criteria in some detail, and in practice most transfers do go ahead without difficulty, though sometimes a transfer fee is payable. Qualification criteria tend to relate to financial good standing and prior hospitality experience. Where a well funded candidate has no hospitality experience, the franchisor will provide training to overcome this.

4.7 There are other cases where the transfer of the franchise agreement is at the discretion of the franchisor, with no formal ‘mechanism’ within the agreement to appeal or challenge any decision. In those cases, only a nominal value may be attributed to the franchise agreement.

4.8 The nightclub sector is largely split into two categories with wide variations in size and capacity: club and music venue.

4.9 In general, restaurants and nightclubs are operated either under direct management of a corporate entity, or alternatively by owner/occupiers. The majority of these businesses are occupied by way of lease.

4.10 In most cases, the value of the operational entity will be determined by reference to trading potential. For town centre bars, branded restaurants and most nightclubs (particularly those let as a developer’s shell), the rental value is often assessed by reference to size and capacity where there is sufficient comparable evidence for the valuer to reach a conclusion. It is important, even when this approach is adopted, that the valuer has a sound understanding of the trade related use that is currently in operation or that may be appropriate for the property. This is necessary in order to be able to analyse comparable evidence properly and apply such analysis when valuing the subject property.

4.11 When a valuer is reporting a capital valuation, particularly that of the freehold interest, it may be necessary to consider whether a higher value might prevail if the property was put to alternative use. It would be appropriate for the valuer to identify within the report that such higher value might arise so that the client may consider seeking further valuation advice.

4.12 As with all valuations, it is the market that determines price and/or rent. A valuer of trade related property needs to fully understand the trading aspects of the type of property to enable:

- proper understanding and comparison of physical characteristics, e.g. location, size, configuration, relevant and surplus accommodation, etc.;
- analysis of actual trading results of the incumbent operator, where available;
- analysis of actual trading results of similar businesses, where available;
- assessment of the effect of the terms of trade (particularly if there is a wholesale supply tie); and
- assessment of trading potential, profitability and market demand.

4.13 The valuer should use past experience to review, for example, the following:

- a proper assessment of the existing business against the general market;
- scope for development, by either change of style or physical alterations;
- scope for movement between one submarket and another;
- compliance with statutory requirements;
- quality of fit out; and
- potential impact of external influences.

4.14 When analysing comparable evidence, whether it is transactional evidence or trading results of comparable or competitor businesses, the valuer must be careful to ensure that relevant adjustments are made to reflect issues such as location and style of operation. The wide variety of licensed property and the different methods of operation make analysis complex and subjective.

4.15 The accounts of the current occupier may or may not be available. When actual accounts are used to assist in the formulation of an opinion on future trading potential, they will show only how a property is trading under the particular management at the time. Current and past
performance is no guarantee as to the future FMT and FMOP.

4.16 The valuer should be satisfied with the accuracy and reliability of trading information and/or projections supplied for the purpose of the valuation. The source and basis of the trading figures (actual and/or projected), and other trading information and assumptions made, should be stated in the report.

4.17 Different owners/operators account for their businesses in different ways. There is no formal or predetermined format of a profit and loss statement (P&L). Valuers need to be able to assess the full extent of costs to owners/operators. Relevant benchmarking data may assist in the assessment of FMOP. Sometimes corporate entities reflect certain costs (e.g. accounting, marketing, etc.) at head office level rather than in the individual P&L. Similarly, one owner/occupier may reflect additional costs (e.g. drawings, director’s salaries, motor expenses, health insurance, etc.) within the P&L that may not necessarily be appropriate to another operator.

5 Valuation methodology

The profits method of valuation

5.1 The profits method of valuation involves the following steps.

Step 1: An assessment is made of the FMT that could be generated at the property by an REO.

Step 2: Where appropriate an assessment is made of the potential gross profit, resulting from the FMT.

Step 3: An assessment is made of the FMOP. The costs and allowances to be shown in the assessment should reflect those to be expected of the REO – which will be the most likely purchaser, or operator, of the property if offered in the market.

