Scottish Assessors Association

Revaluation 2010

Commercial Properties Committee

Practice Note 17
Valuation of Licensed Premises

1.0 Introduction

1.1 Use of Practice Note

This Practice Note should be used for the valuation of licensed premises with the character of Public Houses, Licensed Restaurants and Nightclubs.

1.2 Licensing

The requirements of the Licensing (Scotland) Act 2005, which became effective on 1 September 2009, changed the licensing situation for all establishments licensed to sell liquor in Scotland.

Prior to that date, the Licensing (Scotland) Act 1976 had provided for various types of licence which could be held by licensed premises operators, and these were listed and defined in Schedule 1 of the Act.

During a transition period which began on 1 February 2008 and ended on 1 September 2009, Operating Plans were prepared and submitted by licensed premises operators for the consideration and approval of their local Licensing Boards. After 1 September 2009, the licensing position became much less diverse, with each licensed establishment simply requiring a premises licence to operate, and the premises manager required to hold a personal licence. Some establishments will have more than one personal licence holder.

The Operating Plans contain information relating to the proposed operation of the premises, and copies should be available from Licensing Boards. Although they provide some detail, the Plans are nevertheless fairly general, and examination of an Operating Plan alone could be insufficient to clarify if the premises are being run as a nightclub, public house, bar/restaurant etc.

2.0 Basis of Valuation

The subjects covered by this Practice Note should be valued by application of the comparative principle, using the percentages of turnover contained in Appendix 1, which should be applied to the adjusted "hypothetical achievable turnover" which excludes VAT.

Licensed premises differ in their locational advantages, attractiveness, and character, and are affected by the trading policies of licensees, along with being subject to the vagaries of current popular trends (circuits).

It should be recognised by valuers that the essence of the valuation scheme is that it is based on the hypothetical achievable turnover. The scheme is designed to enable valuers to ascertain "the rent at which the lands and heritages might reasonably be expected to let from year to year" on the statutory terms, by identifying a relationship between rents and turnovers which can then be used to arrive at Net Annual Value.

The figure of turnover adopted should represent the annual amount considered to be the hypothetical achievable level in the year to 1st April, 2008, having regard to the physical nature of the property and its location as at 1st January, 2010, on the assumption that the premises will be operated by a competent operator seeking to maximise profits. The statutory hypothesis assumes that the letting takes place in an open market, which includes prospective tenants who would recognise past and/or current good practices and operating techniques, and seek to at least replicate them.

Although the 2005 Act has simplified the licensing position and removed the various types of licence previously available, for valuation purposes it will still be useful to be able to identify the use to which each licensed establishment is being put. Local evidence may suggest that some licensed restaurants /cafés selling alcohol may be more appropriately valued in accordance with the approach taken to the valuation of other similar surrounding properties.

Due care should be taken when valuing vacant licensed premises, to ensure that all relevant factors are taken into account.

3.0 Rental Analysis

Rental analysis has been undertaken in accordance with the Scottish Assessors' Association Basic Principles Committee Practice Note 1 (Adjustment of Rents).

For analysis purposes the turnover considered was the gross turnover excluding VAT for the nearest accounting period to the year of the rent or rent review, and adjustment was carried out in accordance with the procedure described at 4.0 below which should be used in the valuation process to arrive at hypothetical achievable turnover.

4.0 Adjustment of Turnover

4.1 Income From Liquor On Sales

Take at 100%.

4.2 Income from Liquor Off Sales

Take at 100%,
except in the case of the minority of public houses which do have identifiable and significant levels of off-sales (say in excess of 10% of total turnover), where it can be shown that there is a low level of profitability, and it may be considered appropriate at the valuation stage to reduce these sales by up to 50%. Such instances should, however, be the exception rather than the rule.

4.3 Income from Cross-Counter Tobacco Sales

Where a breakdown of turnover has been provided, and these sales can be clearly identified, the relevant income should be taken at 20%.

The purpose of this discounting is to reflect the relative value to the operator of these tobacco sales in comparison with liquor sales, and to bring this element of income to parity with liquor sales, before application of the appropriate percentage to NAV.

4.4 Income From Food Sales

All food income up to £40,000 should be excluded.

This practice is adopted to reflect the fact that in many cases, licensed premises operators opt to sell relatively small amounts of food simply to maintain their liquor sales. At these low levels of food income, there would often be no impact on rental value, with the food sales being de minimus in relation to the value of the whole premises.

