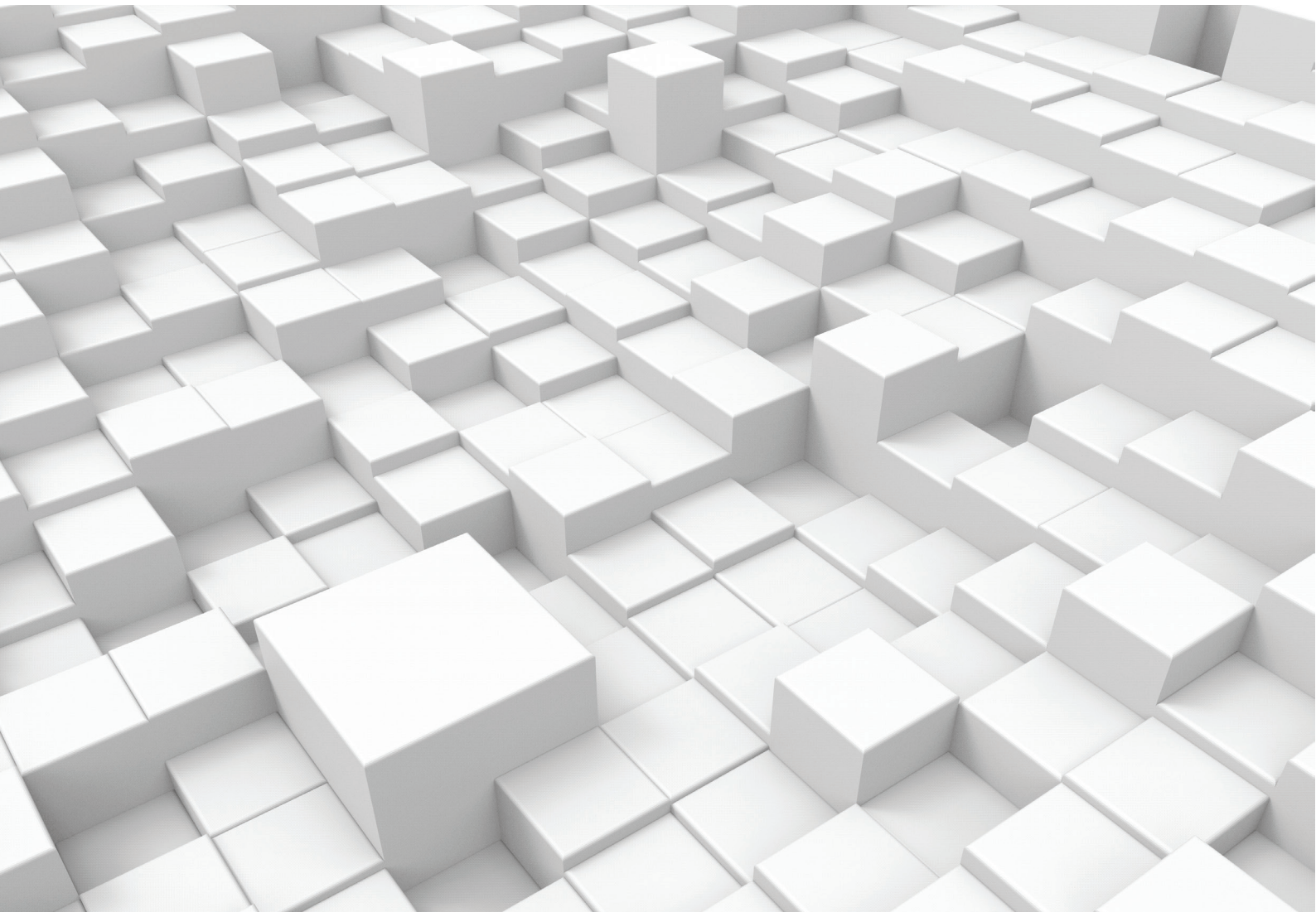




RICS professional guidance, UK

# The valuation of buy-to-let and HMO properties

1st edition, December 2016



# The valuation of buy-to-let and HMO properties

RICS guidance note, UK

1st edition, December 2016

## Copyright acknowledgment

Crown copyright material is reproduced under the Open Government Licence v3.0 for public sector information: [www.nationalarchives.gov.uk/doc/open-governmentlicence](http://www.nationalarchives.gov.uk/doc/open-governmentlicence)



## Published by the Royal Institution of Chartered Surveyors (RICS)

Parliament Square  
London  
SW1P 3AD  
[www.rics.org](http://www.rics.org)

No responsibility for loss or damage caused to any person acting or refraining from action as a result of the material included in this publication can be accepted by the authors or RICS.

Produced by the RICS Valuation Professional Group.

ISBN 978 1 78321 173 9

© Royal Institution of Chartered Surveyors (RICS) December 2016. Copyright in all or part of this publication rests with RICS. No part of this work may be reproduced or used in any form or by any means including graphic, electronic, or mechanical, including photocopying, recording, taping or Web distribution, without the written permission of the Royal Institution of Chartered Surveyors or in line with the rules of an existing licence.

Every effort has been made to contact the copyright holders of the material contained herein. Any copyright queries, please get in touch via the contact details above.

Typeset using Typefi.

# Acknowledgments

RICS would like to thank the following for their contributions to this guidance note:

**Lead author:** David Hitches MRICS (Paragon)

**Working group**

**Chairs:** Andrew Bulmer and Fiona Haggett (RICS)

Tim Bradford MRICS (Appraisers UK)

Paul Britland FRICS (Countrywide)

Keith Denholm FRICS (Allied Surveyors)

Chris Ellis MRICS (esurv)

Peter Foulds MRICS (Allied Surveyors)

Anne Hinds FRICS

David House MRICS (Santander)

Neil Richardson (One Savings Bank)

Nick Swinburne MRICS (Nationwide Building Society)

# Contents

<b>Acknowledgments</b> .....	<b>ii</b>
<b>RICS professional standards and guidance</b> .....	<b>1</b>
<b>1 Introduction</b> .....	<b>3</b>
1.1 Purpose and scope of the paper .....	3
1.2 Property .....	3
1.3 Overview of the sector .....	3
1.4 Broader issues affecting the market .....	4
1.5 Financial services regulation and buy-to-let properties .....	4
1.6 Regulation and the private rented sector .....	5
<b>2 Instruction</b> .....	<b>6</b>
2.1 Clarity of instruction .....	6
2.2 The lending process .....	6
2.3 Instruction content .....	6
2.4 Service Level Agreements .....	7
<b>3 Inspection</b> .....	<b>8</b>
3.1 Shared houses and HMOs .....	8
3.2 Regulation .....	8
3.3 Licensing .....	10
3.4 Housing and Planning Act 2016 .....	11
<b>4 Valuation</b> .....	<b>12</b>
4.1 Background and skills .....	12
4.2 Single residential units .....	12
4.3 Shared houses .....	12
4.4 Houses in Multiple Occupation .....	12
4.5 Rental value, sustainable rents and use of comparable evidence .....	14
4.6 Planning – Town and Country Planning (Use Classes) Order 1987 (as amended) .....	15
<b>5 Matters for further consideration</b> .....	<b>17</b>
5.1 Buildings insurance .....	17
5.2 Leasehold property ground rents and onerous restrictions .....	17
5.3 Flooding .....	17
5.4 Energy Performance Certificates .....	17
5.5 Financial crime .....	18
5.6 Refurbishment products .....	18
5.7 Reporting .....	18
<b>6 Scotland, Wales and Northern Ireland</b> .....	<b>19</b>
6.1 Scotland .....	19
6.2 Wales .....	19
6.3 Northern Ireland .....	19
<b>Appendix A: Valuers' checklist</b> .....	<b>20</b>



# RICS professional standards and guidance

## RICS guidance notes

This is a guidance note. Where recommendations are made for specific professional tasks, these are intended to represent 'best practice', i.e. recommendations that in the opinion of RICS meet a high standard of professional competence.

Although members are not required to follow the recommendations contained in the guidance note, they should take into account the following points. When an allegation of professional negligence is made against a surveyor, a court or tribunal may take account of the contents of any relevant guidance notes published by RICS in deciding whether or not the member acted with reasonable competence.

In the opinion of RICS, a member conforming to the practices recommended in this guidance note should have at least a partial defence to an allegation of negligence if they have followed those practices. However, members have the responsibility of deciding when it is inappropriate to follow the guidance.

It is for each member to decide on the appropriate procedure to follow in any professional task. However, where members do not comply with the practice recommended in this guidance note, they should do so only for good reason. In the event of a legal dispute, a court or tribunal may require them to explain why they decided not to adopt the recommended practice.

Also, if members have not followed this guidance, and their actions are questioned in an RICS disciplinary case, they will be asked to explain the actions they did take and this may be taken into account by the Panel.

In some cases there may be existing national standards that may take precedence over this guidance note.

National standards can be defined as professional standards that are either prescribed in law or federal/local legislation, or developed in collaboration with other relevant bodies.

In addition, guidance notes are relevant to professional competence in that each member should be up to date and should have knowledge of guidance notes within a reasonable time of their coming into effect.

This guidance note is believed to reflect case law and legislation applicable at its date of publication. It is the member's responsibility to establish if any changes in case law or legislation after the publication date have an impact on the guidance or information in this document.

## Document status defined

RICS produces a range of professional standards, guidance and information documents. These have been

defined in the following table. This document is a guidance note.