Step 4:

(a) To assess the Market Value of the property the FMOP is capitalised at an appropriate rate of return reflecting the risk and rewards of the property and its trading potential. Evidence of relevant comparable market transactions should be analysed and applied.

(b) In assessing Market Value the valuer may decide that an incoming new operator would expect to improve the trading potential by undertaking alterations or improvements. This will be implicit within the valuer’s estimate of FMT at step 1. In such instances, an appropriate allowance will be made from the figure resulting from step 4(a) to reflect the costs of completing the alterations or improvements and the delay in achieving FMT. Similarly, if the property is in need of repair and/or decoration to enable the REO to achieve the FMT, then an appropriate allowance should be made from the figure resulting from step 4(a) to reflect the cost of such repairs and decorations.

(c) To assess the market rent for a new letting, the rent payable on a rent review or the reasonableness of the actual rent passing, (particularly when preparing an investment valuation), an allowance should be made from the FMOP to reflect a return on the tenant’s capital invested in the operational entity – for example, the cost of trade inventory, stock and working capital. The resultant sum is referred to as the divisible balance. This is apportioned between the landlord and tenant having regard to their respective risks and rewards, with the landlord’s proportion representing the annual rent.

5.2 It is important that the valuer is regularly involved in the relevant market for the class of property, as practical knowledge of the factors affecting the particular market is required. Such knowledge will aid in the analysis and review of historic and current trading performance, as well as with forecasts that may show increases or decreases on actual trade. This can assist in forming an opinion of the FMT and FMOP considered achievable by a likely purchaser or REO.

5.3 When preparing a trade related property valuation it is essential that the valuer reviews the cumulative result of the different steps of the valuation process. The valuation should be considered having regard to the valuer’s general experience and knowledge of the market.

Valuation special assumptions

5.4 Trade related property will usually be valued to Market Value or market rent. However, valuers are commonly asked for a valuation subject to special
assumptions as well. Typical special assumptions are:

(a) on the basis that trade has ceased and no trading records are available to prospective purchasers or tenants;
(b) as in (a) but also assuming the trade inventory has been removed;
(c) as a fully equipped operational entity that has yet to trade (also known as ‘Day One’ valuation); and
(d) subject to stated trade projections – assuming they are proven. This is appropriate when considering development of the property.

**The valuation approach for a fully equipped operational entity**

5.5 The valuation of a trade related property as a fully equipped operational entity necessarily assumes that the transaction will be either the letting or the sale of the property, together with the trade inventory and licences, etc., required to continue trading.

5.6 However, care must be taken because this assumption does not necessarily mean that all the trade inventory is to be included in the valuation of the property. For example, some equipment may be owned by third parties and therefore would not form part of the interest being valued. Any assumption made about the trade inventory to be included in the valuation should be clearly set out in the report.

5.7 Where tangible assets that are essential to the running of the operational entity are either owned separately from the land and buildings, or are subject to separate finance leases or charges, an assumption may need to be made that the owners or beneficiaries of any charge would consent to the transfer of the asset as part of a sale of the operational entity. If it is not certain that such an assumption can be made, the valuer must consider carefully and comment accordingly in the report on the potential impact on the valuation that the lack of availability of those assets would have to anyone purchasing or leasing the operational entity.

5.8 When trade related properties are sold or let as fully equipped operational entities, the purchaser or operator normally needs to renew licences or other statutory consents and take over the benefit of existing certificates and permits. For these valuations, it is normally assumed that all licences and permits will be transferred or granted on the date of transfer of the property interest. If the valuer is making any different assumption, it should be clearly stated as a special assumption.

5.9 Where it is not possible to inspect the licences, consents, certificates and permits relating to the property, the assumptions made should be identified in the report, together with a recommendation that their existence should be verified by the client’s legal advisers.

