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Residential Property Journal

Focus on the private rented sector

• Tenancy deposit protection update • Rental valuation for buy to let •
• HMOs and council tax • New local authority/PRS partnerships •

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A transforming influence

It may not be a perfect system, but protection of nearly £2bn-worth of AST deposits and accessible dispute resolution have limited exploitation and boosted confidence in the private rented sector. Ian Potter reviews 3.5 years of tenancy deposit protection

Since tenancy deposit protection (TDP) came into effect in April 2007, it has had a major impact on how landlords and letting agents behave towards their tenants. While cynicism exists in some quarters over the benefits of the schemes, no-one can dispute that, at the end of September last year, tenants in more than 2m tenancies in England and Wales were much better protected than they used to be against some of the sharp practices that were once all too common in the industry. This can only promote the faith in the private rented sector (PRS) that is so important if it is going to grow.

The case adjudication process has resulted in a major improvement in the quality of inventories, which has benefited landlords as much as tenants

The total value of protected deposits stands at £1.89bn – a staggering amount of money in anyone's language. At the same time, just under 37,000 disputes have been submitted for adjudication.

So what problems have emerged in 3.5 years? There is anecdotal evidence that not all deposits that should be protected are. I don't think that should surprise anyone, since no law is adhered to by everyone. Not all drivers abide by the speed limit; nor, for that matter, do 100% of them even hold a driving licence, but the regulations do make for safer roads, nevertheless. What can be said for TDP is that it improves the consumer experience for the vast majority of tenants.

Exempt deposits

There are several exemptions to the rule that deposits should be protected. Until 1 October last year, tenancies with rents of more than £25,000 a year were excluded. Now the maximum rent for an AST is £100,000 a year, so tenancies with rents higher than that are excluded. (The UK government has indicated that all existing tenancies drawn into the AST net by the threshold change should have their deposits protected, even if they were not required to be protected before 1 October.)

Tenancies are also exempt where the tenant is a company or business, which includes a significant part of the market in London and the South East. Then there are the tenancies that have been allowed to become periodic – in other words, they are just rolling on, with no fixed term. Deposits in these cases do not have to be protected. Of course, some landlords do not take deposits, and others use deposit guarantee schemes, where the tenancy is backed by a financial guarantee, very often from the local authority or a charity.

Attitudes have had to change – especially among those landlords who tend to forget that the deposit actually belongs to the tenant. To withhold a proportion of the deposit now, the landlord not only has to say how

Get the basics right

The Tenancy Deposit Scheme (TDS) has been protecting tenants' deposits since April 2007. Three years on, Head of Adjudication Michael Morgan is still surprised to see where things go wrong for landlords, agents and tenants

Since TDS started, it has registered around 1.7m tenancies, with a current dispute rate of between 2.6% and 2.8% a year.

In 2009-10, TDS received more than 11,000 disputes and the figure will be much higher this year, judging by a seven-month total of 7,000 disputes received between April and October. An analysis of awards made in resolved disputes shows that, on average, landlords receive 42% and tenants 56%. The remaining balance reflects awards made to agents. Figures supplied by the Deposit Protection Scheme show a total of 1,233,057 deposits protected (value: £927.253,254.49) since the scheme started, and a total of 6,886 adjudications, of which 18.3% were found in favour of landlords, 37.1% in favour of tenants and 44.6% split between them. Cleaning remains the most common cause of dispute, featuring in 46% of cases, closely followed by damage at 39%, redecoration at 24% and gardening at 12%. Rent arrears featured in only 15% of cases. Of course cleaning claims are often subjective and

	2008-09 (year ending 31 March 2009)	2009-10 to date (21 October 2010)
Tenancies registered	786,405	948,618
Tenants registered	1,215,003	1,470,264
Total amount of deposits protected from current tenancies registered	**£694,738,318.34**	**£981,786,443.11**

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much he feels is due to him, but why. Agents have to prepare evidence in a much more formal manner than before, and, of course, be able to produce a comprehensive inventory and schedule of condition (of which more below). This in itself has created a huge uplift in the number of businesses – often very small companies – providing this service. Self-employed inventory providers were a very rare breed outside the M25 before TDP, but can now be found from Lands End to (probably) John O'Groats.

The case adjudication process has resulted in a major improvement in the quality of inventories, which has benefited landlords as much as tenants. Fewer inventories are just lists of movable items in the property, without reference to condition, and claims are less frequently received without estimates attached and from the landlord operating alone. While there are still lots of stubborn failings in the whole rental and complaints/claims process, it is certainly becoming more professional and the schemes do report an increase in landlords achieving the full value of their claims.

From all points of view, there are still issues to be resolved. The schemes do not appear to operate to exactly the same standards and principles and there can be inconsistencies of outcome – after all, adjudication is carried out by human beings, not computers. This creates the perception that one scheme is more favourably disposed than another to a particular group: landlords, tenants or agents. There is an acknowledgement among the schemes that some co-operation on practice principles would be beneficial, as long as it does not interfere with independence and impartiality, but so far there are no definite plans.