## Publications status

Type of document	Definition	Status
<b>Standard</b>		
<b>International standard</b>	An international high-level principle-based standard developed in collaboration with other relevant bodies.	<b>Mandatory.</b>
<b>Professional statement</b>		
RICS professional statement (PS)	A document that provides members with mandatory requirements or a rule that a member or firm is expected to adhere to.  This term also encompasses practice statements, Red Book professional standards, global valuation practice statements, regulatory rules, RICS Rules of Conduct and government codes of practice.	<b>Mandatory.</b>
<b>Guidance and information</b>		
RICS code of practice	Document approved by RICS, and endorsed by another professional body/stakeholder, that provides users with recommendations for accepted good practice as followed by conscientious practitioners.	Mandatory or recommended good practice (will be confirmed in the document itself).  Usual principles apply in cases of negligence if best practice is not followed.
RICS guidance note (GN)	Document that provides users with recommendations or approach for accepted good practice as followed by competent and conscientious practitioners.	Recommended best practice.  Usual principles apply in cases of negligence if best practice is not followed.
RICS information paper (IP)	Practice-based information that provides users with the latest technical information, knowledge or common findings from regulatory reviews.	Information and/or recommended best practice.  Usual principles apply in cases of negligence if technical information is known in the market.
RICS insight	Issues-based input that provides users with the latest information. This term encompasses thought leadership papers, market updates, topical items of interest, white papers, futures, reports and news alerts.	Information only.
RICS economic/ market report	A document usually based on a survey of members, or a document highlighting economic trends.	Information only.
RICS consumer guide	A document designed solely for use by consumers, providing some limited technical advice.	Information only.
Research	An independent peer-reviewed arm's-length research document designed to inform members, market professionals, end users and other stakeholders.	Information only.

# 1 Introduction

## 1.1 Purpose and scope of the paper

Over the past 25 years there has been a major shift in the housing market in the UK that has led to an increased bias to private renting, both out of choice and out of need. These changes have their roots in the more tenure-neutral housing policies that have been adopted since the 1980s, the impact of which has been amplified by the general undersupply of homes and the affordability challenge faced by would-be homebuyers.

Today's Private Rented Sector (PRS) is the second largest housing tenure, accounting for one in five homes in England alone (5.2 million households in the UK as a whole), overtaking the social rented sector for the first time since the 1960s. This represents a significant rise in the number of households in private rented homes. Demand from tenants continues to be high and is expected to increase.

The rapid expansion of buy-to-let has created significant challenges for valuers in this market and the purpose of this guidance note is to provide sufficient background information and guidance to ensure consistency in the assessment of residential investment properties ranging from single units to houses in multiple occupation and multi-unit blocks. The guidance is applicable to valuers who are instructed by lenders and private clients. Information has been specifically included to assist the valuer when acting for a lender as it is recognised that the majority of instructions tend to be for secured lending purposes.

Legislation affecting the PRS has increased the regulation that residential landlords have to comply with, resulting in increasing costs. The level of control and enforcement exercised by local authorities in their management of Houses in Multiple Occupation (HMO) stock in their areas continues to increase and the powers they have are now more widely applied in terms of HMO licensing, management regulations and planning control. It is essential that valuers acting in this specialist market have a good understanding of all relevant factors that influence both capital and rental value.

Valuers should be aware that, in the case of borrower default, the lender may choose to appoint an LPA Receiver of Rent and, at that point, it is expected that the property will be capable of being let, at or above the level of rent assessed initially and without significant expenditure to maintain the property in a lettable condition. Where applicable, an appropriate level of regulatory compliance should be in place for HMOs. All this assumes no significant changes in market conditions and that the landlord has adequately maintained the property during the interim.

It is important to emphasise that this guidance note is not prescriptive. Its application therefore needs to take account of a wide variety of market conditions and circumstances. Valuers should be aware of its contents and use them to guide their general approach in adopting the most appropriate valuation methodology while allowing for particular circumstances affecting the property being valued. In particular, refer to the most current version of *RICS Valuation – Professional Standards* global and UK (the 'Red Book') in particular the mandatory Valuation Practice Statements (VPS 1-4) which cover the terms of engagement, inspections and investigations, valuation reports and the bases of valuation (including any assumptions or special assumptions).

## 1.2 Property

RICS Valuation – Professional Standards UK (Red Book) – UK Appendix 11 Application of the RICS residential mortgage valuation specification to related purposes refers in section 5 to the main buy-to-let categories:

'5.1 Buy-to-let valuations will encompass a number of different categories. The main three are:

**Category 1:** a single individual residential unit let to a single household on a single assured shorthold tenancy (AST) where it neither forms, nor is intended to form, part of a portfolio

**Category 2:** a single residential unit let on a single AST, but to individuals on a sharing basis up to a maximum of four individuals and

**Category 3:** licensable houses in multiple occupations (HMOs) and multiple units held on a single title. They will include categories of properties not capable of being valued on an assumption of owner occupation and/or by adopting a traditional comparable methodology. These will be valued only after confirmation of direct terms of engagement with the instructing lender and referring to the lender's specific guidance.'

## 1.3 Overview of the sector

The UK population is expected to grow to 73.2 million by 2035 but housing supply is failing to keep pace. It has been estimated that 290,500 new homes need to be built each year to meet this growing demand. *The Housing and Planning Act 2016* introduces policies designed to assist in achieving 1 million new homes by 2020. In the UK, in 2014, only 141,000 homes were built. Current supply, while increasing, is failing to meet demand across all tenures – owner occupation, PRS and social housing – placing pressure on the overall housing stock and on the PRS.

Research carried out prior to the EU referendum predicts that by 2025 just under 25 per cent of housing will be in the PRS. So with this continued growing demand from



tenants for good quality rental homes, landlords are likely to see ongoing opportunities for investment in the sector. At the start of 2016, the buy-to-let market represented more than 15 per cent of all house purchases although the rate of growth slowed as a result of tax changes and the uncertainty created in the short term following the UK's decision to leave the EU, making the economics of investing in the PRS less attractive for some landlords. Institutional investment in the rented property market may well take up some of this future demand.

### 1.4 Broader issues affecting the market

In March 2016 the Bank of England Prudential Regulation Authority (PRA) consultation paper:

[www.bankofengland.co.uk/pr/Documents/publications/cp/2016/cp1116.pdf](http://www.bankofengland.co.uk/pr/Documents/publications/cp/2016/cp1116.pdf)

sought views on a supervisory statement setting out proposals regarding its expectations of minimum standards that lenders should meet when underwriting buy-to-let mortgages. The proposals aim to prevent a relaxation in buy-to-let underwriting standards and to curtail inappropriate lending and the potential for excessive credit losses.

Following the consultation, a supervisory statement, SS13/16, Underwriting standards for buy-to-let mortgages was released by the PRA in September 2016:

[www.bankofengland.co.uk/pr/Documents/publications/ss/2016/ss1316.pdf](http://www.bankofengland.co.uk/pr/Documents/publications/ss/2016/ss1316.pdf)

This outlines the minimum standards that firms should use to underwrite mortgage contracts which include:

- Affordability testing to constrain the value of the loan that a lender can make for a given income. Among other things, the lender should consider all costs associated with renting out the property where the landlord is responsible for payment and any tax liability associated with the property
- Interest rate affordability stress test. Lenders should consider the likely future interest rates, mainly over a minimum period of five years from the start of the mortgage term contract and assume a minimum 2 per cent increase. Even if the interest rate determined indicates that the borrower's interest rate will be less than 5.5 per cent during the first 5 years of the loan, the lender should assume a minimum borrower interest rate of 5.5 per cent
- Portfolio landlords. The PRA has confirmed a standard definition of a portfolio landlord. Landlords will be considered to be portfolio landlords where they have four or more mortgaged buy-to-let properties across all lenders in aggregate. The PRA is expecting lenders to implement a specialist underwriting process that accounts for the complex nature of the borrower and their portfolio of properties
- Risk management. The PRA requires that firms have robust risk management, systems and

controls in place specifically tailored to their buy-to-let portfolios. These should include risk appetite statements governing how core risks will be identified, mitigated and managed and monitoring of portfolio concentrations and high risk segments.

The principles and expectations set out in the Supervisory Statement are to be implemented on a phased basis:

- (a) Interest rate and affordability stress tests by 1 January 2017
- (b) Remaining expectations for portfolio landlords by 30 September 2017

The industry will be watching developments closely and will assess any impacts accordingly.

Against this background, government policy (including devolved administrations) has indicated a desire to 'cool' the buy-to-let market with the aim of addressing a perceived market imbalance between buy-to-let landlords and owner occupiers. It has introduced two key tax changes that will affect landlords. The first change in respect of reduced tax relief will come into effect from April 2017 and will have a four-year phasing-in period, meaning landlords will only be able to claim tax relief at the basic tax rate for their finance costs (mortgage interest) going forward. In addition, since April 2016, an extra 3 per cent stamp duty levy has been applied on all properties purchased for investment.

In October 2015 the chancellor confirmed to the Treasury Select Committee that he was in the process of granting extended powers to the Financial Policy Committee (FPC). The FPC believes the ability to restrict loan-to-value (LTV) and debt income ratios will safeguard the UK housing market from 'overheating' and will contain the risk of rising house prices. The body requested its new powers of direction are applied more broadly across the housing industry, particularly in buy-to-let. From early 2017, the FPC will have the power to tell the Financial Conduct Authority (FCA) and the Prudential Regulation Authority to place limits on loan-to-values and interest coverage ratios for regulated lenders in the buy-to-let sector.

