



## **Basic Principles Committee**

### **Practice Note 2**

### **REVALUATION 2005**

### **CONTRACTOR'S BASIS VALUATIONS**

#### **1.0 Introduction**

1.1 This practice note gives guidance on Contractor's Basis Valuations and related matters for the 2005 Revaluation in Scotland and has the following contents: -

- |           |  |
|-----------|--|
| Para. 1.0 | Introduction   |
| 2.0       | A standard approach.   |
| 3.0       | Stage by stage procedure.                                      |
| 4.0       | A model valuation format.                                      |
| 5.0       | Cost information.  |
| 6.0       | Cost analysis procedure.                                       |
| 7.0       | Cost adjustment and application for valuation purposes         |
| 8.0       | Obsolescence.  |
| 9.0       | Grants etc.  |
| 10.0      | Use of Contractor's Basis in Comparative Principle Valuations. |

1.2 Examples of related reference reading include: -

- (i) "Armour on Valuation for Rating", currently at **19-38** to **19-59**, dealing with The Contractor's Principle.
  
- (ii) "The Contractor's Basis of Valuation – A Guidance Note" produced by the Joint Professional Institutions Rating Forum and published by RICS Business Services Ltd.

#### **2.0 Standard Approach**

2.1 The approach recommended comprises the 5 "classic" stages of a Contractor's Basis valuation as listed below and dealt with in more detail in para. 3.0

*Stage 1* - Estimated Replacement Cost. (**E.R.C.**)

*Stage 2* - Adjusted Replacement Cost. (**A.R.C.**)

*Stage 3* - Land value.

*Stage 4* - Decapitalisation.

*Stage 5* - Review ("Stand back and look").

2.2 A sixth stage to reflect the “higgling” between landlord and tenant is mooted in some quarters but not particularly predated in Scotland. Stages 1 to 5, properly applied, should render this unnecessary.

2.3 The statutory prescribed base date or, as hereinafter referred to, “tone” date, for the 2005 Revaluation is 1<sup>st</sup> April 2003.

### **3.0 Stage by Stage Procedure**

#### **3.1 Stage 1 – Estimated Replacement Cost (E.R.C.)**

3.1.1 Estimated Replacement Cost (E.R.C.) is an estimate of the development cost of lands and heritages and should reflect the following conditions: -

- (a) the development is provided on an undeveloped site in its actual location.
- (b) the development is provided at the “tone” date.
- (c) the development is provided under a single contract.
- (d) the development does not benefit from any form of grant, donation or financial assistance.

3.1.2 In most cases the procedure involves the replacement costing of the actual property but in some instances a modern substitute may be envisaged. e.g.: -

- (a) When the property is so old that the mode of construction is no longer employed and therefore unable to be costed.
- (b) Where current practice would not envisage rebuilding in the original form.
- (c) Where an alternative use is made of an obsolete building.

3.1.3 Replacement costs to be estimated should reflect the prevailing level of cost of provision in the identified location and the effect on cost of contract size. They should include those of all rateable siteworks, buildings, structures, pertinents, plant and machinery in or on the lands and heritages together with relevant items such as design, services, supervision and professional fee costs.

3.1.4 Estimated Replacement Cost should exclude V.A.T. and any element of “unremunerative cost” perceived at this stage. Examples of the latter being the duplication of tasks during construction due to severe weather or natural disaster, commonly termed “reworks” or; costs involved in the provision of unnecessary embellishment as a “personal choice” of a particular occupier which may not particularly enhance annual value.

3.1.5 Estimated Replacement Cost should retain or positively reflect any element of cost funded by grant or donation. (see para 7.5.2 )

3.1.6 The basis of costing should be by the use of unit cost rates or actual costs. The approach to this is covered in sections 5.0, 6.0 and 7.0 of this practice note with particular guidance on the effect of time, location, contract issues, professional fees and the adjustment of actual costs. Guidance on tender price indices, location factors, contract size adjustments and fee additions are given therein with indices and location factors available from the RICS BCIS publication.