The courts have also not always been consistent in their findings, and several decisions could have been challenged had one or other party had the will to do so. However, with no guarantee of success in any circumstances, many cases have been abandoned. One thing landlords and agents could have learnt from these cases is that they can escape penalties for late protection of deposits if they use a custodial scheme to protect the deposit at the point of dispute. This might not stand up, however, should tenants be well represented in their claims.

The largest of the three schemes is TDS (The Dispute Service), started as a joint venture between RICS, the National Association of Estate Agents (NAEA) and the Association of Residential Letting Agents (ARLA), but run completely independently. As it is dealing with a rapidly increasing number of disputes, its analysis (below) of the main causes of disputes and the problems that arise in adjudication, will help those still wondering if TDP is really necessary. Whatever the imperfections, it certainly is.

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frequently generate heated argument between the parties. Whatever the cause of a dispute, the stress involved is much reduced when the parties have kept good records and can submit or respond to claims with clear evidence. So
it still surprises us how often, and in how many ways, evidence tends to fall short.

The role of TDS

Many agents, landlords and tenants still think we 'investigate' disputes in the same way as an ombudsman. The timescale we are required to work to does not allow us that luxury. As an independent adjudicator, we:

- review the evidence submitted and determine how the amount in dispute should be allocated between the parties. The review process relies largely on the documentary evidence provided
- expect the party bringing the dispute to support the allegations and the respondents to refute them, without guidance from TDS
- do not go looking for evidence under normal circumstances. Only if we believe that critical information or documents are being withheld do we seek them.

This 'hands-off' approach comes as a surprise to some disputants. Landlords often advise TDS to '*contact the agent for all relevant information*', and do not submit any documents themselves. And agents often do not provide 'relevant information' relating to proposed deductions from deposits for 'let only' properties.

Common failings of tenancy records

- No check-in or check-out report, or both (more on this below)
- Poor inventories, with the following problems typical:
  - use of abbreviations without an index or guide to what they stand for
  - a list of items or contents with no description of their condition
  - handwritten inventories that make it difficult to distinguish between check-in and check-out comments
  - inventories based solely on photographs (particularly thumbnail photographs)
  - no updated or fresh inventory when a tenancy is renewed, or where there has been a change of tenants – especially where a joint tenancy becomes a sole tenancy
  - unsigned and undated inventories
  - inventories that give vague or very general one-word descriptions of the condition of the property, such as '*awful*', '*terrible*', '*dirty*', '*ruined*', etc.

Common failings of claims

- Claims for rent arrears are often let down by incomplete or non-existent rent statements. We sometimes receive a record of when rent arrears arose during the tenancy, but no reconciliation of the tenancy account at ❯❯

Deposit protection gains ground

Scotland and Northern Ireland have drafted tenancy deposit protection legislation based on the system in England and Wales, but with important differences. David Smith explains

The Scottish Executive has been consulting on the introduction of tenancy deposit protection in Scotland along the lines of the system that operates in England and Wales. However, unlike the more limited provision in England and Wales, deposit protection in Scotland is intended to apply to all residential tenancies that are subject to landlord registration, not just short assured tenancies under the Housing (Scotland) Act 1988. This means that the protection regime will extend to lettings to companies.

As in England, only monetary deposits will be affected, and since there is no maximum rent threshold under the Housing (Scotland) Act 2006, there will be no exception for high-value tenancies. Holiday lettings will fall outside the legislation and, given the fairly unclear decisions of the courts on what constitutes a holiday, this is an area that has potential for significant further litigation.

The proposals seem to have benefited from the experience of England and Wales, in that they are detailed and consideration has obviously been given to closing loopholes. In particular, the regulations have wisely moved away from making receipt of the deposit the trigger for registration; instead they impose a general duty on landlords to comply with the regulations by holding the deposit in accordance with the rules of a scheme. This avoids some of the uncertainties that have emerged south of the border, leading to litigation over such issues as late registration, what is meant by 'receipt', and whether there is a duty to keep the deposit protected within a scheme.

One issue remains unclear, however. The consultation document and the rules of the draft scheme both make reference to the deposit being lodged within 30 days of receipt. However, the draft regulations seem to envisage landlords participating in a scheme as soon as they receive a deposit, and allow for a tenant to go to Court immediately. This contradiction ought to be addressed before the regulations are finalised.

On application, the Sheriff can, provided he is satisfied that the duty has not been complied with, order the deposit to be protected or returned. The Sheriff is also empowered to award a sum up to three times the value of the deposit to be paid to the tenant, which means

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the end of the tenancy. And a letter from a landlord saying '*this tenant owes me £1,500 in rent arrears*' does not amount to a rent statement.

- Believe it or not, we still see cases where agents fail to pay over the amount of a disputed deposit to TDS. Claims that '*it's been agreed and there is no dispute*' don't cut much ice without some written confirmation from the tenant to confirm that this is the case. Some agents still believe that '*the tenancy says you must pay it, therefore you cannot dispute it*'. Agents should be aware that the disputed deposit must be sent to TDS – and that includes rent arrears and check-out fees.
- We are still seeing some members not putting the correct clauses in their tenancy agreements. Our guidance document *Clauses for inclusion in tenancy agreements and terms of business*, available from the members' section of our website, sets out what agents should put in their tenancy agreements to ensure they comply with the scheme's rules. Failure to comply will normally result in the disputed deposit being awarded to the tenant.