However, with growing demand for rented property, stable yields for landlords and void periods low, buy-to-let will likely remain an attractive option. Similarly, with limited company profits being subject to a different tax regime as at April 2016, not all the new tax rules will impact those landlords holding their properties in limited company structures so we may well see more landlords choosing to incorporate.

### 1.5 Financial services regulation and buy-to-let properties

A buy-to-let loan is essentially a business transaction. It is the borrowers' intention to let property in which they are investing to generate a return, and in the long-term, they aim to make capital growth.

In early 2015, HM Treasury took a pragmatic approach to the regulation of buy-to-let under the EU Mortgage Credit Directive (MCD), after finding no compelling case for widespread regulation of the market. HM Treasury identified that only a small subsection of the buy-to-let market who they named as 'buy-to-let consumers' would be addressed under the MCD. The extract below, from HM Treasury's consultation, gives an example of what constitutes consumer buy-to-let, which would therefore fall subject to regulation:

'There are some situations where borrowers do not seem to be acting in a business capacity. Examples of this may be where the property has been inherited or where a borrower has previously lived in a property, but is unable to sell it so resorts to a buy-to-let arrangement. In these cases, the borrower is a landlord as a result of circumstance rather than through their own active business decision. The government's view is that such borrowers are consumers and would need to be covered by an appropriate framework. We would expect such instances to represent a small proportion of total buy-to-let transactions'.

The new framework by the FCA has been effective from March 2016 for those in the mortgage industry lending to or advising customers who fit the definition of 'consumer buy-to-let'.

## 1.6 Regulation and the private rented sector

It is a common misunderstanding that the private rented sector (PRS) is unregulated. The sector is heavily regulated and, according to the National Landlords Association (NLA), landlords must comply with a wide range of rules governing the sector – more than 50 Acts of Parliament and 70 sets of regulations. Regulation already gives local authorities the power to introduce local licensing schemes for the PRS, and places statutory obligations on landlords to check:

- tenants' immigration status
- appropriate electrical gas and fire safety regulations
- energy efficiency obligations and much more.

Local authorities already have extensive powers at their disposal, as do tenants and landlords, but there has been discussion about regulating the PRS further, whether by:

- introducing area-wide licensing programmes, as adopted by some local authorities
- extending mandatory licensing beyond the current definition or
- the discussion around the need for long-term tenancies.

At the time of writing, new legislation is being introduced so there may be further changes or additional requirements applied giving rise to valuation impacts that valuers need to be aware of.

## 2 Instruction

### 2.1 Clarity of instruction

The lender should provide appropriate guidance as to the basis of valuation to be adopted for buy-to-let valuations. This should be separate from the lender's standard residential valuation policy for owner-occupied homes. It is important that the valuation guidelines clearly set out the lender's expectations in terms of approach and methodology to be applied, though this does not discharge the responsibility on the part of the valuer to ensure that the valuation is not misleading (see Red Book global VPS 3). The instruction should provide sufficient detail and clarity to enable valuers to assess the property having regard to the lender's published property criteria and risk appetite.

### 2.2 The lending process

The lender will assess the affordability of a mortgage based on the expected monthly income generated from letting the property to a tenant.

Buy-to-let mortgages are therefore underwritten having regard to the level of rental income that the proposed security is capable of achieving. Some lenders may also have additional minimum income requirements for the applicant(s) derived from other sources of employment and this may vary dependent on product criteria. Professional landlords may be treated differently where all their income is from a property portfolio.

The accuracy and sustainability of the rent assessed by the valuer is therefore critical to the underwriting process. Lenders will apply an Interest Coverage Ratio (ICR) calculation to determine the maximum amount of the loan based on the rental income confirmed in the valuation report. This rent should be based on the definition of market rent in the Red Book and not simply an approval or confirmation of the rent passing unless the comparables support that level of rent.

The ICR calculation is designed to ensure that the rental income is sufficient to service the proposed loan amount, pay additional taxes as relief is withdrawn and maintain the property during the mortgage term and forms part of the PRA Supervisory Statement outlined in 1.4 above. The gross rental income from the property should exceed the interest coverage ratio requirements as defined in the selected product criteria, subject to an absolute minimum coverage of 125 per cent for most lenders although some are now increasing this with a figure in excess of 135 per cent likely to be adopted going forward. The coverage for HMOs tends to be at a higher rate to reflect increased cost. Affordability calculations and stress testing are subject to regular review and enhancement by lenders to account for economic and government policy changes.

Once a buy-to-let loan has been offered, the application moves through the completions process, at which point the solicitors may be expected to confirm that all relevant statutory consents are in place and licensing provisions adhered to, as applicable. Alternatively, some lenders may rely on an indemnity policy. It is therefore essential that valuers report clearly and concisely any legal or regulatory matters that need to be verified, to enable solicitors to make the appropriate checks prior to the submission of the report on title and satisfy the lender's requirements based on their specific instructions. Where the property has been appraised on an investment basis and the capital value of the security is reliant on the rental income being achievable on a sustainable basis, it is critical that any issues that could potentially result in enforcement action by the local authority or prevent the continued use of the property in its existing arrangement are identified in the valuation report. Recommendation for further enquiries should be made accordingly. Valuers should be familiar with the HMO guidance issued by local authorities, which is normally on their websites. Valuers should also realise that having an HMO licence does not guarantee that a property is fully compliant with the local authority's requirements. Licences may be issued initially based on the landlord's assessment of the property and completion of the application form on a self-certification basis. Until the house has been inspected by an Environmental Health Officer it may not be known if it is fully compliant.

### 2.3 Instruction content

The valuation instruction should provide sufficient information to allow an appropriately qualified and experienced (in the particular property sector or market) surveyor to carry out the valuation having regard to the specialist nature or market of the property to be valued.

In addition to the standard instruction details, critical information contained on the instruction should ideally include:

- the rental information and
- the basis of letting (single unit or multiple occupation)

to allow the valuer to assess, in addition to the capital value, the correct level of rental income that the property is capable of generating on a sustainable basis.

The valuation reporting format should be suitable for the type of appraisal to be carried out and allow the valuer scope to comment on all relevant factors having regard to the fact that the property will be let during the mortgage term and the rental income relied upon to service the loan.

The instruction should meet the minimum requirement for the terms of engagement as set out in the Red Book global VPS 1, Minimum terms of engagement, with the aim to clearly identify:

- applicant details
- full address
- tenure details
- leasehold terms if applicable/known (lease length, ground rent and service charge)
- the type of valuation required and report to be completed
- the lender's guidelines to be applied (separate document)
- access details – vendor/landlord/managing agent's name and contact details (as applicable)
- purchase price or estimated value
- proposed loan amount
- rent passing or estimated rent and frequency
- number of tenants/nature of occupancy – single unit/sharers/multiple occupation
- the Service Level Agreement (SLA) that applies
- any intentions of the applicant (proposed works) if applicable.

## 2.4 Service Level Agreements

Having regard to the instruction content above, any SLA between the lender and the valuer should reflect the potential complexity of a case and allow the appropriate time required to gain access to a tenanted property. The SLA should also allow the valuer adequate opportunity to carry out a full inspection and assessment of the accommodation and prepare the valuation, which, in the case of more complex forms of property, may take longer to complete due to the methodology applied and the need to carry out additional research, including comparable yield analysis where applicable.

Valuers accepting the instruction should be familiar with the buy-to-let market, to include HMOs if applicable, and have sufficient local market knowledge and experience to carry out the appraisal to provide both a capital and rental assessment.

Valuers should report positive and negative factors and it is fundamental to recognise that the assessment and sustainability of the rental value provided is as important as the capital valuation. Accurate and full reporting, including the condition of the property for letting purposes, is essential information for the lender, subject to any guidance issued. Lenders should consider the suitability of their reporting format for an HMO to identify all the risks and appoint a suitably experienced valuer to carry out appraisals of those HMOs that are subject to more stringent regulation and compliance.

## 3 Inspection

Inspection of properties should be in accordance with the RICS Red Book global VPS 2 Inspections and investigations, and Red Book UK Appendix 10, RICS residential mortgage valuation specification, where the property has been purchased singularly as a buy-to-let investment.

### 3.1 Shared houses and HMOs

The *Housing Act 2004* introduced the current definition of a House in Multiple Occupation (HMO):

- An entire house or flat, which is let to three or more tenants, who form two or more households and who share a kitchen, bathroom or toilet
- A house that has been converted entirely into bedsits or other non-self-contained accommodation and that is let to three or more tenants who form two or more households and who share kitchen, bathroom or toilet facilities
- A converted house, which contains one or more flats that are not wholly self-contained (i.e. the flat does not contain within it a kitchen, bathroom and toilet) and which is occupied by three or more tenants who form two or more households
- A building that is converted entirely into self-contained flats and the conversion did not meet the standards of the Building Regulations 1991 and more than one-third of the flats are let on AST
- To be an HMO the property must be used as the tenants' only or main residence and it should be used solely or mainly to house tenants. Properties let to students and migrant workers will be treated as their only or main residence.

Where the property has been converted into an HMO there will be additional factors to consider relating to both condition and value. You should make appropriate allowance in the time allocated to carry out the inspection and subsequent market research. More complex residential investment property will take longer to appraise than a standard single unit so that all relevant factors can be fully assessed while on site.