### 3.2 Stage 2 – Adjusted Replacement Cost (A.R.C.)

3.2.1 The estimated replacement cost should be adjusted to take account of the comparison between the actual property in its actual state and the “new” property costed at Stage 1. This normally reflects deficiencies or what is generally termed obsolescence

3.2.2 Obsolescence can be subdivided into various headings such as “physical”, “functional”, “technical” or “economic”. Not all are dealt with at Stage 2. e.g. economic obsolescence is usually a Stage 5 consideration. (See 3.5.2)

3.2.3 Physical obsolescence reflects deterioration due to age or wear and tear. Functional obsolescence can reflect design deficiencies relative to current requirements. Technical obsolescence, a variation of functional, reflects technological changes rendering consequences such as redundancy.

3.2.4 The use of a modern substitute cost at Stage 1 should limit physical and functional obsolescence to reflection of the effect of repair and running costs. Care must be taken not to duplicate considerations already given at Stage 1.

3.2.5 Scales for physical obsolescence based initially on age are recommended later at 8.0. However, further functional or technical obsolescence may require reflection at this stage. The application and magnitude of these is a matter of valuer judgement.

3.2.6 Application of relevant allowances to the result of Stage 1 produces Adjusted Replacement Cost. (A.R.C.)

### 3.3 Stage 3 – Land Value

3.3.1 Land should be costed using bona fide actual costs or in comparison with undeveloped land cost evidence in the particular area for similarly sized sites with similar use classes at the “tone” date. Ground Rents may, perhaps, be available to assist and dispose of Stage 3 actions.

3.3.2 Consideration should be given to the appropriateness of any allowance to reflect the site being “encumbered” by obsolete buildings, structures, plant and machinery or some other factor. [The so called “Ebdon Allowance” – for background see *Imperial College of Science and Technology v Ebdon (VO) and Westminster City Council 1984 LT RA 84 page 213*]. The quantum of any such allowance may be influenced by adjustments made between Stage 1 and Stage 2 of the particular valuation but in all cases this is a matter of valuer judgement.

3.3.3 Consideration should also be given to possible surplus land within the site that may, for instance, be reserved for future development. This may attract a lower level of value but “Ebdon Allowance” may not be appropriate. This is, again, a matter of valuer judgement.

### **3.4 Stage 4 – Decapitalisation**

3.4.1 The appropriate decapitalisation rate should be applied to the sum of Stages 2 and 3. This converts the “Effective Capital Value” to initial Net Annual Value. However, where relevant Ground Rent information is available, this may be incorporated at Stage 4 as annual value added to the decapitalised Stage 2, no Stage 3 having been necessary.

### **3.5 Stage 5 – Review –“Stand Back and Look”**

3.5.1 Adjustments are made here which generally affect the property as a whole and should not duplicate adjustments for unremunerative expenditure or other allowances already made at stages 1, 2 and 3.

3.5.2 Examples of matters possibly to be considered here could be; access, general layout, unremunerative expenditure, new ventures, state of the industry, relativity to local pattern of values, negotiation between the parties etc.

3.5.3 Allowing for “rounding”, application of any Stage 5 “Review” allowance produces Net Annual Value.

### **3.6 Comment**

Stage 1 of a Contractor’s Basis valuation is purely a costing exercise. The actual valuation process commences at Stage 2. However, a uniform approach to costing at Stage 1, as recommended in this practice note, is the key to consistency with relevant valuation judgements made thereafter.

### **4.0 Model Valuation Format**

4.1 There is no ideal valuation format or layout, but one which follows the five classic stages of a Contractor’s valuation, caters for necessary adjustments within the stages as described in the Stage by Stage Procedure at 3.0 and allows clear noting of reasoning, is the model. Varied media may be utilised from paper to computer spreadsheets or databases.

### **5.0 Cost Information**

5.1 In accordance with the first Wood Committee Report, a Unit Cost Rate approach to calculating **E.R.C.** is recommended. SAA practice notes or Rating Cost Guide (R.C.G.) information are the prime source. When comparing SAA rates with the RCG for complete buildings it should be noted that the R.C.G. is expressed in terms of Gross Internal Area

- 5.2 Actual cost information for complete lands and heritages on the “tone” date should be irresistible if appropriately adjusted. If available, this is also recommended, *if carefully adjusted and then rationalised with a unit cost rate approach.*

## **6.0 Cost Analysis Procedure**

### **6.1 Background**

6.1.1 With adequate availability of “tone date” costs or tenders from every location in Scotland for similar examples of the categories of subjects (or elements thereof) being analysed, reasonable conclusions may be drawn on relative cost levels in different locations and on what is a mean or average level.