**Assessing the trading potential**

5.10 There is a distinction between the Market Value of a trade related property and the value (or its worth) to the particular operator. The operator will derive worth from the current and potential net profits from the operational entity operating in the chosen format. While the present operator may be one potential bidder in the market, the valuer will need to understand the requirements and achievable profits of other potential bidders, along with the dynamics of the open market, to come to an opinion of value of that particular property.

5.11 A trade related property is considered to be an individual trading entity and is typically valued on the assumption that there will be a continuation of trading.

5.12 When assessing future trading potential, the valuer should exclude any turnover and costs that are attributable solely to the personal circumstances or skill, expertise, reputation and/or brand name of the existing operator. However, the valuer should reflect additional trading potential that might be realised by an REO taking over the property at the date of valuation.

5.13 The actual trading performance should be compared with similar trade related property types and styles of operation. Therefore a proper understanding of the profit potential of those property types and how they compare with one another is essential. The valuer should test by reference to market transactions and similar trade related properties, whether the present trade represents the FMT in current market conditions. When available, the actual trading accounts of the
subject property and similar properties may need adjusting to reflect the circumstances of the REO.

5.14 For many trading entities, the vehicle for a transfer of the business will be the sale of a freehold or leasehold interest in the property. Such transactional evidence can be used as comparable evidence in the valuation of trade related properties, so long as the valuer is in a position to exclude the value of the component parts of the transaction that are not relevant. Examples include stock, consumables, cash, liabilities and intangible assets (such as brand names or contracts, to the extent they would not be available to the REO).

5.15 Changes in competition can have a dramatic effect on profitability, and hence value. The valuer should be aware of the impact of current, and expected future, levels of competition. If a significant change from existing levels is anticipated, the valuer should clearly identify this in the report and comment on the general impact it might have on profitability and value.

5.16 Outside influences, such as the construction of a new road or changes in relevant legislation, can also affect the trading potential and hence the value of trade related property.

5.17 Particular care must be taken where the valuation is for the purposes of financial statements to ensure that the valuation is compatible and consistent with current guidance and practice.

5.18 Where the property is trading and the trade is expected to continue, the valuation will be reported as:

\[ \text{Market Value [or market rent]} \] as a fully equipped operational entity having regard to trading potential [subject to any agreed or special assumptions which must be clearly set out].

The valuation approach for a non-trading property

5.19 The valuation process for a non-trading property is the same as outlined earlier, but where the property is empty either through cessation of trade, or because it is a new property with no established trading history, different assumptions are to be made. For example, an empty property may have been stripped of all or much of its trade inventory, or a new property may not have the trade inventory installed, but either could still be valued having regard to its trading potential.

5.20 The cessation of an operational entity and the removal of some, or all, of the trade inventory are likely to have an effect on the value of the property. It would therefore be appropriate to express the value on the basis of one or more special assumptions, as well as on a basis reflecting the status quo. This is often a requirement when advising a lender on the value of trade related property for loan security purposes. For example, the differences could reflect the cost and time involved in purchasing and installing the trade inventory, obtaining new licences, appointing staff and achieving FMT.

5.21 Where the property is empty, the valuation will be reported as:

\[ \text{Market Value [or market rent]} \] of the empty property having regard to trading potential subject to the following special assumptions … [which must be clearly set out].

Apportionment

5.22 The valuer may need, or be requested, to provide an indicative apportionment of a valuation, or a transaction price, for:

- analysis as a comparable;
- inclusion in financial statements to comply with the applicable accounting standards;
- secured lending; or
- tax purposes.

5.23 Any such apportionment of Market Value would usually relate to:

- the land and buildings reflecting the trading potential; and
- the trade inventory.

5.24 When considering the apportionment of a transaction price, particularly where the sale is through share transfer in a limited company, the valuer should proceed with caution as the transaction may, in addition to that listed in paragraph 5.23, reflect the following:
• the trading stock, consumables and cash;
• intangible assets; and
• liabilities, such as salaries, taxes, debts, etc.

5.25 Apportionments for tax purposes have to be in accordance with specific legislation and are outside the scope of this guidance note.