The lender will expect the property to be in a lettable condition when the loan completes so that the rental income is readily available to service the loan. Reference should be made to the lender guidance but this typically requires the accommodation to be presented to a satisfactory standard and to meet the expectations of the target tenant market for the area in which the property is located.

The fact that a property is let at the point of inspection, albeit in poor condition, does not mean that the property is capable of being re-let in that state to a new tenant. In this scenario the lender needs to be made aware that

the rent passing is not capable of being achieved on a sustainable basis without investing in the property to bring it to an acceptable standard. In the case of a remortgage, the lack of maintenance may be an indication of the way in which the landlord manages the property and is unlikely to change, whereas a purchaser may be looking to upgrade the security once the transaction completes and prior to letting. Depending on the lender's criteria, certain essential repairs required to make the property lettable and that have a material impact may be dealt with by way of a retention.

Consideration should be given to the matters set out in the Regulation (3.2) and Licensing (3.3) sections, below, to determine whether the property appears generally compliant with all relevant legislation. The scope of the inspection for mortgage purposes is not sufficient to confirm full compliance with all regulatory aspects but the property should display reasonable signs of conformity with the legal requirements.

Market rent should be the figure that is attainable on the date of inspection reflecting the condition of the property on that date with no assumptions regarding repairs or improvements for instance, to the kitchen or bathroom, unless otherwise instructed by the lender. See also the Red Book global, VPS 4, paragraph 1.3, Market rent, with assumption.

### 3.2 Regulation

Local authorities are increasingly extending their level of control as permitted by legislation and taking enforcement action where appropriate.

#### 3.2.1 The Management of Houses in Multiple Occupation (England) Regulations 2006

[www.legislation.gov.uk/ukxi/2006/372/pdfs/ukxi\\_20060372\\_en.pdf](http://www.legislation.gov.uk/ukxi/2006/372/pdfs/ukxi_20060372_en.pdf)

The regulations place the following duties on landlords to maintain their HMOs and to carry out safety measures. They should:

- provide information to the occupier
- take safety measures
- maintain a good water supply and drainage
- supply and maintain gas and electricity
- maintain common parts, fixtures, fittings and appliances
- maintain living accommodation
- provide waste disposal facilities.

Occupiers also have some duties:

- not to hinder or cause damage
- to dispose of rubbish as per instructions and
- otherwise comply with landlords' reasonable instructions in respect of fire safety.

Here is a sample of local housing authority expectations in a **larger** HMO (typically five or more occupants):

- Class A or D mains-linked smoke detectors
- Protected escape route must not pass through a higher risk area and **MUST** be kept clear of obstructions and combustible materials
- Doors leading onto the escape route should be 30 minutes fire-resistant with intumescent strips/smoke seals
- The stairs must lead directly to the final exit without passing through a risk room
- The staircase enclosure must be of sound, conventional construction throughout the route
- If the property has a carbon-burning appliance you should install a carbon monoxide alarm
- One bath or shower for up to five tenants
- Bathroom should not be more than one floor away
- For five people one toilet must be separate from the bathroom but can be in a second bathroom
- For six to ten people, two separate toilets are required, one can be in a bathroom
- At least 0.5m length of kitchen work surface space for each tenant
- At least one single cupboard storage space for each tenant
- Fridge/freezer must be in one room
- Exit doors should have thumb turn locks
- Room size requirements: see below.

### 3.2.2 HMO minimum room sizes

These standards apply where some or all facilities are shared i.e. HMOs where:

- Occupiers live independently of others, such as single room lettings or bedsit accommodation (kitchen facilities in own room)
- Occupiers forming a group such as students, professional persons and others who interact socially.

Where part of the property is not accessible during the inspection, any assumptions made regarding room sizes should be clearly stated in the valuation report.

The table below is provided as a typical guide and it should be recognised that some local authorities apply their own variation to the figures shown and valuers should be familiar with the information on the relevant local authority website. As part of the proposed extension to HMO licensing it is intended that a lettable bedroom will have a mandatory minimum floor area of 6.52m<sup>2</sup> and a minimum ceiling height of 1.5m.

### 3.2.3 Statutory overcrowding

A property is statutorily overcrowded under Part X of the *Housing Act* 1985 when either the room standard or the space standard is contravened.

#### Room standard

'The room standard is contravened when the number of people sleeping in a dwelling and the number of rooms available as sleeping accommodation is such that two persons of opposite sexes who are not living together as man and wife are forced to sleep in the same room.'

'children under the age of ten shall be left out of account, and

'a room is available as sleeping accommodation if it is of a type normally used in the locality either as a bedroom, living room or other habitable room.'

That means that living rooms must be regarded as an extra bedroom.

Where the room is for the sole use of occupier[s]	1 person	2 persons			
Kitchen	4m <sup>2</sup>	5m <sup>2</sup>			
Bedroom	6.5m <sup>2</sup>	10m <sup>2</sup>			
Combined kitchen and living room	11m <sup>2</sup>	15m <sup>2</sup>			
Combined kitchen and living room [independent living only]	9m <sup>2</sup>	14m <sup>2</sup>			
Combined bedroom, living room and kitchen	13m <sup>2</sup>	19m <sup>2</sup>			
Where the room is shared by occupiers	1-3 persons	4 persons	5 persons	6 persons	7-10 persons
Kitchen	5m <sup>2</sup>	6m <sup>2</sup>	7m <sup>2</sup>	9m <sup>2</sup>	11m <sup>2</sup>
Total communal living space **	13.5m <sup>2</sup>	17m <sup>2</sup>	18m <sup>2</sup>	20m <sup>2</sup>	27.5m <sup>2</sup>

\*\*occupiers forming a group [includes kitchens, dining rooms and living rooms – the kitchen must be at least the minimum size specified above].



### Space standard

The permitted number of people per room is the smaller of the number of people obtained from the following two calculation methods:

Where a house consists of:

1 room	2 persons
2 rooms	3 persons
3 rooms	5 persons
4 room	7.5 persons
5 rooms or more	2 for each room

or:

Floor area of room	Number of persons
Below 4.65m <sup>2</sup>	Nil
4.64m <sup>2</sup> – 6.5m <sup>2</sup>	½ person [child under 10 years]
6.5m <sup>2</sup> – 8.37m <sup>2</sup>	1.5 persons
8.37m <sup>2</sup> – 10.22m <sup>2</sup>	1 person
10.22m <sup>2</sup> or greater	2 persons

- No account shall be taken of a child under the age of one
- A child of one to ten counts as ½ a person

The tables above are adapted from information on the legislation website [www.legislation.gov.uk/ukpga/1985/68/part/X](http://www.legislation.gov.uk/ukpga/1985/68/part/X)

### 3.2.4 The Housing Health and Safety Rating System

[www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/9425/150940.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/9425/150940.pdf)

In addition to the controls mentioned, non-compliance in terms of property fitness will be assessed by the local authority using the Housing Health and Safety Rating System (HHSRS) which is a risk-based approach. The HHSRS controls the standard of all properties, particularly tenanted HMO properties, which are susceptible to tenant complaints. The HHSRS assessment is based on the risk to the potential occupant who is most vulnerable to that risk. There are 29 housing hazards and HHSRS assesses the effect that each may have on the health and safety of current or future occupants of the property.

Cold	Falls	Fire	Hot surfaces
Damp/mould	Carbon monoxide	Radiation	Electrical
Noise	Lead	Asbestos	Intruders
Crowding/ space	Explosions	Domestic hygiene	Food safety
Personal hygiene	Sanitation/ drainage		Structural failure
Inadequate lighting		Entrapment	Poor ergonomics

The HHSRS enforcement framework is determined by the presence of a hazard above or below a threshold set in the regulations. Hazards above the threshold are defined as Category 1 hazards and those below as Category 2 hazards. The council must take enforcement action to deal with Category 1 hazards and may take action to deal with Category 2 hazards. Enforcement action includes:

- improvement notice
- prohibition order
- hazard awareness notice or
- remedial action.

### 3.2.5 Fire safety

The introduction of the *Housing Act 2004* and the Regulatory Reform (Fire Safety) Order 2005 has placed responsibility on landlords, property managers and 'responsible persons' in charge of buildings, for fire safety provisions in multiple occupied housing.

The definitive guidance on fire safety for residential housing is now provided by the LACORS *HOUSING FIRE SAFETY: guidance on fire safety provisions for certain types of existing housing*.

[www.cieh.org/library/Knowledge/Housing/National\\_fire\\_safety\\_guidance\\_08.pdf](http://www.cieh.org/library/Knowledge/Housing/National_fire_safety_guidance_08.pdf)

This guidance helps to manage the relationship between the *Housing Act 2004* and the *Fire Safety Order* by offering advice and assistance to enforcers, landlords, managing agents and tenants, among others, on ways to make residential buildings safe from fire, regardless of which legislation is relevant. All valuers operating in this area of valuation should be aware of this industry guidance. It is not expected that a valuer carrying out an appraisal for mortgage-lending purposes will confirm full compliance but simply identify that the property displays evidence, from a visual inspection, of standard fire protection equipment, including, for example:

- hard-wired smoke alarms
- heat detectors
- fire doors leading from high-risk rooms onto a protected fire escape route and
- emergency lighting in large HMOs.