6.1.2 However, with inadequate availability it may be necessary to refer to published price indices and related factors to establish any relativity of costs due to time and/or location. In these circumstances the following (6.2 etc.) is recommended.

### **6.2 Index and Related Information**

6.2.1 The BCIS “ All in” Tender Price Index is to be used in the adjustment of construction cost information for time for analysis purposes.

6.2.2 The adopted index point to reflect 2005 Revaluation “tone” is “**195**”. (This “harmonised” approach recognises the consistency of the index up to the first quarter of 2003.)

6.2.3 The related BCIS “Location Factors” are to be used as directed later in this practice note.

6.2.4 The adopted “normal” contract size for analysis (and valuation) purposes is set at £ 2,000,000. A table of recommended contract size adjustments is contained in Appendix 1.

### **6.3 Cost Adjustment for Analysis Purposes**

6.3.1 Cost or tender information available for analysis to provide a building unit cost rate may require adjustment for various reasons. e.g.

- (i) Exclusion of non-rateable elements.
- (ii) Exclusion of land/siteworks/ fee costs. \*
- (iii) Local economic conditions.
- (iv) Contract size.
- (v) Difference in time from the “tone” date.

*\* These costs should not be totally discarded as some of them may be analysed separately for common elements and siteworks unit cost rates using the same methodology presented in this document. The relationship of fee costs to the contract may also be analysed.*

- 6.3.2 Where cost or tender information is effective at the 2005 Revaluation “tone” date it will require no adjustment for time as in 6.3.1(v) but may require some adjustment in respect of 6.3.1 (i), (ii), (iii) or (iv)
- 6.3.3 Where cost or tender information is effective at another date, adjustment for time is also necessary.
- 6.3.4 Unless excluded in terms of 6.3.1. (i) or (ii) elements of cost funded by grant, donation, or other financial assistance must be retained in, **or added to** the sums to be analysed.

## **6.4 Adjustment Steps for Analysis Purposes**

### **6.4.1 Step 1 - Exclusions /Additions**

- (i) Non – rateable items reflected in cost/tender information require to be eliminated. e.g. loose furniture, racking etc.
- (ii) Equivalent costs of uncharged donated labour, materials to be added.
- (iii) If a building unit cost rate is to be analysed, all land, siteworks and fee costs require to be eliminated.
- (iv) If land or siteworks unit cost rates are to be analysed, all other irrelevant costs require to be eliminated.
- (v) Fee costs for non rateable elements require elimination if fee costs are to be analysed.

### **6.4.2 Step 2 - Local Economic Conditions**

Confirm geographical origin and effective date of cost/tender information and establish the relevant, and timeous, BCIS “Regional”, “County” and/ or “District” Location Factor [if the latter is available]. Use these factors to adjust to the “UK Mean” level at the effective date.

The location factors contained within the BCIS tables provide an indication of the relativity of: -

- i) Scotland to the U.K. mean by way of the Scottish “Regional” factor,
- ii) the former local authority regions as they existed between 1975 and 1996 to the U.K. mean by way of the “County” factor,
- iii) The former local authority districts as they existed between 1975 and 1996 to the U.K. mean by way of the “District” factor.

The BCIS state in their publications that it is the “Regional” factors (6.4.2 (i) above) that are more reliable statistically, being based on a larger sample size than both the other two factors.

**NB:** The results of this analysis, actual cost information available and/or local knowledge may belie the cost relationships portrayed by BCIS factors and apparently render them, or the costs, unreliable. Careful (and clearly recorded) judgement by the analyst must be exercised at this stage in these circumstances. The SAA's previous and generally accepted practice of recommending a Scottish mean level in Reports is to continue to be used for this Revaluation. Individual practice notes will give clear guidance on whether or not any further adjustments to the recommended Scottish mean level are to be carried out for valuation purposes.