Alternative forms of valuation

5.26 Certain extended or more detailed forms of profits valuation may be appropriate, particularly for some larger or more complex trade related properties. Consideration of different income-streams, and/or use of a discounted cash flow model may be appropriate.

5.27 This guidance assumes that the current trade related use will continue. However, where it is clear that the property may have an alternative use that may have a higher value, an appropriate comment should be made in the report. Where such an alternative use value is provided it should be accompanied by a statement that the valuation takes no account of the cost of business closure, disruption or any other costs associated with realising the value.

6 Rental valuations

6.1 When assessing the market rent of a trade related property the valuer will have to liaise with the client’s legal advisers with regard to the proposed terms of the lease and set out clearly such terms and any assumptions made in reaching an opinion of value.

6.2 More often than not, the valuer will be assessing the rental value of a trade related property let on an existing lease, for rent review or lease renewal purposes, or in connection with the preparation of an investment valuation. It will be the actual lease terms that will need to be considered. In particular, the following items may need consideration:

• Extent of the demise: Is it a ground rent, a shell rent, a fully fitted rent or something in between?
• Lease or hypothetical lease term: There has been a move in recent years towards shorter leases in the general commercial property sector. However, licensed property operators, particularly those leasing properties finished to builder’s shell condition, usually require longer terms, typically 15 to 25 years, in order to amortise the initial fit out costs. Valuers need to be conversant with the requirements of the particular submarket in which the subject property sits. Lease criteria for fully fitted public houses trading as community locals are very different to those for a large club or branded restaurant.

• User provisions: Does the lease specifically prohibit change of use within the prevailing submarkets?
• Tenant obligations: Examples are repairing and decorating requirements, and terms of occupation.
• Alienation provisions: Is the lease assignable? Can the tenant sublet?
• Rent review provisions: Such provisions are basis of rental assessment, hypothetical term and disregards, e.g. occupation, goodwill and improvements.
• Trading matters: This includes hours of operation and licence conditions.
• Wholesale supply tie provisions.

6.3 As with all property valuation, the valuer must look to the market for evidence of transactions. This might be lettings, rent reviews, sales of leasehold interests, independent expert determinations and arbitrator’s awards, giving appropriate weight having regard to the hierarchy of evidence.

6.4 The difficulty with licensed properties is the complexity of the submarkets that exist and the wide variety of lease terms that prevail in the market.

6.5 In assessing the rental value by reference to size or capacity (e.g. high street bars, branded restaurants and nightclubs), it is the unit size and configuration that will challenge the valuer’s mind. Often direct comparables will not be available and the valuer will need to research a wider geographical area to obtain adequate comparable evidence. Adjustments to reflect negative trading factors, such as surplus space, secondary location or unusual style of property, can be very subjective. It is often not possible to obtain full details of transactions due to confidentiality agreements or failure of the parties to agree analysis.
6.6 Therefore, the valuer should, as a second stage, consider the profits method of valuation. Where comparing comparables with reference to size or capacity is not realistic or is highly subjective, the assessment of the property on a profits method basis should be chosen.

6.7 The profits method of valuation, as set out in paragraphs 5.1–5.3, applies equally to rental valuations as for capital valuations. (See also step 4(c) in paragraph 5.1.)

6.8 How the divisible balance is apportioned will be a matter for discussion and negotiation. In simple terms, it must provide adequate reward to each party to reflect the risk each take in owning or operating the property.

6.9 The landlord provides the property, and the tenant provides time, skill and effort in operating the business. The divisible balance has already taken account of the tenant’s capital investment. There is no formulaic approach, but it is market evidence that will give guidance. In most cases, the landlord’s share will lie within the range of 35 to 65 per cent of the divisible balance. Issues influencing this range are addressed in the following paragraphs.

6.10 It may be that at the lower threshold of a particular submarket, the available proceeds are insufficient to reward both landlord and tenant properly, resulting in a need for an alternative form of operation – e.g. direct management to lease or franchise, or sale for owner occupation or alternative use.