## 3.3 Licensing

### 3.3.1 Mandatory HMO licensing

Part 2 of the *Housing Act 2004* details the licensing requirements for mandatory HMOs as follows:

- A mandatory licence will be needed where a property comprises three or more storeys, has five or more tenants forming more than one household, and who share facilities such as toilet, bathroom or kitchen
- The licence may be granted subject to conditions and is to be displayed at the property
- The licence is personal to an individual who will be the 'most appropriate person'. This is normally the person

in control of the property and can be the managing agent

- There is a 'fit and proper person' test for the new HMO licence holder
- The licence specifies the number of permitted occupants – it therefore influences the rental assessment and capital value where the value reflects the capitalisation of a sustainable rent
- Failure to comply is a criminal offence and can also result in a Rent Repayment Order, loss of accelerated s. 21 grounds for possession and a possible Management Order allowing the local authority to take control of the property.

In 2015 the Department for Communities and Local Government went to consultation on a technical discussion paper, Extending mandatory licensing of Houses in Multiple Occupation. In October 2016, following the responses, a further eight-week consultation was announced to consider how the government now intends to implement, through secondary legislation, its decision to extend the scope of mandatory licensing and introduce mandatory national minimum room sizes for rooms used as sleeping accommodation in licensable HMOs. The *Houses in Multiple Occupation and residential property licensing reforms*

[www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/560774/161018\\_HMO\\_CONSULTATION.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/560774/161018_HMO_CONSULTATION.pdf)

include:

- Removing the storey rule so all houses (regardless of how many floors) with five or more people from two or more households are in scope – this will further enable local authorities to tackle poor standards, migration and the problems being seen in high risk smaller properties as the sector has grown
- Extending mandatory licensing to flats above and below business premises (regardless of the number of storeys) – as the evidence shows more problems in these properties and
- Setting a minimum room size of 6.52m<sup>2</sup> (10.23m<sup>2</sup> for two persons) in line with the existing overcrowding standard (*Housing Act 1985*) to close a loophole recently created by an upper-tier tribunal ruling that is enabling some landlords to let rooms far too small for an adult to legally occupy. Any part of the floor area of a room falling below a minimum ceiling height of 1.5m is to be disregarded.

In addition it is proposed that:

- A formal criminal record check is made mandatory as part of the 'fit and proper person' requirement
- It should be a mandatory HMO licence condition that the licence holder provides adequate receptacles for storing and disposing of normal household waste from the property. The facilities must be suitable for the number of persons permitted to occupy under the licence and will need to be stored in a suitable accessible place within the curtilage of the property.

### 3.3.2 Discretionary and selective licensing

Discretionary and selective licensing schemes are increasingly being implemented locally by individual local authorities although there may be a lack of consistency between the authorities. They bring additional categories of HMOs into the licensing regime including single residential units and shared houses/flats. These can often be in high density rental areas but also where there are perceived social issues, including areas around universities.

- A selective licence scheme may flag up the possibility of a property being in a poor area
- Some areas operate informal accreditation schemes, particularly in university cities where landlords and their properties are approved by the particular university or local authority for letting to their students.

Find out more about licensing in a particular area: [www.landlords.org.uk/reentriskresolve/licensing-in-your-area](http://www.landlords.org.uk/reentriskresolve/licensing-in-your-area)

The local authority may not inspect the property when a licence is granted but will do so within five years. The existence of the licence does not therefore necessarily mean that the property is compliant, but at the point of inspection by the local authority Environmental Health Officer, the property will be assessed against the HHSRS.

## 3.4 Housing and Planning Act 2016

The *Housing and Planning Act 2016*, Part 2 is about rogue landlords and property agents and allows a banning order to be made where a landlord or property agent has been convicted of a banning order offence. A database of rogue landlords and property agents is to be established and the Act allows a Rent Repayment Order to be made against a landlord who has committed an offence. Much of the detail of the Act will be left to the Secretary of State to specify by making regulations at a later date but offences are expected to include breaches of licensing requirements under the *Housing Act 2004* and breaches of improvement orders and prohibition notices, as well as breach of a banning order under the 2016 Act. The Act also makes amendments to the *Housing Act 2004* to provide that a financial penalty may be imposed by a local authority as an alternative to prosecution in relation to certain offences under the 2004 Act. A landlord or managing agent who is subject to a banning order cannot hold an HMO licence.

Part 3 of the Act deals with abandoned property in England and sets out the procedure that a landlord may follow to gain possession of a dwelling without the need for a court order. A private landlord may give a tenant notice that brings the tenancy to an end on that day if:

- a certain amount of rent is unpaid
- the landlord has given a series of warning notices and neither the tenant nor a named occupier or deposit payer has responded in writing to those warning notices before the date specified in the notices.

Full details are at:

[www.legislation.gov.uk/ukpga/2016/22/contents/enacted](http://www.legislation.gov.uk/ukpga/2016/22/contents/enacted)



## 4 Valuation

### 4.1 Background and skills

The sections above set out the legislative and other matters that valuers should be aware of before embarking on a buy-to-let or HMO valuation. In particular valuers should:

- have sufficient knowledge of residential rental and capital valuations
- be familiar with the buy-to-let market in the locality of the property
- have a thorough understanding of the regulations affecting the HMO sector of the market
- be aware of the local authority's policy requirements on HMOs (which can vary according to the authority)
- be aware of any areas designated under Article 4 Directions – see 4.6 below
- be aware of any area-wide selective or additional licensing schemes that can apply to both buy-to-let and HMO properties
- be aware that the valuation will assume, unless otherwise stated, that there are no restrictions to letting the property on standard residential terms.

The following circumstances are typical of the types of instruction/valuation reports that valuers may face. They are not exhaustive and are provided to assist valuers in the methodology that might be adopted in varying situations.

### 4.2 Single residential units

These comprise either a single flat or house, let (or proposed to be let) on a single Assured Shorthold Tenancy. These are the most common buy-to-let propositions, where a straightforward comparable-based valuation methodology will normally be used in arriving at both the capital and rental valuation. It is accepted that in certain areas, which now contain predominately tenanted accommodation, that the comparables available may only come from other investment property transactions that have taken place. In all cases, consideration should be given to the RICS information paper, *Comparable Evidence in Property Valuation*.

### 4.3 Shared houses

These are typically dwellings in an area that comprises both investment- and owner-occupied houses, or in some cases just investment properties (high density student areas in university towns being an example). Facilities are normally communal and there are no significant conversion works other than basic fire safety compliance and individual locks on doors. The occupancy will be on a single AST with multiple joint tenants, or with individual ASTs. The property will therefore fall within the definition(s)

of an HMO (three or more tenants forming two or more households sharing facilities) but may not be licensable. Here the valuer will probably have sufficient comparable evidence to apply a comparable-based methodology (as for a single unit). In certain areas, with a high density of other investment property, it is accepted that the majority of comparable evidence will be investment property, with little evidence of owner-occupied sales. The rental assessment, however, can reflect the income received from multi occupation, assuming this is sustainable, subject to any overriding guidance issued by the lender and assuming compliance with local authority requirements. Again the valuation methodology will reflect the local market.

While the assumption has been made that shared houses can be valued on a comparable basis, it is accepted that the valuer may wish to analyse the comparables on an investment basis. The rationale applied should include a comment on the method chosen.

### 4.4 Houses in Multiple Occupation

In planning terms, a small HMO with up to six occupants falls into the C4 Use Class and larger HMOs with more than six occupants are considered sui generis. For further information, see the Planning portal:

[www.planningportal.co.uk/info/200130/common\\_projects/9/change\\_of\\_use](http://www.planningportal.co.uk/info/200130/common_projects/9/change_of_use)

#### 4.4.1 General considerations for the valuation of all HMOs

HMOs can be particularly complex in terms of valuation methodology and compliance. The valuer should refer to section 4.1 above before accepting instructions to provide a report on any HMOs.

It may be possible to value the property having regard to comparable evidence of other similar investment properties being sold in the locality, where such evidence is readily available. This may well demonstrate that there is no significant premium attributable to the HMO use over and above the value as a single family house. However, in many circumstances, where, as a result of the alterations and adaptations carried out, the property is not directly comparable with other properties in the area, an investment valuation may be considered.

For properties in mixed-investment/owner-occupied areas any valuation would be expected to fit in with the tone of values in the area (making any reasonable and appropriate adjustments for extra facilities and adaptations). The extent of works required to convert a building into an HMO is fundamental when considering its value. If minimal work is required, it is logical that the property does not necessarily have an independent value as an HMO and should be

assessed as a private dwelling with a modest premium for the work done. This is because the property is not particularly specialised compared to other similar asset classes. In other words, subject to planning consent, an investor could easily purchase a cheaper property in the same street and convert this to an HMO for a lower cost.

The following sections provide more detail on the different circumstances that valuers may face in dealing with HMOs but are not exhaustive.

#### 4.4.2 Area predominately owner occupied but subject property used as HMO

Valuers may well come across a situation where, for example, a four-bed terraced house over three storeys is used as a five-bed HMO with a licence and appears to be fully compliant. Other houses in the vicinity may be either owner occupied or let as single family units. Where the area is not subject to an Article 4 Direction, nor any form of additional licensing, valuers should consider the methodology to be adopted for both the rental and capital value. In such circumstances, where the evidence suggests limited demand for HMOs (the register of HMO licences on the local authority website will provide a steer) it is likely that there will be little evidence to suggest any premium value attached to the HMO. In such cases it is unlikely that an investor would pay any more than the vacant possession value in the locality (with perhaps a little additional value for any well-considered expenditure to comply with a licence, if applicable). In certain areas it is possible that the value of an HMO may be lower than the surrounding owner-occupied stock. In those circumstances, local market knowledge should be applied.