#### 6.4.3 Step 3 - **Difference in Time**

Establish the BCIS "All in" Tender Price Index point for the effective date and use that to adjust the dated "UK Mean" level to the "tone date" index point of "**195**". This index shows the movement over time for the "UK Mean" level and should be applied after any adjustment for location. Adjust this "UK Mean" level to "Scottish Mean" level at "tone" by application of the "tone" BCIS Scottish "Regional" Location Factor 0.94.

#### 6.4.4 Step 4 – "Unit Cost Rate"

A Scottish unit cost rate can then be calculated by application of the measured units to the adjusted Scottish mean cost.

#### 6.4.5 Step 5 - **Contract Size**

Cognisance must be given to the overall magnitude of the contract that is the source for analysis when arriving at unit cost rates for buildings or other elements. Analysed unit cost rates should reflect the adopted "normal" size of contract of £2,000,000 and the resultant unit cost rate from Steps 1, 2, 3 and 4 may require further adjustment to place it in this perspective. A table of recommended contract size adjustments is contained in Appendix 1. Appropriate application of these adjustments to the unit cost rate calculated at Step 4 will produce the "tone" Scottish Mean unit cost rate for the "normal" size of contract.

#### **NB: Unit Cost Rates exclude Fees!**

Cost	=	£3,300,000
Gross External Area	=	10,000 m2
Effective Date	=	August 2002
Location	=	Glasgow

#### **Calculations**

The example below illustrates the adjustments using BCIS Scottish "Regional" Location Factors at Effective and "Tone" dates. The principle is the same when using BCIS "County" and "District" Location Factors at the Effective Date. Separate analyses should be carried out on the available cost sample using "Regional",

“County” and District” Location Factors at Effective Date for comparison purposes.

Cost [adjusted for exclusions/additions]  
÷ 3<sup>rd</sup> Q 2002 Scottish Location Factor (Regional, County, District) to adjust to UK Mean  
÷ 3<sup>rd</sup> Q 2002 TPI Index x adopted index point “195”  
x “Tone” Scottish “Regional” Location Factor to adjust to Scottish Mean  
÷ units (m<sup>2</sup>, m<sup>3</sup>, metre run, hectare etc.)  
÷ inverse of recommended Contract Size adjustment (based on “adjusted “ cost) to bring to “normal” level. (0.98 in example below)

i.e.  
£3,300,000[adjusted] = £3,000,000  
£3,000,000 ÷ 1.00 = £3,000,000  
÷ 192 x 200 = £3,046,875  
x 0.94 = £2,864,063  
÷ 10,000 = £ 286.41 [“actual”]  
÷ 0.98 = £ 292.25 (say) £ 290[“normal”]  
  
(Scottish Mean Unit Cost Rate)

**NB** in analysis procedure, as a check, contract sizes above £2,000,000 should generate “normal” rates that are higher than “actual” rates and vice versa for contract sizes below £2,000,000

6.5 The effective date of a “cost” is the actual mid-contract point. The effective date of a “firm price tender” is the notional mid -contract point midway between the tender’s envisaged start and completion dates. The effective date of a “variation of price tender” is the “tender base date” which is the date by reference to which costs are adjusted to produce the final account. This should normally be taken as 1 month prior to the date of the tender’s submission.

## 7.0 Cost Adjustment and Application for Valuation Purposes

In arriving at E.R.C., cost information, whether unit or actual, may require to be adjusted for one reason or another. SAA Revaluation 2005 practice notes will give clear guidance on the adjustments to be made.