The bottom line

Undoubtedly, inventories and check-in/check-out reports are the foundation of good tenancy management. These documents enable us to compare the condition of the property at the start and end of the tenancy. In their absence, we are usually unable to make any award to the landlord and can do so only if we have other compelling evidence, such as an admission by the tenant that damage claimed for did, in fact, take place.

Inadequate and poorly prepared inventories and check-in/check-out reports are all too common. We often see inventories that make no mention of whether items are clean or damaged. We take the view that silence does not mean that an item is clean or undamaged, unless there is an overall statement to the effect that '*all items are in good and clean condition in the absence of a note to the contrary*'.

Pragmatic approach

We accept that we cannot insist on 'independent' reports and that independent inventory clerks may not be available in all parts of the country. When landlords produce their own inventories and reports, we consider them at face value.

In some cases we do accept evidence that substitutes for missing check-in/check-out reports. In a recent dispute, the tenancy had no check-in report, but TDS was supplied with a check-out report detailing damp/condensation problems. The evidence included a specialist's report stating that the problem was not damp, but condensation caused by the tenant's lifestyle. A check-out report from the previous tenancy, which had ended less than a month before the new tenancy started, made no mention of any problems with damp/mould, etc. In that case, we accepted the evidence from the previous tenancy, because so little time had elapsed between the two, making it very unlikely that anything else could have happened to change the condition of the property.

TDS also takes a pragmatic approach when a dispute involves inventories and check-in reports that predate the tenancy by months or

As an independent adjudicator, we expect the party bringing the dispute to support the allegations and the respondent to refute them, without guidance from TDS

he has a discretion in relation to the precise size of the award. One of the main complaints about the system in England and Wales has been the imposition of the full penalty of three times the deposit in all cases, even for accidental and fairly minor breaches. This has led some judges to pronounce the system unfair and use every means in their power to avoid imposing the penalty. In the process, they have exposed loopholes in the legislation that unscrupulous landlords can exploit. Hopefully, permitting a degree of discretion will prevent the same thing from happening in Scotland, since there will not be the same incentive to look for gaps in the legislation.

The consultation closed on 3 October last year and the intention seems to be to introduce deposit protection during the course of this year.

Northern Ireland, too, has drafted tenancy deposit protection legislation. The system there is more embryonic, but appears to be mirroring closely the system in England and Wales. However, one substantial difference is that Northern Ireland has no plans to introduce the system of allowing tenants to seek a penalty order through the civil courts. It will enforce deposit protection by way of fixed penalty notices and criminal prosecutions by local authority officers. This is a radically different system, but any legislative loopholes found in England and Wales are sure to be used to avoid prosecution in Northern Ireland.

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Clarity on TDP compliance

In November, the Court of Appeal upheld the High Court's finding in *Draycott v Hannells* that late protection of deposits is acceptable.

In a majority judgement handed down in the two conjoined cases of *Tiensia v Universal Estates* and *Honeysuckle Properties v Fletcher*, the Court of Appeal went further, ruling that, provided the deposit has been protected and the correct information provided to the tenant before the court comes to consider the matter at a hearing, that is acceptable. In other words, the landlord's deadline for compliance is the court hearing itself, not the deadline for registration specified in the rules of the protection scheme, and not even the date on which court proceedings are issued.

The court did hold that if a tenant is compelled to issue proceedings to force the protection of a deposit, they are probably entitled to legal costs. It also emphasised the importance of pre-action conduct and discouraged any attempt to 'ambush' landlords by issuing proceedings for an unprotected deposit without writing to the landlord first.

In terms of the judgement, the imposition by a tenancy deposit scheme of a deadline for the protection of deposits (14 days in the case of TDS) is no more than an administrative requirement of the scheme, not a legal requirement. Later registration of a deposit is not invalid for the purposes of TDP legislation, but as a violation of the scheme's rules, may be taken into account in the adjudication process and affect the landlord's case negatively.

years because the tenancy agreement has been renewed at least once. It would be ideal if inventories and check-in reports were renewed at the same time, but we recognise that most tenants and landlords would rather avoid the cost and inconvenience. In such cases, we decide what is fair and reasonable based on the evidence presented. Of course, the value of any awards made has to reflect the extended tenancy and consequent wear and tear.

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Signatures on documents are another desirable element of evidence that we cannot insist upon. In the absence of the tenant's signature on inventories and reports, we usually expect to see a clear audit trail demonstrating that the documents were sent to the tenant at the start of the tenancy. If a document was sent to the tenant to sign and return and the tenant failed to comply, silence may be taken as assent, depending on the circumstances.