6.11 As with all valuations, it is the market that provides the best evidence by analysis of transactions of similar properties with similar lease terms. The valuer should always treat ‘abnormal’ comparables that reflect an overbid, for whatever reason, with caution.

6.12 The level of rent that a tenant will offer will be based on economic supply and demand principles. The greater the demand for a particular property, the higher the percentage of the divisible balance a tenant will be prepared to offer to secure the lease. Where demand is lower, the percentage of the divisible balance will be lower.

6.13 Matters that are likely to be considered include:

- attractiveness and style of property;
- availability of finance;
- economic and regulatory matters;
- length of lease and lease terms;
- location;
- provision of domestic accommodation;
- quantum of profit;
- supply of similar properties;
- surplus or obsolescent accommodation/amenities;
- terms of, and restrictions on, trading;
- trading potential and risk; and
- type of operation.

6.14 As with valuations assessed by reference to size and capacity, comparable evidence and the analysis thereof are key criteria to assessing rental value by the profits method of valuation.

6.15 Comparable evidence can be derived from differing sources, as the valuer will be looking for evidence at three levels. These are:

(a) the FMT;
(b) the FMOP, i.e. the conversion of turnover to profit for a particular style of operational entity; and
(c) the split of the divisible balance between landlord and tenant.

6.16 The valuer’s role is to collate relevant comparable information, ascertain its reliability and analyse it to make appropriate adjustments to assist with the subject valuation.

6.17 The valuer may need to reflect the tenant’s investment on improvements. The issue of tenant’s improvements usually derives from Section 34 of the Landlord and Tenant Act 1954, Part II (the Act). It states that on the grant of a new tenancy in accordance with the Act, as amended, the rent should, inter alia, disregard ‘any effect on rent of any improvement carried out by the tenant or a predecessor in title of his otherwise than in pursuance of an obligation to his immediate landlord’.

6.18 Many leases have amended versions of this statement in the rent review provisions. It is the
lease wording, together with the original intention of the parties, which should prevail.

6.19 Many leases refer to tenant’s improvements that have been approved through formal consent. Such consent is not to be unreasonably withheld or delayed and is usually given by way of a Licence to Alter or similar legal document. It will usually detail the extent of the works, possibly including plans showing before and after detail, and will state that such works are deemed to be improvements and thus to be disregarded at future reviews. Where the works of improvement are completed, the possibility of obtaining a retrospective licence should be considered, but not automatically assumed.

6.20 Tenant’s improvements will usually involve the tenant in capital expenditure on the property that is over and above its obligations under the terms of the lease. *Prima facie*, any change in the trading potential of the business that can be reasonably attributed to improvements carried out at the cost of the tenant, with the consent of the landlord and otherwise than pursuant to an obligation to the landlord, is to be disregarded. The intention of the parties should be (except where explicitly stated otherwise) that the tenant will not suffer an increase in rent directly as a result of having carried out the improvements.

6.21 As examples, fitting-out works of shell units are usually documented as tenant’s improvements, as are building extensions to existing premises or converting previously disused accommodation to trade use.

6.22 The valuer must review the terms of the subject lease and value accordingly. Careful consideration of subsequent and associated Licences to Alter, or any Deeds of Variation, is essential. If necessary, the valuer should seek legal advice.

6.23 When assessing the rental value of the property ignoring the tenant’s improvements, the valuer will usually consider the matter in two ways, as set out in paragraphs 6.24 and 6.25. It is important to consider both approaches, as usually direct comparable evidence is not readily available. The final assessment of rental value will be determined by the specific circumstances of each case, the weight of evidence available and any overriding legal precedents.

6.24 The first approach requires the valuer to analyse comparable evidence of properties that are similar to the subject premises as they were in an unimproved state. The difficulty that arises is that comparable transactions may not relate to properties that offer similar trading potential as a consequence of the potential improvement(s).