If food sales are higher than £40,000, then a proportion can reasonably be assumed to enhance the rental value. In order to reflect this value enhancement, but account in some way for start-up costs, etc., the next £40,000 should be taken at 75%, and any income over £80,000 at 100%.

4.5 Income From Machines

An analysis of the turnover returns supplied by independent operators indicates that a net machine return of up to 3% of total turnover is normal, whereas analysis of the larger operators' returns averages in the region of 6%.

It is the larger operators' contention that their higher figures are achieved as a result of their machine specialists' expertise in monitoring trends and their corporate buying power, enabling them to regularly update equipment. While the independent operators may have some degree of similar ability, the results of analysis tend to support the larger operators' case.

In order to ensure that significant amounts of net machine income are not disregarded, a sliding scale has been adopted, as follows:

If net machine income amounts to 3% or less of total turnover the whole amount should be included with liquor income at 100%.

Any net machine income between 3% and 6% of total turnover should be excluded.

Any net machine income amounting to more than 6% of total turnover, should also be included with liquor turnover at 100%.

In summary, add any machine income up to 3% and over 6% of total turnover to the liquor income at 100%.

4.6 'Other' Income

Take at 100%.

4.7 Entertainment Costs

If a specific admission charge is made to cover the cost of providing entertainment and there is a surplus of income over expenditure, the surplus should be taken at 100%.

If, however, either expenditure exceeds income from admission charges or expenditure on entertainment is not offset by admission charges, and the expenditure incurred could be seen to have increased turnover, then the following approach should be adopted.

The larger operators contend that spending on entertainment costs within their companies is closely monitored to ensure that where a suitable return in the form of a satisfactorily increased turnover is not being obtained, then they would take action to have the provision of entertainment ceased.

Analysis of entertainment costs shows that most operators will spend on average approximately 3% of their total turnover on entertainment costs, and therefore expenditure for this item should be treated as follows:-

No account should be taken of entertainment costs amounting to the first 3% of total turnover.

Entertainment costs amounting to the next 3% of total turnover - deduct at 3 x the actual costs incurred.

Entertainment costs amounting to the next 3% (i.e. over 6% and less than 9%) of total turnover - deduct at 1.5 x the actual costs incurred.

Any entertainment costs exceeding 9% of total turnover - deduct at 1 x the actual costs incurred.

Door stewarding costs are now the norm in urban locations, and are a licensing board requirement if premises are open after 1 a.m. They should not be allowed as entertainment costs, being considered as one of a range of operating costs which requires to be met in certain locations.

5.0 Valuation

5.1 Percentages To Be Applied & Recommended Approach to Valuation

Using the turnover figures from the year closest to the year of the rent, an analysis relating all rents to adjusted turnovers was carried out, and the appropriate percentages to be applied to adjusted turnover are contained in Appendix 1 to this Practice Note.

It should be borne in mind that while actual turnover figures will have been provided and these are, in many cases, likely to be adopted in order to arrive at a valuation, it is nevertheless the hypothetical achievable turnover which should be used if the actual figures are considered not to be representative of the hypothetical situation.

5.2 Valuation Of Extensions to Existing Establishments

In order to estimate the increase in value which might be achieved as a result of an extension having been added to an existing establishment, the reduction factors contained in Appendix 2 may be applied to the floor area of the premises in order to arrive at a rate per square metre of reduced area, which can then be used as a guide.

A strictly arithmetical approach should, however, be treated with extreme caution, as the hypothetical achievable turnover in relation to any property is not necessarily proportionate to floor area.

5.3 Valuation of Establishments Where Turnover is Not Known

In the absence of any indication of the anticipated level of turnover, the hypothetical achievable turnover should be estimated by comparison with other similar properties.

6.0 Other Factors

6.1 Hours Of Opening

With extensions to permitted opening hours being fairly commonplace, it should be assumed that the hypothetical tenant will seek to maximise turnover by opening during the hours which generate the maximum income.

Opening hours should be clearly specified in the new Operating Plans.

6.2 Over or Under Performance

As stated at 6.1, it should be assumed that the hypothetical tenant will seek to maximise the potential turnover of the premises.

No adjustment to actual turnover should be made solely on the grounds that a particular brewery company occupies the property, nor should the popularity of the products on offer give rise to any adjustment.