Dates, times and copies

Some tenants will claim never to have received a check-in report and/or deny that they are the signatories in documents produced in evidence. TDS can accept at face value an agent's statement that a check-in inventory was given to the tenant, but a file copy of a letter showing that it was sent would reinforce this assumption. If a tenant disputes such a statement, TDS would expect to see a complaint in writing from the tenant at the start of the tenancy about the failure to provide this documentation.

We are often faced with a single document covering the condition of the property at both the start and the end of the tenancy. This can be problematic, as TDS needs to ensure that records of condition are contemporaneous. If the document is an updated check-in report – i.e. prepared at the start of the tenancy and then updated at its end – it might be acceptable. But a check-out report with retrospective information added about the condition of the property at the start of the tenancy is unlikely to serve this purpose without other evidence.

As a general rule, then, we regard the inventory and check-in/check-out reports as the primary evidence, unless there are compelling reasons not to. Undated and/or unsigned photographs are of little evidential use – for example, a photograph of a cracked sink could be anywhere, at any time. Photographs are more useful if they back up a written report to which we can cross-refer, but may be undated if a tenant admits the damage but disputes the cost.

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C Related competencies include: T048, T050

Good as new

What happens when a homeowner discovers that the soil beneath his family's feet and feeding his home-grown vegetables is contaminated with metals such as lead and cadmium? Surveyor Peter Napier found out

I had lived on my property for about a year when I learnt that all might not be well with my garden. It was 1983, and my neighbour showed me a copy of an old field or tithe map identifying the land my house is built on as 'smelt house yard' and the cottage next door as 'smelt house'.

That was the first clue that the land we were living on might be contaminated, but I wasn't unduly concerned. The people I had bought the house from were in their 80s, had lived on the property for 50 years, had brought up a healthy family there and were enthusiastic consumers of home-grown vegetables.

Another clue was the existence of black slag-like material about 450mm below the surface. Pontesbury is situated about 10 miles south-west of Shrewsbury, on the edge of the Shropshire coalfield, and two miles north-east of Snailbeach and Stiperstones, where a large lead mine operated until the 19th century, dating back to Roman times.

In 1995, my neighbour, who was worried about her husband's health, invited the local authority to test the soils in her garden, and they tested the soil and vegetables in my garden at the same time.

The samples from my garden showed high levels of lead, cadmium and other metals and we were advised to stop growing vegetables, or at least to refrain from giving away or selling vegetables and to wash all produce thoroughly before cooking. The council also suggested that we could remove the top metre of soil and replace it with uncontaminated soil, but offered no financial assistance to do this. At this stage, I took basic measures to reduce the lead levels in the vegetables by creating raised beds with a barrier beneath them.

By this time I was raising a family and had two daughters aged six and nine. I carried out my own research into the risk and found a mass of conflicting advice from various different sources about the digestibility of lead in vegetables and the risk from dust-borne particles. I also took into account the relatively old age of the previous occupants, one of whom had a sister living in an adjoining property on the same land who survived well into her 90s. My immediate neighbours, who instigated the tests, had lived in their house for 50 years and brought up a healthy family. (They subsequently lived into their late 80s).

My neighbour on the other side was born in the same house, had a family who showed no ill effects, and is still living there. His father lived on the same property through the war years, when home-grown vegetables were his staple diet, and had continued to live off the land until his death in his 80s. Far from constituting an unacceptable risk, in our case, contamination seemed to hold the key to longevity!


The garden before operations started

Far from constituting an unacceptable risk, in our case contamination seemed to hold the key to longevity


Day 1 and the garden features are being removed

All the soil removed, including the area in front of my house which belongs to my neighbour. Because the site slopes downhill and the tarmac area on the right of the picture wasn't lifted, all the water on the site migrated to this point and could go no further – hence the lake

The new soil is laid on the isolating membrane

All images Peter Napier

The remediation is complete

While there was a risk, in theory, I concluded that the facts on the ground (so to speak) pointed to the risk being very low and requiring no action. Others seemed to draw the same conclusion, as several of the eight affected houses were sold after the contamination was made public and lending institutions continued to offer mortgages.

In 2005, things changed suddenly. The hands-off approach adopted by Shrewsbury and Atcham Borough Council was abandoned and we received a letter out of the blue notifying us that a more comprehensive investigation was needed under the Environmental Protection Act 1990, Part IIA. This was followed by a protracted series of investigations and more investigations, punctuated by letters keeping us up to date with progress.

At this point, I and the rest of my family had blood tests and were found not to have elevated levels of lead or other toxic metals. By now my children were 16 and 19 and neither was demonstrating any academic problems, which I understand can be one symptom of elevated lead levels.

The local authority organised a public meeting to explain the statutory requirements for remediating contaminated land, but offered no assurances that financial assistance would be available. Some of the residents were told they would not be eligible for financial assistance, even if it became available, because they had bought their houses since a certain date, in full knowledge of the contamination. Those of us who had bought our houses before that date, without knowing about the contamination, *might* be eligible for assistance.