#### 4.4.3 House in mixed owner-occupied/HMO locality

A number of older properties (Victorian/Edwardian), have been converted to take advantage of the student letting market. Some conversions of, for example, former two-bed/two reception room houses with roof spaces converted to provide additional letting rooms are typical, so valuers need to be aware of the sizes of the rooms, irrespective of the number that are occupied or let. Subsection 3.2.2 above sets out minimum room sizes to comply with HMO regulations. Assumptions made regarding the size/standard of any room that is not accessible for inspection should be clearly stated. Assuming that there is an HMO licence in place or pending, valuers need to consider the methodology to be adopted for assessing the rental value and the capital value. There are a number of considerations for valuers in such cases. For example, with regard to the size of the rooms, are there issues around the sustainable number of occupiers? Just because there is an HMO licence in place or pending, you cannot assume that the property is fully compliant, as there is a five-year period within which the local authority can inspect the property. In these circumstances the number of occupiers could be restricted to fewer than the number of bedrooms.

From a practical point of view, it is likely that, for properties in mixed owner-occupied/HMO localities valuers may wish to take two approaches i.e.

- a purely investment approach by capitalising the sustainable rent and
- a vacant possession approach based on local market evidence in the locality.

With regard to the valuation practice approach the valuer should also take account of any costs of compliance with HMO regulations.

#### 4.4.4 HMO in areas subject to Article 4 Direction

Local authorities are continuing to make more use of Article 4 Directions (see 4.6 below) and other powers at their disposal, to control the type of residential market in certain locations, especially in areas close to hospitals and universities.

Take, as an example, a large Edwardian house with an established lawful use as an HMO, in an area subject to an Article 4 Direction. In such areas there may be evidence of sales of HMOs on an investment basis with sales of owner-occupied properties of a similar size at lower values because they cannot be converted into HMOs without planning. An Article 4 Direction may mean that no intensification of HMOs would be allowed.

In such circumstances scarcity value may apply if an HMO established use/licence is in place, especially if it is fully compliant. In those circumstances valuers would probably consider an investment approach by capitalising the sustainable rent (excluding utility costs) at an appropriate yield based on local market evidence. Alternatively, if there is comparable sales evidence that demonstrates an uplifting in value or premium for properties benefitting from established HMO use, this can be reflected in the valuation.

#### 4.4.5 Sui generis HMO (more than six occupants)

In planning terms, larger HMOs, with more than six occupiers have their own use class (sui generis) and therefore are treated predominately on an investment basis, unless specifically agreed otherwise with the client. The planning position, compliance with the HHSRS, local authority requirements, market rent and adopted yield will be significant. Experience shows that many of these properties have been subject to an intensification of use and conversion to accommodate the higher levels of occupancy without formal planning consent being obtained. In such cases it would only be possible to regularise the situation by applying for a Lawful Development Certificate with evidence that the change of use to a large HMO took place more than 10 years ago.

Valuers may be asked to report on a large house converted into, say, eight rooms or eight bedsits. The area is made up of mainly buy-to-let properties with few owner-occupied houses. The units, if bedsits, would not be capable of sale separately into the market.

It is important to note that if the property has been converted into self-contained bedsits or small flats it may still be classified as an HMO if it is not to a standard that complies with the *Building Regulations* 1991, as a minimum. In this scenario, the whole building may be classified as an HMO (see the definition in the *Housing Act* 2004, s. 257).

The methodology to be adopted for the valuation is likely to be an investment approach, capitalising the sustainable rent at an appropriate yield based on local evidence.

Where there is transactional evidence available it may be possible to compare the outcome of the investment calculation with the value of the property as a large house with vacant possession. In some instances comparable investment sales of larger HMOs may also be available to analyse. For situations that are quite individual, valuers need to consider whether the property would actually transact at any higher investment value (compared with a 'bricks and mortar' value, whether for owner occupancy or otherwise). Be careful where there is no demonstrated demand to support an investment methodology or where there is limited evidence at the level of investment value being sought.

### 4.4.6 Multi-unit blocks

These will be converted or purpose-built blocks of self-contained flats where it is proposed to secure a mortgage on the freehold title. Valuers should have an awareness of the legal requirements for conversions including the expectation in the market that a Professional Consultant's Certificate may be required by some lenders for recent conversions as well as the usual new home warranty on purpose-built blocks.

Refer to the lender's guidance notes for the required valuation methodology. In the absence of any such guidance, approach the valuation in two ways and then recommend the most appropriate for adoption. Firstly, the valuation will be based primarily on the capitalised rental income. Consideration should be given to comparable sales evidence of other similar investment property in the locality where applicable.

Secondly, where the property comprises individual units e.g. self-contained flats, which are capable of sale separately (possibly on a phased disposal basis, depending on lender guidance) and the sum of the individual values, adjusted to reflect the fact that they are on one title, more accurately reflects the overall value, then this approach may also be adopted. In these cases an allowance should be made to reflect the fact that expense will be incurred in creating separate leasehold titles, holding the tenanted property and investor/developer profit etc. to facilitate sale. The valuation form should facilitate this type of reporting.

When considering the valuation methodology to be applied, valuers should have regard to the occupier profile and what is right for the area. There may be instances where all flats in the block are fully self-contained but the development is only likely to sell to an investor as a single

entity, in which case valuers should adopt an investment approach.

Valuers may be instructed to value the freehold of a multi-unit block where a number of the flats have been sold off on long leases. In this scenario, there should be a performing block management arrangement in place. Valuers should also be aware of enfranchisement provisions. Once 50 per cent or more of the units are sold separately, the freehold then needs to be offered to the leaseholders prior to disposal on the open market. Reference should be made to lender policy in this respect.

## 4.5 Rental value, sustainable rents and use of comparable evidence

The rental figure required is to be a market rent and is to comply with the Red Book global version, VPS 4, paragraph 1.3, definition of market rent on the special assumption (VPS 4 paragraph 3) that it is an unfurnished, six-month AST. The figure should be a sustainable rent and not one distorted by temporary factors of high demand such as:

- seasonal workers
- holiday lets
- asylum seekers or
- other special cases.

Special care should also be taken with new build property, particularly in large developments and city centres where a similar 'new build' factor will apply to rent as it does to market value. Initial rent on such property will attract a new build premium that will not necessarily be obtainable after the first letting.

Valuers should also be aware of the impact of rental incentives in respect of properties suitable for buy-to-let investment. Guaranteed rents that are above market rent and cashbacks in lieu of rental income for a number of years may affect price. Valuers should consider these impacts and report accordingly. Also, if a property is likely to incur higher-than-average maintenance costs because of its age/type, existing condition or intensity of occupation this should be identified in the report, as the proportion of rent required for reinvestment will exceed normal levels and accordingly reduce net income.

Valuers should fully research, document and retain comparable rental evidence in the same robust way as they would for determining market value. If there is insufficient or limited evidence they should either decline to provide a market rent figure, or clearly state the limitations of accuracy.

### Allowances from gross rents and yield considerations

The valuer may choose to adopt either a gross or net yield approach for an investment calculation. Where properties that have been analysed for comparable yield evidence are similar, a gross yield may be appropriate. For more

complex or individual properties, a net yield approach may provide a more accurate assessment and allow all relevant expenditure incurred by the landlord to be factored into the calculation.

Relatively high gross rental generated from multiple occupation rents appears attractive BUT a high management input and the incidence of other costs need to be factored in. Remember to think about the following:

- Health and safety plans/fire risk assessments/asbestos management plans
- Application of management regulation standards in terms of work requirements
- HMO licensing: cost of application fee, any additional manager fee and work requirements
- Costs associated with complying with fitness standards (HHSRS)
- The tenant profile can often require cash collections and landlord meter top-ups
- Where utility costs are non-reclaimable (inclusive rents) or only partially reclaimable (tenant meter cards) this should be reflected in a deduction from gross rents
- In HMOs council tax is often levied on the landlord (outside any void periods, properties occupied solely by students in full-time education are not liable for council tax)
- Relatively high maintenance costs are a common factor with old, large, converted properties
- High degree of wear and tear with intensive use/high density occupation
- It may also be appropriate to reflect quantitatively an allowance for one or two voids if the profile of the property, area and tenant indicates that this is appropriate
- Insurance premiums may be higher than usual, depending on the area/tenant profile and the history of claims
- Dealing with the local authority (for Housing allowance payments) and redirecting payments directly to the landlord can take time and can be reflected in management fees
- A restriction on occupation, e.g. small rooms, (see 3.2.2, above) also needs reflecting in the achievable rental value.

The above considerations are in addition to the usual risk profile associated with the buy-to-let sector of the residential property market. Implicit tenant issues according to the local tenant profile and market are generally reflected in the yield. Such factors can include:

- The general high turnover of tenants with associated re-letting costs and voids
- Costs associated with evicting tenants, which can arise more frequently and be expensive relative to low rent receipts per unit of accommodation

- Landlords becoming involved with anti-social behaviour issues including complaints from other tenants, neighbours and the police
- A general high ongoing management requirement. This should be factored into the yield
- The general state of the local market and the prospect of functional obsolescence is a risk that should be factored into the yield adopted
- Housing allowance payments are different in each local authority and they can change. Some authorities may reduce rental income (reduced housing allowance payments) but the increase in the age threshold for one bed self-contained accommodation can potentially increase tenant demand in HMOs locally.