6.25 The other approach involves the assessment of the FMT and FMOP of the improved property, but with an additional allowance to the tenant for the cost of carrying out the improvement(s) at the valuation date. This deduction will usually be treated in the same way as interest on tenant’s capital, although the valuer will need to consider the best approach to amortisation of the cost. This will depend on the quantum of investment, the hypothetical term and the expectation that an REO would undertake similar improvements. The intention is the same – to not penalise a tenant for having carried out improvements by an increase in rent.

7 Tied lease market for public houses

7.1 Historically, most public houses were owned by brewers and operated by way of tied tenancy, or under direct management.

7.2 Typically the tied tenant occupied by way of a rolling, internal repairing and non-assignable three year agreement, with no security of tenure. Some or all drinks sold from the property were purchased from the brewer landlord.

7.3 Following the Monopolies and Mergers Commission report in 1989, the market changed dramatically as the largest brewers were forced to sell substantial numbers of public houses and security of tenure was afforded to public house tenants.

7.4 This resulted in the creation of a number of companies (known as pubcos) which operated using a business model that involved owning and leasing property through full repairing and assignable leases. From the outset, companies adopted differing lease provisions.

7.5 Such companies benefited from economies of scale by becoming wholesale suppliers as well as property owners.
7.6 Since 1989, the tied lease market has evolved and grown. There has been consolidation of the number of pubcos and further variations in the lease terms provided.

7.7 The valuer has to analyse market evidence that results from such a wide variety of differing leases and supply terms.

7.8 The leases vary not only in length, but also in terms of repairing and decorating obligation, user provisions, rent review provisions and trading obligations.

7.9 Supply terms vary widely from a simple beer tie (with or without freedom for guest ales) through to a full drinks tie, and from zero contractual discounts through to substantial contractual discounts.

7.10 Some operators are also restricted in terms of supply of amusement and gaming machines and may be required to share machine income with their landlord.

7.11 When advising for tied rents, the valuer should read the landlords’ Code of Practice for the operation of their tied properties. Certain aspects of the Code of Practice may be inconsistent with the provisions of the lease, or a landlord may have given an undertaking to waive certain lease provisions (e.g. upward only rent reviews and the treatment of machine income).

7.12 The valuer will need to consider the legal implication of matters arising from the Code of Practice, with regard to both present and future operational and rental value issues. In particular, the valuer should establish whether or not matters within the Code of Practice that relate to rental value have been embodied in a Deed of Variation to the lease.

7.13 Some landlords also offer a wide variety of support services to their tenants, known as special commercial or financial advantage (SCORFA). Some are free and other are at a discounted cost. Examples include:

- accounting services;
- codes of practice;
- design services;
- financial support at commencement of lease and in times of difficulty;
- gaming machine management;
- management and marketing support;
- product and service support and discounts;
- rating services; and
- training.

7.14 The value of such benefits to an operator can be difficult to quantify, as they may be substantially less to a long established multiple outlet operator than to an individual operator trading for the first time.

7.15 Whilst it is preferable when seeking comparable evidence from market transactions to compare like with like, subjective adjustment to reflect differing lease and supply terms is often inevitable.

7.16 When assessing the FMOP of a tied property, the valuer will need to reflect the terms of supply and contractual benefits available to the tenant, along with all other matters referred to earlier in section 6.

7.17 The divisible balance will reflect the terms of the lease (e.g. internal or full repairing obligations) and the terms of supply of drinks and other services. The apportionment of the divisible balance follows the practice as set out earlier in section 6.

7.18 The supply tied lessee, aside from paying property rent and in some cases a share of machine income, also pays the wholesale prices of the supplying landlord, which are usually higher than those the lessee would pay in the open market. The tenant may compare its own property with the circumstances of being free of a supply tie and consider the profit achievable under those circumstances.

7.19 The REO would consider many factors, some outlined in paragraph 6.12, against the background of the supply and demand for such properties. In respect of the effects of supply agreements, the REO may have regard to the fact that free houses are available in the market. Therefore, it could expect to make an increased profit as a result of being able to buy products in the open market and not at the prices charged by the supply tying landlord or its nominated supplier.