Eventually, we were served with a notice formally declaring that the land was contaminated. Thankfully, the council managed to procure 100% financial assistance for all the householders for a process that would involve removing all built features, excavating our gardens to a depth of 600mm, removing the contaminated soil to a temporary store in a nearby field and bringing in fresh soil. Each householder was awarded a sum of money based on the area of the garden as compensation and to help with reinstatement.

A contractor with a team of 10 began work in July. Since the contamination went deeper than 600mm, the new soil was isolated from the contaminated soil beneath by a double-thickness of plastic mesh and membrane. The soil was reinstated in layers of approx 200 – 300mm, with a final layer of topsoil. The other gardens were provided with turf to cover the entire area, but I took only a small section, as I wanted to reinstate paving, flower beds and a vegetable garden.

In September, when the excavation phase was over and the reinstatement started, so did the rain. And all that exposed soil turned out to be of a type that became as squishy as soft putty when wet, so that even the grassed section was impossible to walk on. My first task was to build a patio at the very bottom of the garden and we hit problems immediately. The lowest membrane was permeable and the original soil beneath it was free-draining,

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probably due to the depth of the build up of smelt-house waste. I had expected the new soil to be free draining too, but because of the compaction of the soils this was not the case. As we dug we hit water – lots of it – and had to create a much more substantial stone base for the patio than we'd have had to do if the water had not been there.

Next was the reinstatement of the vegetable beds. Here again, I hit water beneath the surface. I found that if I dug through the compacted subsoil to the membrane 600mm below, the water ran away freely. As a result, my garden is now peppered with soakaways and I dug one beneath every tree and large shrub I planted. I dug in plenty of horse manure and tons of composted organic matter bought from a local supplier.

It was costly, but on the bright side, the finished garden is very productive and the plants seem to like what we've done. Had I not been so ambitious about reinstatement, and had it been spring when the work was completed, I would have had a usable garden (albeit all grass) in three to four months. As it was, I had a presentable garden, complete with fences, paving, vegetable garden and ornamental garden, by spring/summer of the following year and a garden as established as it had ever been a year after that.

The garden as it is now

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C Related competencies include: T015, T083

Equal values

Valuers should not underestimate the importance of rental valuations, but they can't be held responsible for a lack of reliable evidence to support them, argues Ian Brindle

It should go without saying that all valuations are equal, whatever their purpose, and deserve the same rigour and care… but of course it's not that simple. Residential valuers are frequently asked to provide valuations that are supplementary to the main market valuation on which the lender will base the loan decision and there is some doubt about the relative importance of such valuations – especially in a property market so changed from a few years ago.

Rental valuations fall into this supplementary category and there is a tendency among valuers to believe they are for guidance only. However, valuations of the passing rent are no less significant than the main market valuation and may be relied on by lender and/or borrower, so they should be treated with considerable care.

This was confirmed by the recent decision in the case of *Scullion v Bank of Scotland plc (2010)*, which has wide implications for the residential surveying profession. In this case (see 'A case for caution', *Residential Property Journal* July-August 2010) the court found that the valuer had not only overestimated the capital value, but had provided a negligently inaccurate rental valuation. The reported rental of £2,000pcm could not be achieved and the court decided that the real value was just £1,100pcm. Mr Scullion had been relying on the rental valuation provided as part of the buy-to-let valuation because he needed the rent to cover monthly mortgage repayments of £1,440.

The *Scullion* case illustrates that the valuer has a duty of care to the borrower when providing a rental valuation, but the large number of claims being made against valuers by buy-to-let lenders indicates that they, too, rely on rental valuations. For some buy-to-let loans, the rental value is even more important to the lender than the capital value and forms the primary consideration in the loan decision. This underlines how important it is to take great care over rental valuations.

The valuer could be forgiven for believing that an approximate rental valuation is sufficient; after all, the passing monthly rental value is usually only a few hundred pounds. Location and other factors appear to have little impact on rents; for example, a two-bed, terraced property in a town is often worth much the same monthly rental as any other similar dwelling, irrespective of widely disparate capital values.

However, rental valuations are provided on a specific date and there are many seasonal and other factors that make for rental market volatility. In locations with high student populations, for example, demand fluctuations between the end of one academic year and the start of the next can cause significant changes in passing rent. Likewise, the short-term nature of ASTs – typically as little as six to 12 months – allows changes in market demand and supply to impact on rental values and on the length of void periods across the residential market.

Changes in the wider economy, such as rises and falls in employment and changes in interest rates, can be slow to register as significant changes in rental levels. On the other hand, increases in the supply of vacant property can impact on rental values very rapidly. There are numerous examples of this in towns where new-build apartments have produced an oversupply, apparently overnight. Of course, in some cases, apartments have been built specifically to target the buy-to-let market and are offered to buyers with the inducement of rental incomes underwritten for up to two years.

Conversely, since AST tenants have little security of tenure, they can respond to changes in the market. As a result, the rental coverage offered on a loan can shrink or disappear very suddenly, and with it the ability of a landlord to meet his commitments to the lender.

Considering the uncertainties, it is surprising that lenders place as much faith as they do in rental valuations, instead of simply relying on capital valuations to inform their lending decisions.

