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SAA
Scottish Assessors Association

Revaluation 2010

Basic Principles Committee

Practice Note 2
Contractor's Basis Valuations

1.0 Introduction

1.1 This Practice Note gives guidance on Contractor's Basis Valuations and related matters for the 2010 Revaluation in Scotland and has the following contents: -

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 precedented 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 2010 Revaluation is 1st April 2008.

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 estimation of the development cost of lands and heritages and should reflect the following assumptions: -

(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 respective prevailing levels of cost of provision on the Scottish mainland and the Islands 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 preliminaries, 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; cost 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 3.1.6 The basis of costing should be by the use of unit cost rates or actual costs. The approach to obtaining these is covered in 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

RICS BCIS publications or the “BCIS online” internet facility.

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 technology 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 discrete reflection at this stage. The application and magnitude of these is a matter of valuer judgement based upon the nature of the lands and heritages.

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, 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 standard 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 Category 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 lands and heritages where necessary adjusted to "tone" date may be preferable.

6.0 Cost Analysis Procedure

6.1 Background

6.1.1 With adequate availability of "tone date" costs or tenders from every location

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 for Scotland.

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 Use the BCIS "All in" Tender Price Index to adjust construction cost information for time.

6.2.2 The adopted index point to reflect 2010 Revaluation "tone" is **"250".** (This "harmonised" approach recognises the consistency of the index up to the first quarter of 2008.)

6.2.3 Use the related BCIS "Location Factors" as directed later in this Practice Note.

6.2.4 The adopted "normal" contract size for analysis (and valuation) purposes is set at £3,000,000. A table of recommended contract size adjustments is produced below.

Contract Size Adjustments (to be interpolated as necessary)					
Value	% Adjustment	Factor	Value	% Adjustment	Factor
Less than 500,000	**10%**	**1.1**	5,000,000	**-2%**	**0.98**
500,000	**10%**	**1.1**	6,000,000	**-3%**	**0.97**
750,000	**7%**	**1.07**	8,000,000	**-5%**	**0.95**
1,000,000	**6%**	**1.06**	11,000,000	**-7%**	**0.93**
1,500,000	**4%**	**1.04**	14,000,000	**-8%**	**0.92**
2,000,000	**2%**	**1.02**	17,000,000	**-9%**	**0.91**
3,000,000	**0%**	**1**	20,000,000	**-10%**	**0.9**
4,000,000	**-1%**	**0.99**	More Than 20,000,000	**-10%**	**0.9**

The table is based on the assumption that reasonable quantities of all types of work are included within each contract.

6.3 Cost Analysis for Adjustment 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) Difference in time from the "tone" date
(v) Contract size.

* ***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 2010 Revaluation "tone" date it will require no adjustment for time as in 6.3.1(iv) but may require some adjustment in respect of 6.3.1 (i), (ii), (iii) or (v).

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. It is considered as cost necessary to achieve completion and that a **hypothetical** landlord would insist on a return. (See also note at **9.0**)

6.4 Adjustment Steps for Analysis purposes

6.4.1 Step 1 - **Exclusions**

(i) Non – rateable items reflected in cost/tender information require to be eliminated. e.g. loose furniture, racking etc.

(ii) If a building unit cost rate is to be analysed, all land, siteworks and fee costs require to be eliminated.

(iii) If land or siteworks unit cost rates are to be analysed, all other irrelevant costs require to be eliminated.

(iv) Fee costs for non rateable elements require elimination if fee costs are to be analysed.

Additions

(i) Preliminaries are effective costs and relevant items should be included.

(ii) Equivalent costs of uncharged donated labour and materials must be added.

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. Caution should therefore be applied before relying on "County" or "District" factors! **In view of this it is recommended that the Scottish Regional factor should always be used in the first instance with the others used as a check.**

NB: The results of the analysis of 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 Practice Notes 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 **"250".** 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 **"1.02"**.

The following should be noted:-

(i) the effective date of a "cost" is the actual mid-contract point.
(ii) The effective date of a "firm price tender" is the notional mid - contract point midway between the tender's envisaged start and completion dates.
(iii) 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.

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 adjusted to the "tone" date (i.e. inclusive of all relevant preliminaries, contingencies, building and external works) 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 £3,000,000 and the resultant unit cost rate from Steps 1, 2, 3 and 4 may require further

adjustment to place it in this perspective. The previously recommended table of contract size adjustments is repeated below.

Contract Size Adjustments (to be interpolated as necessary)					
Value	% Adjustment	Factor	Value	% Adjustment	Factor
Less than 500,000	**10%**	**1.1**	5,000,000	**-2%**	**0.98**
500,000	**10%**	**1.1**	6,000,000	**-3%**	**0.97**
750,000	**7%**	**1.07**	8,000,000	**-5%**	**0.95**
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3,000,000	**0%**	**1**	20,000,000	**-10%**	**0.9**
4,000,000	**-1%**	**0.99**	More Than 20,000,000	**-10%**	**0.9**

The table is based on the assumption that reasonable quantities of all types of work are included within each contract.