Valuers should be clear as to the basis of the reported market rent, that is, what is, and what is not, included in the quoted rent. Gross or net rent is usually not enough. Valuers should refer to the RICS information paper *Comparable evidence in property valuation, 1st edition*. It is important that valuers understand how the market rent has been arrived at by reference to the comparable evidence and what adjustments have been made to compare like-with-like. It is acknowledged that obtaining such detail on rental evidence can sometimes be difficult.

Valuers should also be careful not to double count when calculating a net rent i.e. the matters that have been deducted from a gross rent to arrive at a net rent should not also be reflected in the yield adopted to capitalise that rent.

Valuers should fully appreciate the importance of the gross market rental value, adjusted for any inclusive utility costs. This is critical information for the lender as it is a key component in the lender's assessment of the maximum loan amount and affordability.

The valuation figures adopted should be based on evidence that can be validated through the various sources that are available in the market.

## 4.6 Planning – Town and Country Planning (Use Classes) Order 1987 (as amended)

Legislation in this area of housing continues to evolve and valuers should ensure they keep up to date.

Planning controls to be considered in the valuation of HMOs are as follows:

- Change of use from a single residential unit (Use Class C3) to a small HMO, up to and including six sharers (Use Class C4) falls under permitted development
- Moving from C4 to C3 is also a permitted change of use
- Local authorities can elect to use an Article 4 Direction Order (subject to a 12-month notice period) to withdraw these permitted development rights in a particular area, which will result in the need to obtain planning consent for this change of use

- Planning consent is still required for the change of use to larger HMOs (more than six sharers) being in the sui generis planning use class
- Some local authorities may make exceptions on occupancy numbers if the property is effectively still capable of being occupied by a group of tenants living as a single household
- The above requirements are in addition to the fact that HMOs, by their very nature, often involve internal alteration/redesign and the possibility that extensions have been added over previous years, for which normal statutory Planning and Building regulations documentation would be required for the present physical form of the building
- The lack of paperwork for Planning and Building regulations consents could indicate issues of non-compliance or, at the very least, affect future saleability if adequate documentary evidence is not available
- A Lawful Development Certificate may be required to prove an established planning use
- Separate departments of the local authority deal with:
  - 1 planning
  - 2 building regulations
  - 3 HMO standards/licensing.

Approval from one department does not imply compliance with another.

When assessing a property in an area where there is an Article 4 Direction Order, a property already let with up to six tenants as a 'small' (in planning terms) HMO may continue to be rented on that basis so long as it is not subsequently re-let as a single unit. The property may therefore command a premium over and above the value of a neighbouring house currently in single occupancy if the local authority refuses consent for change of use for that property from C3 to C4.



## 5 Matters for further consideration

### 5.1 Buildings insurance

Valuers should ensure that the reinstatement cost given reflects the full cost of rebuilding the property, including fixtures and fittings, domestic outbuildings and garages, terraces, walls and fences all included as part of the property or for which the owner may be legally responsible. For HMOs, appropriate allowance should be made for additional facilities, such as multiple kitchens and bathrooms. The figure quoted should also allow for site clearance, professional fees, removal of debris charges and any local authority costs.

The lender will expect to be alerted to areas that are associated with flooding (see section 5.3 below) coastal erosion, or any other factors that may potentially affect the structural stability of the building and the buildings insurance cover.

The reinstatement cost is usually calculated using the BCIS Rebuild online. The reinstatement value given may reflect the more complex nature of the property or multiple unit configuration with additional allowances having been made. The lenders/applicants should be made aware that in some circumstances these allowances may be inadequate and are advised to obtain specialist advice from a chartered quantity surveyor.

### 5.2 Leasehold property ground rents and onerous restrictions

Ground rents on leasehold properties can be fixed or escalating. The lease will specify when the ground rent is reviewed, on what basis, and by how much it increases. Some modern leases can contain escalating ground rents, which may result in onerous and substantial increases. Ground rents are therefore not straightforward and can have an impact on the market value of the property. The valuer should make appropriate enquiries and consider the impact, if any, on the capital value of any leasehold property.

The issue of escalating ground rents is of particular concern on new build sites, where investment value can be created by drafting leases in a manner that secures a ring-fenced income stream for future freehold owners. This can take the form of shortening of the lease term, imposing escalating reviews, tightening of the regularity of rent review clauses, introduction of notice fees for alterations and other income generating provisions. Such clauses may have implications for the market value of an investment property and, again, valuers should make appropriate enquiries as to lease terms and consider the impact on market value and suitability for mortgage purposes.

### 5.3 Flooding

Valuers of properties in the residential lettings market should be aware of an important exclusion to the historic commitment of insurers to provide policy cover on residential properties at risk of flooding.

The Flood Re scheme came into force from April 2016. This offers insurance protection for flood risk properties via a levy on household insurance policies for the majority of owner-occupier residential properties. However the scheme excludes certain types of property occupation including properties occupied under residential tenancies.

Landlords and/or tenants will therefore have to purchase flood insurance in the open market, if it is available, at whatever price and excess level insurers set for the flood risk profile of the particular property. In some cases insurance may not be available or may be uneconomical.

Valuers should consider this, and any effect on value when doing a valuation for buy-to-let or HMO properties that may be in a flood risk area.

For further information valuers should consult *Flooding: issues of concern to RICS surveyors and valuers (Residential property) 1st edition*.

### 5.4 Energy Performance Certificates

Valuers should be aware of the changes regarding EPC ratings (*Energy Act 2011, The Energy Performance of Buildings (Certificate and Inspection) (England and Wales) Regulations 2007*) in connection with domestic lettable properties and consider the impact, if any, on the value of the property and/or its suitability for mortgage purposes.

Since 1 April 2016, tenants living in properties with an F or G EPC rating have been able to request that the landlord carries out measures to bring the property up to a standard where it will have a minimum rating of E. If requested, landlords are legally obliged to carry out these works.

With effect from 1 April 2018 landlords will not be able to let a property with an EPC rating of F or below (minimum EPC rating is E). Existing lettings can continue beyond that date but will not be renewed until appropriate works have been completed to increase the EPC rating of the property to E or above. With effect from 1 April 2020 all properties with existing tenancies will be required to have an EPC rating of E or above. Exemptions may apply if the costs to bring the property up to standard involved are prohibitive.

## 5.5 Financial crime

Valuers should be aware that there is evidence that financial crime is prevalent in the buy-to-let and HMO investment market and should therefore be conversant with some of the potential indicators, such as:

- Introducer-made appointments
- No borrower name on instruction
- Instructions issued at weekends
- Evidence of connections between the seller/estate agent and introducer/broker/financial adviser/letting agent
- Selling or letting agent out of area from the property
- Telephone number for borrower being the same as that for the introducer
- Application as HMO but HMO requirements not met and/or property is in an area where there would be no demand
- Instruction doesn't indicate that the property is an HMO but it meets the requirements and there are locks on all the doors
- Estimated rental income and/or market value is based on property being an HMO but property should be valued on an AST basis and therefore estimated values are too high
- High capital value based on rental figures that are not realistic
- High capital value based on rental figures that are achievable but the property is in poor condition
- High occupancy levels that are not realistic, resulting in false income levels.

This is not an exhaustive list and valuers should keep an open mind. However, if an issue is suspected then valuers should ensure that they make the appropriate suspicious activity report (SAR) to their lender client. Currently, official SARs are made to the National Crime Agency under legislative obligations. However, it is recognised that valuers and lenders have introduced informal referral or reporting arrangements around financial crime.

### Property hijack

A recent trend has been identified in respect of buy-to-let properties that are at high risk of take-over as the owner does not occupy the property. This is especially high if the property is owned unencumbered, or the owner is recently deceased, which the valuer may not be aware of. A typical example is a fraudster gaining access to the property on a six-month AST and then impersonating the owner. In this instance it is more likely to be a buy-to-let remortgage application but can be sold on as a purchase as both the 'new' borrower and 'new' seller will have fraudulent documents.

## 5.6 Refurbishment products

Where a valuation instruction is issued on refurbishment product loan, the valuer should refer to the lender's specific

guidance regarding the basis on which the property is to be assessed.

## 5.7 Reporting

Reporting formats vary between lenders but should be suitable for the type of property being appraised and allow valuers sufficient scope to report fully on all relevant aspects of the property outlined in this guidance note.

## 6 Scotland, Wales and Northern Ireland

### 6.1 Scotland

Scotland has a different legal system and a different approach and legislation for the letting of residential property. The references in this paper are based on legislation and practices adopted in England, Wales and Northern Ireland and do not necessarily apply in Scotland. While the general approach to the valuation of residential property for buy-to-lets and, in particular, HMOs is similar, it is vitally important when carrying out a valuation of such property that the valuer is fully conversant with the current Scottish legislation and also aware of proposed changes in this sector prior to preparation of the valuation and report. In particular the valuer should have knowledge of the *Private Housing (Tenancies) (Scotland) Bill* which, when fully enacted, will introduce significant changes to residential letting.

The following brief list includes some of the key points:

- All landlords in Scotland are required to be registered
- Gas safety certificates must be produced yearly and electrical safety certificates must be produced every five years
- The right to rent, introduced in England and Wales from 1 February 2015, does not apply in Scotland
- For Assured and Short Assured tenancies the landlord is required to provide a tenant information pack. This gives various details about: the tenancy, the property (including copies of certificates for gas safety, electrical safety, energy performance and permitted number of occupants that can live in the property), the landlord and details of the landlord's and tenant's responsibilities
- An HMO is a property rented by at least three unrelated people forming more than one household who share a bathroom or toilet and kitchen (also known as a house share)
- A large HMO (in licensing terms) has at least five tenants living there, forming more than one household. The property is at least three storeys high and facilities are shared.
- HMOs must be licensed.