Quality of evidence

Most valuers opt for the comparable method of valuation for capital valuations, and the same principles apply to rental valuations. Therefore, the quality of the comparable rental evidence is all-important.

The valuation challenges that have emerged from this and previous recessions should have made valuers more scrupulous than ever about keeping records of the comparables they rely on and the reasoning behind their opinions of value. One recurring issue of complaints investigations is the traceability of comparable

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The fortune-teller factor

Should valuers be held to account for the crystal-ball gazing they are required to do to provide projected market values? Chris Rispin thinks not

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The country is going through an economic crisis, the shockwaves of the Chancellor's cutbacks are still reverberating, the property market is in crisis… and you are contemplating providing a 'projected market value' (PMV) for three months hence! What is the practical purpose of PMV and how should surveyors approach such valuations?

PMV was introduced after the demise of 'estimated restricted realisation price' (ERRP) and 'estimated realisation price' (ERP). It came about in response to calls from some lenders for valuations that took into account the direction of the market in the short term, so that they were better equipped to make decisions about offers on properties they had in their possession.

UKPS 3.3 of the *Red Book* defines PMV as '*the estimated amount for which a property is expected to exchange, at a date after the date of valuation and specified by the valuer, between a willing buyer and a willing seller, in an arm's length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion*'.

That makes PMV very similar to market value except for the predictive element, which attaches value to a date after the date of market value as specified by the valuer. The commentary in the *Red Book* puts it like this: '*The date specified by the valuer must be stated clearly whenever a PMV is provided. It should reflect the period that the valuer considers will be necessary for adequate marketing and the completion of negotiations.*' It goes on to say: '*This basis should be used to provide clients with an estimated valuation in respect of future exchange, assuming that marketing begins on the date the valuation is prepared.*'

In fact, it seems that most valuers operating in this area are told what period they should use. The *Red Book* instruction creates an interesting dilemma, too, in that most such valuations are required alongside the main valuation based on market value. So, having established the market value, the valuer is faced with predicting how long it might take to sell the same property and then determining a price it might sell for after that period. But of course in some ways these interact, as a property put on the market at a higher price might well take longer to sell than one offered at a reduced price.

So, the valuer has a choice, provided of course he/she can forecast what is going to happen in that intervening period. For example, a surveyor doing a valuation on 20 October last year would have had the unenviable task of trying to determine what the property would sell for in, say, 90 days – around about now. Most of us in the property industry know what Januaries are like… but of course there have been exceptions when things have been quite buoyant. (Not that I have any great optimism for January at the time of writing.)

Given all that, how do you determine what value to place on a property being valued now but marketed in 90 days?

The *Red Book* gives the following guidance: PMV '*represents the valuer's opinion of anticipated market changes during the period up to the specified date. It will reflect facts, market sentiment and public forecasts existing at the date of valuation*'. It does go on to say that, because things change, it may be incorrect.

It also says that it is intended to '*illustrate the valuer's opinion of whether the market is likely to fall, rise or remain static in the period that it is anticipated will be necessary to complete the sale*'. It's not every day/year that you will be faced with 'unknown unknowns', but forecasting is always a tricky business – and has never been trickier. It is understandable that financial institutions want this kind of advice, and who can they turn to for it but surveyors? Nevertheless, valuers should not be put in the position of losing their shirts if forecasting goes somewhat awry at times.

So here are a few tips:

- There will be some occasions when it is inappropriate to estimate what will happen in 90-180 days, so cut the timescale. As a result, you will also have to reduce the price significantly to reflect a short selling period. This might seem extreme, but it reflects the level of risk the lender faces.
- Set the scene. For example, given a period of stable interest rates, inflation and unemployment, with no major announcements expected, you could say: '*given a continuation of current economic factors (state what they are), property prices in the area should remain stable for normal selling periods – i.e. 90 days*'.
- If the property is known to be a problem case, this should be reflected in the marketing period and projected price, with reasons given for your judgement: limited potential buyers, special purchase, reduced market appeal, difficult area, etc.
- You might also want to reflect the potential market demand – for example, you might be aware that a development is nearing completion, meaning that a lot of new properties will be released onto the market within the 90-day selling period.

- It is always going to be difficult to reflect matters over which you have no control, such as banks restricting lending by reducing affordability. Such matters should be recorded in a log, so that, if you are challenged, you can refer back to your dated notes. This applies to local as well as national events – for example, the flooding in Tewkesbury in 2007 would have had a dramatic effect on the flooded areas themselves and a significant spin-off effect on other areas nearby.

Another issue is that PMV is often associated with 'forced sale' values. This is due, at least in part, to the fact that UKPS 4.2 on repossession proceedings uses PMV as the basis for valuation. However, I believe that most lenders will seek market value in the first instance, and those who want PMV will request it later, when an offer is being considered. PMV is then a reduced amount to allow for the fact that the property is '*unoccupied and that all furnishings and fittings have been removed*'. This may not always be the case, of course, and it is for the valuer to advise accordingly.