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!

6.5 Example of Cost Adjustment for Analysis Purposes

6.5.1 The example overleaf 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 "County" and District" Location Factors at Effective Date for comparison purposes.

Details

Building Cost	=	**£5,300,000**
(Overall Contract Sum)	=	£6,500,000
Gross External Area	=	10,000 m2
Effective Date	=	May 2007
Location	=	Glasgow

Calculations

Process	Building cost	Adjustment	Adjusted cost
Building Cost adjusted for exclusions and additions	**£5,300,000**	Estimated at **£300,000**	**£5,000,000**
Apply 2nd Q 2007 Scottish Regional Location Factor to adjust to UK Mean		**÷ 1.01**	**£4,950,495**
Adjust by 2nd Q 2007 TPI Index and adopted R2010 index point of 250		**X 250 / 242**	**£5,114,148**
Apply tone Scottish "Regional" Location Factor to adjust to Scottish Mean		**X 1.02**	**£5,216,431**
Divide by size units (m2, m3, metre run, hectare etc.) to give actual cost unit rate.		**÷ 10,000**	**£521.64** (actual)
Adjust by recommended Contract Size factor interpolated from table at 6.2.4 or 6.4.5 (based on "tone" date adjusted "overall contract" cost) to bring to "normal" level.		**÷ 0.965**	**£540.56** (normalised)

Say £540
(Scottish Mean Unit Cost Rate)

NB. In analysis procedure, as a check, contract sizes above £3,000,000 should generate "normal" rates that are higher than "actual" rates and vice versa for contract sizes below £3,000,000

7.0 Cost Adjustment and Application for Valuation Purposes

7.1 In arriving at E.R.C., cost information, whether unit or actual, may require to

be adjusted for one reason or another. SAA Revaluation 2010 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.

7.2 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.

7.3 On the Scottish mainland the “tone” Scottish “Regional” Location Factor of **1.02** 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 “Regional” level. [Bearing in mind that the majority of plant and machinery items require no adjustment for Location]

7.4 Having arrived at an initial **Notional Cost of Contract**, the table of adjustments at 6.4.5 should be used to reflect the effect of the hypothetical overall **Contract Size**.

7.5 Adjustments for professional **Fees** should be made based on the following:-

7.5.1 Percentage additions as set out below should be added to the **Notional Contract Cost** after adjustment for location and contract size where appropriate.

7.5.2 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)

(to be interpolated as necessary)

***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.*

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

Hospitals
Conference and Exhibition Centres
Breweries
Airport terminals
Oil Refineries
Petrochemical Works
Gas Processing Plants/Terminals
Specialist Microelectronics Factories

7.5.4 Some large lands and heritages (i.e. those with an ERC in excess of £6 million) which comprise mainly 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:

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

(to be interpolated as necessary)

N.B. *It is highly unlikely that any lower level fees would apply to lands and heritages identified at* **7.5.3**

7.6 Actual cost information for complete development at 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

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

7.6.2 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.

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

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

7.6.5 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)

7.6.6 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 below and 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 of up to 10 years 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)
2010				
2009	0.50			
2008	1.00			
2007	1.50			
2006	2.00			
2005	2.50			
2004	3.00			
2003	3.50			
2002	4.00			
2001	4.50			
2000	5.00			
1999	6.00	2.00	0.50	1.00
1998	7.00	4.00	1.00	2.00
1997	8.00	6.00	1.50	3.00
1996	9.00	8.00	2.00	4.00
1995	10.00	10.00	2.50	5.00
1994	11.00	12.00	3.00	6.50
1993	12.00	14.00	3.50	8.00
1992	13.00	16.00	4.00	9.50
1991	14.00	18.00	4.50	11.00

Year	Buildings	Plant	Civils	Tanks
	% (A)	% (B)	% (C)	%(D)
1990	15.00	20.00	5.00	12.50
1989	16.00	22.50	5.50	14.00
1988	17.00	25.00	6.00	15.50
1987	18.00	27.50	6.50	17.00
1986	19.00	30.00	7.00	18.50
1985	20.00	32.50	7.50	20.00
1984	21.00	35.00	8.00	21.00
1983	22.00	37.50	8.50	22.00
1982	23.00	40.00	9.00	23.00
1981	24.00	42.50	9.50	24.00
1980	25.00	45.00	10.00	25.00
1979	26.00	45.50	10.50	26.00
1978	27.00	46.00	11.00	27.00
1977	28.00	46.50	11.50	28.00
1976	29.00	47.00	12.00	29.00
1975	30.00	47.50	12.50	30.00
1974	31.00	48.00	13.00	31.50
1973	32.00	48.50	13.50	33.00
1972	33.00	49.00	14.00	34.50
1971	34.00	49.50	14.50	36.00
1970	35.00	50.00	15.00	37.50
1969	36.00		15.00	40.00
1968	37.00			
1967	38.00			
1966	39.00			
1965	40.00			
1964	41.00			
1963	42.00			
1962	43.00			
1961	44.00			
1960	45.00			
Pre 1960	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.