### 6.2 Wales

Part 1 of the *Housing (Wales) Act 2014* came into force on 23 November 2015 and requires all landlords, agents or managing agents of residential rental properties in Wales to register with Rent Smart Wales. Applicants have 12 months to comply with the legislation. The applicant(s) may be expected to provide the lender with a copy of the registration from Rent Smart Wales either prior to offer (where registration is complete) or otherwise provide a copy of the submitted registration application (together with

a copy of Rent Smart Wales acknowledgement) if subject to a current application.

The *Renting Homes (Wales) Act 2016* requires a written statement of occupation contract clearly setting out the rights and responsibilities of landlords and those renting from them. The occupation period is for a minimum of six months. Landlords have to ensure that the property is fit for human habitation. The Act protects tenants from eviction for merely complaining about the condition of the property. Under this legislation, landlords can repossess abandoned properties without a court order. (This is only a brief outline and not an exhaustive list of the Act's full provisions.)

Welsh local authorities can now require landlords to obtain planning permission to change the use of a property from a single household (C3) to a house in multiple occupation with between three and six unrelated tenants (C4). However, the change of use from a small HMO (C4) back to a single household (C3) will be permitted development.

Where an investment property comprises seven or more tenants, the landlord would have to apply for planning permission as a sui generis HMO (defined as 'of its own class') depending on the living arrangements of the seven or more tenants and whether they form a single household.

### 6.3 Northern Ireland

In Northern Ireland an HMO is a house occupied by more than two qualifying persons, being persons who are not all members of the same family. A 'qualifying person' is a person whose only or principal place of residence is the HMO. Students' term time accommodation is regarded as their only or principal place of residence while they are living there. Exemptions apply. The following categories are exempt from registration:

- Any HMO that is occupied by persons who comprise no more than two families
- Any HMO that is occupied by no more than two persons in addition to the owner (or owners) and members of the family (or families) of owner(s).

Northern Ireland operates a Statutory Registration scheme for HMOs. It is the duty of the person specified by the Registration Scheme to register a house to which the scheme applies and to renew the registration as and when required by the scheme.

The NI Housing Executive is responsible for ensuring that HMOs meet a number of requirements in relation to the overall condition of the dwelling, and the number of people living in the dwelling. The standards applied are set out in *Housing in the Multiple Occupation Standards*:

[www.nihe.gov.uk/hmo\\_standards.pdf](http://www.nihe.gov.uk/hmo_standards.pdf)



## Appendix A: Valuers' checklist

Valuers should:

- Have suitable experience of the rental market and property type to which the valuation instruction relates, particularly if it is specialist. (2.4)
- Be familiar with the client's requirements/expectations and consider any guidance notes provided by a lender. (2.1)
- Ensure Service Level Agreements reflect the potential complexity of the property to be valued and the valuation methodology to be applied. (2.4)
- Recognise when the property fits the definition of an HMO and consider the implications for a landlord in terms of compliance and cost. (3.1)
- Have knowledge of the regulatory standards that apply to rented accommodation and the additional requirements that are relevant to Houses in Multiple Occupation. (3.2)
- Appreciate that on inspection by a local authority environmental health officer, a property will be assessed against the Housing Health and Safety Rating System. (3.3)
- Be familiar with the basic fire safety protection measures required in rented accommodation. (3.2.5)
- Consider whether the room sizes are adequate to be classed as lettable accommodation and recognise that published standards may not always be consistent between different local authorities. (3.2.2)
- Keep up to date with changes in relevant legislation and local authority requirements as published on the web. (3.2.2)
- Assess if the property requires a licence. A mandatory licence will be needed where a property comprises three or more storeys, has five or more tenants forming more than one household, and who share facilities such as toilet, bathroom or kitchen (3.3.1)
- Know if a local authority has introduced discretionary or selective licensing schemes and/or Article 4 Direction Orders within the value's area of operation.(4.6)
- Provide clear and concise advice to enable appropriate legal enquires to be made during a lender's completions process to ensure the property conforms to all relevant legislation. (2.2)
- Be aware that a use class change from a single dwelling to an HMO with up to six sharers (C3 to C4) is permitted if there is no Article 4 Direction Order but more than six tenants may require sui generis consent.(4.6)
- Remember that an independently assessed and sustainable rental valuation is critical to a lender's underwriting process. (2.2)
- Recognise that any enforcement action by a local authority that reduces the rental income could adversely affect the value of the client/lender's security. (2.2)
- Be aware of the minimum requirement for an E rating or above on EPC certificates to secure a new letting from April 2018. (5.4)
- Keep up to date with future regulatory/legislative changes affecting the private rented sector and their likely impact for landlords operating more complex forms of residential investment property. (1.6)
- Apply the most appropriate valuation approach having regard to any guidance included with the valuation instruction in addition to the information in this guidance note. (4)
- Where possible, value the property based on comparable evidence. (4.5)
- When it is necessary to apply investment valuation methodology because of the individual nature or complexity of a property, ensure yields applied are supported by comparable evidence and always carry out a logic check to ensure the valuation assessed is consistent with the tone of values in the area. (4.4.1)



## Confidence through professional standards

RICS promotes and enforces the highest professional qualifications and standards in the development and management of land, real estate, construction and infrastructure. Our name promises the consistent delivery of standards – bringing confidence to the markets we serve.

We accredit 125,000 professionals and any individual or firm registered with RICS is subject to our quality assurance. Their expertise covers property, asset valuation and real estate management; the costing and leadership of construction projects; the development of infrastructure; and the management of natural resources, such as mining, farms and woodland. From environmental assessments and building controls to negotiating land rights in an emerging economy; if our members are involved the same professional standards and ethics apply.

We believe that standards underpin effective markets. With up to seventy per cent of the world's wealth bound up in land and real estate, our sector is vital to economic development, helping to support stable, sustainable investment and growth around the globe.

With offices covering the major political and financial centres of the world, our market presence means we are ideally placed to influence policy and embed professional standards. We work at a cross-governmental level, delivering international standards that will support a safe and vibrant marketplace in land, real estate, construction and infrastructure, for the benefit of all.

We are proud of our reputation and we guard it fiercely, so clients who work with an RICS professional can have confidence in the quality and ethics of the services they receive.

### United Kingdom RICS HQ

Parliament Square, London  
SW1P 3AD United Kingdom

**t** +44 (0)24 7686 8555

**f** +44 (0)20 7334 3811

**e** [contactrics@rics.org](mailto:contactrics@rics.org)

### Media enquiries

**e** [pressoffice@rics.org](mailto:pressoffice@rics.org)

### Ireland

38 Merrion Square, Dublin 2,  
Ireland

**t** +353 1 644 5500

**f** +353 1 661 1797

**e** [ricsireland@rics.org](mailto:ricsireland@rics.org)

### Europe

[excluding UK and Ireland]

Rue Ducale 67,  
1000 Brussels,  
Belgium

**t** +32 2 733 10 19

**f** +32 2 742 97 48

**e** [ricseurope@rics.org](mailto:ricseurope@rics.org)

### Middle East

Office G14, Block 3,  
Knowledge Village,  
Dubai, United Arab Emirates

**t** +971 4 446 2808

**f** +971 4 427 2498

**e** [ricsmenea@rics.org](mailto:ricsmenea@rics.org)

### Africa

PO Box 3400,  
Witkoppen 2068,  
South Africa

**t** +27 11 467 2857

**f** +27 86 514 0655

**e** [ricsafrica@rics.org](mailto:ricsafrica@rics.org)

### Americas

One Grand Central Place,  
60 East 42nd Street, Suite 542,  
New York 10165 – 2811, USA

**t** +1 212 847 7400

**f** +1 212 847 7401

**e** [ricsamericas@rics.org](mailto:ricsamericas@rics.org)

### South America

Rua Maranhão, 584 – cj 104,  
São Paulo – SP, Brasil

**t** +55 11 2925 0068

**e** [ricsbrasil@rics.org](mailto:ricsbrasil@rics.org)

### Oceania

Suite 1, Level 9,  
1 Castlereagh Street,  
Sydney NSW 2000, Australia

**t** +61 2 9216 2333

**f** +61 2 9232 5591

**e** [info@rics.org](mailto:info@rics.org)

### North Asia

3707 Hopewell Centre,  
183 Queen's Road East  
Wanchai, Hong Kong

**t** +852 2537 7117

**f** +852 2537 2756

**e** [ricsasia@rics.org](mailto:ricsasia@rics.org)

### ASEAN

10 Anson Road,  
#06-22 International Plaza,  
Singapore 079903

**t** +65 6635 4242

**f** +65 6635 4244

**e** [ricssingapore@rics.org](mailto:ricssingapore@rics.org)

### Japan

Level 14 Hibiya Central Building,  
1-2-9 Nishi Shimbashi Minato-Ku,  
Tokyo 105-0003, Japan

**t** +81 3 5532 8813

**f** +81 3 5532 8814

**e** [ricsjapan@rics.org](mailto:ricsjapan@rics.org)

### South Asia

48 & 49 Centrum Plaza,  
Sector Road, Sector 53,  
Gurgaon – 122002, India

**t** +91 124 459 5400

**f** +91 124 459 5402

**e** [ricsindia@rics.org](mailto:ricsindia@rics.org)