Anyone who has sat down with a financial advisor recently to discuss a financial investment will know it is a different experience from what it was even five years ago. One of the most striking changes is the risk-assessment exercise, which requires the applicant to choose a risk level ranging from ultra-cautious to positively gung ho. Perhaps lender clients who want a PMV should take a leaf from their own book and let the valuer know what level of risk they are prepared to underwrite. The valuer, in turn, should record how sustainable the valuation is likely to be for the property under consideration.

Valuers should not be put in the position of losing their shirts if forecasting goes somewhat awry at times

It is very difficult to account for changes of the kind we've seen recently, such as the collapse of Northern Rock and valuers in different parts of the country report very different impacts of such cataclysmic events, which only aggravates uncertainty. Lenders need to reflect this in the underwriting process – if their systems allow.

Now where is that crystal ball?

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Related competencies include: T083

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sales data after the valuation has been delivered. For decades, valuers relied on their estate agency colleagues to provide (mostly verbal) evidence of comparable sales. In the 'good old days', when the chartered valuation surveyor was also the estate agent, there was a professional understanding that evidence traded in this way could be relied upon. Since then, surveyors have moved from the back office of estate agency premises and become increasingly dislocated from the marketing process. We now rely on fairly tenuous relationships with estate agents, some of whom either do not appreciate the importance of the accuracy of the information they provide, or worse still, regard requests for comparable data as no more than an irritation. As a consequence, the data provided is sometimes seriously inaccurate.

Another common problem is valuers relying on data from sales that are only under offer, a long way from exchanged or completed. Such information might come from agents or from valuers' own records of inspections. It is difficult to obtain accurate statistics from estate agents about the number of sales that fail between acceptance of offers and exchange/completion, but anecdotally it seems to be around 60%. This means that some valuations are based on, at best, just one or two comparable sales capable of being corroborated by Land Registry. The accessibility of property data on the internet has made life considerably easier for valuers, although evidence of completed sales tends to be around six months old, requiring adjustments to be made for changes in market conditions in the meantime. Nevertheless, firm data on sales is much easier to find than reliable evidence of comparable rents.

Proceed with caution

Asking rentals are easily available on internet property portals, but there is no equivalent of Land Registry to confirm actual rental values past or present. Consequently, the traditional source of information – estate agents – remains crucial to rental valuation. Whatever the source, evidence should be approached with caution. Valuers are often presented with existing rental agreements on properties they are valuing, but even these are not reliable – for example, they might be long-standing agreements based on out-of-date values. Written evidence, such as an AST agreement, might seem to be the best possible documentary evidence for a valuer's file, but AST agreements are not registered legal documents, are easy to create and can be falsified. Experience suggests that valuers should treat such evidence with suspicion and rely on it only if it can be backed up by other comparables.

Likewise, declared rents on new-build properties should be treated with suspicion: are they real market rents, or guaranteed as part of the developers' incentives? The principle of valuation outlined in the RICS guidance note *The valuation of individual new-build homes* (April 2009) applies: it is insufficient to rely only on evidence derived from the site itself. A wider view of other new-build sites and of second-hand property has to be considered when arriving at a rental value.

In short: the valuer must develop relationships with rental agents to obtain reliable rental comparable evidence; and the same standards should be applied to rental valuations as to any other valuations and comparable evidence should be scrutinised with the same rigour valuers bring to capital valuations.

There is a need in the market for reliable, widely available records of rental comparables equivalent to the existing records of capital values. This is a challenge the property portals and other providers of data to valuers might want to take up.

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Building Brazil

With its growing economy and high level of urbanisation, Brazil is experiencing a residential property boom, assisted by some innovative methods of financing homes for low-income households. Manoj Chawla explains

Brazil is a country and a market that is probably unfamiliar to many people, except for the usual associations of carnival, football and beautiful beaches. However, Brazil is increasingly gaining importance and visibility as its economy grows. The fact that it is hosting both the football World Cup and the Olympics within two years of each other (2014 and 2016 respectively) is another indicator of its growing confidence and international credibility on the world stage.

The largest economy in South America, Brazil is also the 8th largest in the world since overtaking Spain and Canada in terms of GDP, and is expected to overtake the UK economy by 2025. The Central Bank of Brazil and the World Bank forecast real growth of at least 5% in 2010.

World Bank Estimate 2010	Brazil	UK
1. Nominal GDP (US$ billions)	1,879.3	2,157.8
2. Population (millions)	198.2	60.7
3. GDP per capita, current US$	9,481.0	35,542.0
4. Real per capita GDP growth	5.3	1.2
5. US$ Fx rate	1.8	0.7

Figure 1: GDP expectations for Brazil and the UK in 2010

Anecdotal evidence has shown that investor interest has increased 300% over the last five years. At a global level, investors on the scale of the billionaire real estate entrepreneur Sam Zell, the US's largest public pension fund, CalPERS, and US-based real estate investment company Hines are investing heavily in and profiting from the Brazilian real estate boom.