Recommended unit cost rates may require adjustment to reflect the following: -

**Variation in Specification**  
**Location (if recommended)**  
**Contract Size and Fees.**

- 7.1 Aspects of specification of items to be costed may not be directly reflected in standard recommended rates and will require appropriate adjustment to be made.
- 7.2 On the Scottish mainland the “tone” Scottish “Regional” Location Factor of 0.94 must be used to adjust recommended rates for **Location** if the costs are being imported from the RCG or are non-Scottish actual costs. Such imported rates should also be adjusted to reflect Gross External Area. All rates recommended by the SAA through Category Committee practice notes will reflect the Scottish mean level. [Bearing in mind that plant and machinery items require no adjustment for Location.]
- 7.3 Having arrived at an initial **Notional Cost of Contract**, the table of adjustments in Appendix 1 should be used to reflect the effect of the hypothetical overall **Contract Size**
- 7.4 Adjustments for professional **Fees** should be made based on the following:-
- 7.4.1 Percentage additions as set out below should be added to the **Notional Contract Cost** after adjustment for location and contract size where appropriate.
- 7.4.2 Since fees will vary, particularly depending on the value, type and complexity of the contract, it is accepted that the following additions for fees may not be appropriate in all cases. However, there should be no departure from this approach without the prior approval of the relevant SAA Category Committee. (see details of fees following)

**Estimated Replacement Cost      Addition for Fees/Charges**

Sums up to £500,000	13%
£500,000 to £2,000,000	11% (min fee £65,000)
Sums over £2,000,000	9% (min fee £220,000)

*NB: When considering evidence of fees and charges obtained from local authorities and other public bodies, such costs may require an upward adjustment to allow for "fees" which have been absorbed by the use of "in-house" professional staff.*

- 7.4.3 Up to a further 6% may be added to the above scales for lands and heritages of a more complex nature such as:-

Ambulance, Police & Fire stations  
Hospitals  
Crematoria  
Law courts  
Libraries  
Town Halls

Educational Establishments  
 Recreation & Leisure Facilities  
 Conference and Exhibition Centres  
 Public Conveniences  
 Breweries  
 Community Centres  
 Airport Terminals  
 Oil Refineries  
 Petrochemical Works  
 Gas Processing Plants/Terminals  
 Specialist Microelectronics Factories

7.4.4 Some large lands and heritages (i.e. those with an ERC in excess of £6 million) which contain structures of a relatively simple form or repetitive nature may attract professional fees at a lower level. In such cases, the addition for fees and charges may be varied. However, as there may be other criteria to consider besides contract value, the following scale should only be used after careful consideration and approval of the relevant SAA Category Committee:

<b>Estimated Replacement Cost</b>	<b>Addition for Fees/Charges</b>
Over £6 million	8.5% min fee £540,000
Over £12 million	8.0% min fee £1,020,000
Over £20 million	7.5% min fee £1,600,000

**N.B.** Lower level fees may not necessarily apply to lands and heritages identified at 7.4.3

7.5 Actual cost information for complete development of lands and heritages as envisaged in 3.1.1 should inherently reflect **Location, Contract Size and Fees** but such information is likely to require adjustment for some reason e.g. :-

Unremunerative Expenditure  
 Donated Development Costs  
 Non-Rateable Items  
 Single Contract Hypothesis  
 Time

7.5.1 **Unremunerative Expenditure** must be excised from cost.

7.5.2 It is more than likely that actual cost information will not reflect, when they exist, **donated development costs** such as free labour and materials or other elements with no charge or directly financed by third parties. These require to be allowed for, positively by an addition to the actual cost.

7.5.3 The cost of **Non-Rateable** items must be ignored.

7.5.4 The savings of the **Single Contract Hypothesis** must be quantified and adjusted for if the typical “main contractor “ scenario is not involved.

7.5.5 If the effective date of the cost information, generally the midpoint of the contract, does not coincide with the “tone” date then there must be an

adjustment to cost for **Time**. This may involve some location factor based adjustment also. (refer to 6.4 for guidance)

7.5.6 The foregoing adjustments may impact on **Contract Size** and subsequently some further adjustment may be necessary to reflect this and the consequential effect on the level of **Fees**.

## **8.0 Obsolescence Allowances**

8.1 Tables of recommended % obsolescence allowances are overleaf under the headings of: -

- (A) Buildings**
- (B) Plant**
- (C) Civils**
- (D) Tanks**

These tables recommend **maximum** allowances to be used to reflect age-related obsolescence.

The use of notional age variations may provide flexibility on refurbished buildings, civils, plant or tanks and also on little used items of plant and machinery.