It has been clearly established in Lands Valuation Appeal Court decisions that neither should good management practice be identified as a cause of overperformance requiring an adjustment, since it is open to other hypothetical operators to replicate them.

Where, however, there is clear evidence that the actual turnover is considerably different from the hypothetically achievable turnover, an adjustment to the supplied turnover may be appropriate. The reason for apparent overperformance could be the fact that the premises are operated by a celebrity.

6.3 Pricing Policy

No adjustment should be made to the level of turnover applied to a particular licensed premises simply because the operator's pricing policy permits the sale of liquor at lower prices than those offered by competitors, on the basis that another hypothetical operator could do the same.

6.4 Opening Period

Where a property is new, or has reopened, the initial turnover may be enhanced for the duration of a 'honeymoon' period, and may require caution before estimating the hypothetical achievable level of turnover. The duration of any recognised honeymoon period should be individually assessed according to the particular circumstances.

Similarly, it may be the case that during an initial opening period trade is still building towards the hypothetical level of turnover and again caution should be exercised in assessing the hypothetical achievable turnover.

6.5 Happy Hours, Promotional Discounts, Sponsorship of Football/Darts Teams

No adjustment should be made to reflect alleged reduced profitability resulting from such activities, since it is assumed that any such instances are part of the operator's efforts to maximise his/her turnover.

Appendix 1

2010 REVALUATION - PERCENTAGES TO BE APPLIED TO ADJUSTED TURNOVER

In the absence of local evidence which is sufficient to merit a variation, application of the following percentages is recommended:-

£	%age
0 - 150,000	5% - 8.25%
150,001 - 200,000	8.5%
Over 200,000	8.75%

Notes:

1. Before adopting a particular percentage for turnovers below £150,000, each Assessor is encouraged to consult with his/her neighbouring Assessor(s) to ensure that consistency of approach is adopted.

2. The above percentages may be reduced by up to 0.5 % to account for unique elements associated with the particular property which are not reflected in the turnover.

Appendix 2

2010 REVALUATION - LICENSED PREMISES REDUCTION FACTORS

GROUND FLOOR			FACTOR
1.	PUBLIC BAR	On its own	**1**
2.	LOUNGE BAR	On its own	**1**
3.	LOUNGE BAR WITH PUBLIC BAR With separate accesses and separate service bar.	Public Bar Lounge	**1** **1**
4.	LOUNGE BAR WITH PUBLIC BAR Where no separate access e.g. Lounge enters off Public Bar:	Public Bar Lounge	**1** **0.9**
	Where lounge has no separate service Bar	Lounge	**0.7**
5.	RESTAURANT, LOUNGE, DINING AND DANCE FLOOR AREAS		**1**
6.	GAMES ROOM, DINING ROOM, SITTING ROOM OR FUNCTION HALL ETC. As 3+4 above, depending on access and bar service facilities		**1.0 to 0.7**
7.	CHILDREN'S PLAY BUILDINGS		**0.25**
8.	KITCHEN, TOILETS, CELLARAGE, STORAGE, STAFF ROOMS, STAIRS, ENTRANCE VESTIBULE (OF MODEST AREA) AND PASSAGES		**Nil**

Note however that where the Kitchen area is open to and integral with the bar then that area should be taken at **1**.

9.	OFF SALES	GENERALLY	**1**

Although generally off sales should be taken at 1, consideration may have to be given to quality, extent, access and location.

10.	OFFICES	GENERALLY	**Nil**

Offices situated within the premises occupied for the purposes of the administration of that property alone should be ignored.

Office accommodation used for other commercial purposes or not occupied solely in connection with the premises in which they are situated should be valued in comparison to other commercial offices.

ACCOMMODATION ON OTHER FLOORS

A. First Floor & Basement

As for ground floor, but with consideration being given to a reduction factor where quality, extent, access and location are deserving of such. It is anticipated that where a restaurant is solely situated on a first or basement floor, a reduction factor of **1** will apply.

0.5 to 1

In the case of public houses, a reduction factor of **1** will only be appropriate in exceptionally good circumstances.

Where the main part of the premises is on the ground floor, a reduction factor from the range shown of less than **1** may be adopted, if considered appropriate.

B. Other Floors

An appropriate reduction factor should be applied, having regard to quality, extent, access and location.

Up to 1