7.20 Valuations of tied leasehold interests reflect the terms of the lease and the contractual supply terms that are integral to the lease. When considering a ‘value’ to be attributed within the
rent calculation to SCORFA offered by a landlord, the REO would have regard to matters relevant to its business and the longevity of SCORFA, and whether the latter are enforceable or are capable of being assigned.

7.21 Comparability between public houses held on different lease terms and with different supply terms is problematic, particularly between the tied and non-tied sectors. There is nothing within this guidance that should result in rents in one sector being set at any advantage or disadvantage to another. In arriving at a market rental value, it is preferable for analysis to be made of transactions relating to similar properties with similar lease terms. Indeed, the efficiency of the market relies on transparent market evidence.

7.22 Where the valuer considers that direct comparison is not possible or conclusive, then a broader approach must be made. This will include comparison with both the direct evidence that may reflect different lease/supply terms, and any available benchmarking data. The valuer will use appropriate skill and experience to take account of all available information.

8 Investment valuations

8.1 The basic approach to investment valuations of trade related property is the same as for any other category of property. Where the investment is a portfolio or group of properties GN 3, Valuations of portfolios and groups of properties, in the Red Book will be relevant.

8.2 When valuing a trade related property investment, the valuer will need to carry out the assessment of the FMT and FMOP in the same way as set out in section 5. It is also necessary to assess the market rent of the property so as to determine the security of the income stream and growth potential. The rent payable, and the review thereof, will be determined by the terms of the subsisting or proposed lease.

8.3 In assessing investment value of a property subject to a tied lease, the valuer will also need to review and analyse the net income streams derived from the terms of the lease and the supply tie provisions.

8.4 The capitalisation rate adopted for investment valuations differs from that for vacant possession valuations. The investment rate of return will generally be determined by market transactions of similar trade related property investments. Clearly due to the differing characteristics of trade related property and the wide variety of lease terms, careful analysis of comparable transactions is essential.

8.5 The valuation will include the landlord’s fixtures and fittings with the land and buildings, but probably not the trade inventory, which will usually be owned by the occupational tenant. The valuer should highlight the importance of the trade inventory to the trading potential and value of the property.

9 Valuations for loan security purposes


9.2 Valuations based on trading potential are valid for loan security purposes, since purchasers in the open market tend to bid on this basis, but a clear statement is required that the value based on trading potential excludes any personal goodwill.

9.3 It is usual for the valuer of licensed properties to detail the assessment of the FMT and FMOP in order to assess the serviceability of the intended loan.

9.4 In stating a value for loan security purposes, the sensitivity of the value to future trading potential and outside factors needs to be emphasised. The report must indicate which factors may have an impact on the value and how they are reflected in the valuer’s assessment of the market perception of the risk associated with the future trading potential of the property.

9.5 It is important that the valuer clearly states within the report relating to a fully equipped operational entity that the trade inventory is included within the valuation, as removal of such items would restrict the trading potential and hence have a negative impact on value.

10 Other property

10.1 This guidance note may be applicable to licensed properties that form part only of a larger
property. It should be appreciated, however, that the approach to value may be influenced by the market for the overall property.

11 Confidentiality

11.1 Certain information in respect of trade related property may be confidential. The valuer should strongly endeavour to preserve such confidentiality, whether in respect of the property to be valued or comparable properties.
Public houses, bars, restaurants and nightclubs are among those types of property that are normally bought and sold having regard to their trading potential.

This guidance note provides more detailed guidance on this specific type of property in England and Wales. It deals with the following topics:

- a summary of the statutory issues that impact on the use of licensed property;
- an outline of the approach to market analysis, interpreting comparables and other factors affecting valuation;
- an explanation of the profits method of valuation;
- an outline of the approach to the assessment of market rent, with an indication of common lease terms, and the state of the market at the valuation date, which may need consideration;
- guidance on the tied lease market for public houses with specific reference to the landlord’s Code of Practice for the operation of its tied properties; and
- guidance on valuations for investment and secured lending.