With the exception of any category of lands and heritages where discrete guidance is provided ;

Table **(A)** should be applied for all buildings

Table **(B)** should be applied to all plant and machinery other than tanks

## 8.2 Allowances

Year	Buildings	Plant	Civils	Tanks
	% (A)	% (B)	% (C)	% (D)
2005				
2004	0.50			
2003	1.00			
2002	1.50			
2001	2.00			
2000	2.50			
1999	3.00			
1998	3.50			
1997	4.00			
1996	4.50			
1995	5.00			
1994	6.00	2.00	0.50	1.00
1993	7.00	4.00	1.00	2.00
1992	8.00	6.00	1.50	3.00
1991	9.00	8.00	2.00	4.00
1990	10.00	10.00	2.50	5.00
1989	11.00	12.00	3.00	6.50
1988	12.00	14.00	3.50	8.00
1987	13.00	16.00	4.00	9.50
1986	14.00	18.00	4.50	11.00
1985	15.00	20.00	5.00	12.50
1984	16.00	22.50	5.50	14.00
1983	17.00	25.00	6.00	15.50
1982	18.00	27.50	6.50	17.00
1981	19.00	30.00	7.00	18.50
1980	20.00	32.50	7.50	20.00
1979	21.00	35.00	8.00	21.00
1978	22.00	37.50	8.50	22.00
1977	23.00	40.00	9.00	23.00
1976	24.00	42.50	9.50	24.00
1975	25.00	45.00	10.00	25.00
1974	26.00	45.50	10.50	26.00
1973	27.00	46.00	11.00	27.00
1972	28.00	46.50	11.50	28.00
1971	29.00	47.00	12.00	29.00
1970	30.00	47.50	12.50	30.00
1969	31.00	48.00	13.00	31.50
1968	32.00	48.50	13.50	33.00
1967	33.00	49.00	14.00	34.50
1966	34.00	49.50	14.50	36.00
1965	35.00	50.00	15.00	37.50
1964	36.00		15.00	40.00
1963	37.00			
1962	38.00			
1961	39.00			
1960	40.00			
1959	41.00			
1958	42.00			
1957	43.00			
1956	44.00			
1955	45.00			
Pre 1955	45.00 to 50.00			

## 9.0 Grants etc

- 9.1 Having regard to existing Scottish Case Law (e.g. Banbeath [1982 & 1989], Shell [1989], ICI [1989], Exxon [1989], and SECC [1989]), any effect of grant on rental value is most appropriately reflected in the decapitalisation rate. The working assumption must be that any prescribed rate takes account of this factor.

## 10.0 Contractor's Basis in Comparative Valuations

- 10.1 The most common use of the Contractor's Basis in Comparative Valuations of Industrial Subjects is for the addition of value for items of Excess Land, Siteworks, Plant and Machinery and ancillaries.
- 10.2 Local land cost evidence and **S.A.A.** or **R.C.G.** unit cost rates are recommended for this purpose.
- 10.3 When adjusting for **Contract Size** or **Fees** in these circumstances this should be on the basis of the perceived overall contract sum for the provision of the lands and heritages as a whole.
- 10.4 Awareness that **Location** does not affect plant and machinery unit costs is also important.
- 10.5 The appropriate decapitalisation rate should be applied.

## Contract Size Adjustments.

ERC £	% adjustment
up to 0.5 million	+ 10% max
0.75 million	+ 5%
1.0 million	+ 2.5%
1.5 million	+ 1.0%
2.0 million	ZERO
3.0 million	- 2.0%
4.0 million	- 3.0%
5.0 million	- 4.0%
6.0 million	- 5.0%
8.0 million	- 6.0%
11.0 million	- 7.0%
14.0 million	- 8.0%
17.0 million	- 9.0%
OVER 20.0 million	- 10.0% MAX
<i>NB. Intermediate figures may be interpolated.</i>	

In the valuation process, these adjustments, determined in relation to Notional Contract Cost (NCC), should be applied to NCC prior to any addition for Fees to produce ERC.

In the analysis process, determined in relation to the total “tone” adjusted cost, the inverse effect of these adjustments should be applied to the “actual” unit cost rate analysed to produce the “normal” unit cost rate. **(see Example at 6.4.5 of practice note)**