Foreign investment did slump badly when Brazil was finally hit by the global financial crisis in 2008, but it was one of the first emerging markets to recover. While residential property markets remain under serious strain in the US, UK, Spain and Ireland, Brazil is undergoing a period of rapid expansion in this sector. Reduced poverty levels and a growing and increasingly affluent middle class are contributing to this boom. It was estimated that between 1m and 1.2m new homes would be constructed in Brazil in 2010 alone. The housing deficit is estimated to be more than 8m houses.

Snapshot of the economy

Brazil is the 5th largest country in terms of land and population and, although currently the 8th largest economy in terms of GDP, is forecast by Goldman Sachs to become one of the top five by 2020.

The economic indicators show a country whose solid economic growth is backed up by benign inflation rates hovering between 4% and 6% (4.49% in August), strong consumer spending/confidence and interest rates at an historic low. The Brazilian base rate, the SELIC (the Central Bank's overnight lending rate), is 10.75%, compared to an average of 17.22% from 1999 to 2010.

The positive fundamentals include practically no government deficit, a credible central bank, a stable political situation and more than $220bn in external reserves, which means the economy is well cushioned. While no economy is immune from a global downturn, it would be fair to say that Brazil is relatively well placed.

Brazil also has strong employment growth, with 1m jobs likely to be created this year. Unemployment has dropped from 12% in 2002 to a record low of 6.9% in July 2010, having averaged 7.4% for the first half of last year. This is lower than both the US (last 12-month average: 9.8%; 9.6% for the month of August 2010) and the UK (average for the three months to end August 2010: 7.7%). There are major government programmes to develop infrastructure (ports, roads, rail, etc), reduce poverty and increase home ownership, all of which should help the

Source World Bank	2008	2009	2010e	2011e	2012e
1. Nominal GDP (US$ billions)	1,612.6	1,511.3	1,879.3	2,125.1	2,184.0
2. Population (millions)	193.9	196.1	198.2	200.3	202.4
3. GDP per capita, current US$	8,314.8	7,705.5	9,481.0	10,607.7	10,788.7
4. Real per capita GDP growth	3.9	-1.3	5.3	3.4	3.0
5. US$ Fx rate	1.8	2.0	1.8	1.8	1.9

Figure 2: World Bank growth forecast for Brazil. Below: The skyline of Brazil's largest city, São Paolo

economy grow. Other positive factors include:

- strong domestic demand for housing and other real estate
- significant redistribution of wealth (e.g. new car sales growing at 25% p.a.), with a growing number of people climbing out of poverty thanks to government redistribution measures
- the prospect of the World Cup and the Olympics putting the focus on Brazil and further boosting foreign direct investment.

The middle class is growing and poverty is declining. The former increased from 42% of households to 52% between 2004 and 2009, while poor households decreased from 43% to 33% of households in the same period. The top income group grew from 12% to 16%. Mortgage and consumer debt is low (less than 5% of GDP) and the banking system is conservative and well regulated, which has helped the country stage a rapid recovery from the financial crisis experienced by so many developed countries.

Raw materials are another of Brazil's strengths. The country is self-sufficient in oil and is the world's second-largest producer of ethanol. The Pre-Salt find in 2007 is thought to have made Brazil the 5th largest oil-producing country. The Santos Basin is estimated to contain 2bn barrels of recoverable reserves. It also has vast reserves of iron ore and other minerals.

With 25% of the world's arable land (half of it unused), excluding the rainforest, Brazil is an agricultural superpower: the world's number one producer of tobacco, sugar, oranges and coffee; producer of 85% of the world's orange juice concentrate and the world's largest exporter of beef, chicken, green coffee, sugar, ethanol, tobacco, and the 'soya complex' of beans, meal and oil.

The housing market

Brazil has a high level of urbanisation. According to government statistics, urbanisation increased in the 60 years between 1940 to 2000 from 30% to 81% – higher than most developed countries.

A survey conducted by the business school *Fundação Getulio Vargas* reported that the construction industry supply chain represented 13% of the Brazilian GDP from 2000 to 2005. However, Brazil's total investment in housing has not been sufficient to meet the country's housing needs. According to data compiled by the São Paolo State Housing Syndicate (Secovi-SP), there was a shortage of around 7m units in 2000, and a subsequent report by the official statistical agency *Fundação João Pinheiro* showed the figure unchanged in 2005. More recent estimates put the shortfall at 8m units. Unsurprisingly, the deficit is mainly in the middle- and lower-income housing segments.The main drivers for property development are strong macro-economics, favourable demographics, pent-up demand, an improved regulatory framework, favourable capital markets and a positive political climate.

Affordable housing

The Brazilian government announced its R$34bn (£12.8bn) housing plan *Minha Casa*, *Minha Vida* in March 2009, with the intention of reducing the housing shortage in Brazil by 14% and stimulating the national construction industry. Most of the measures were concentrated in the lower-income segment, limited to families earning up to 10 minimum wages (MW), or R$4,500/month (£1,696), but mainly focused on those below 6MW (R$2,700/month or £1,018). Programme highlights are:

- initial government budget of R$34bn (£12.8bn), and up to R$23,000 (£8,671) per home

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- target of 1m homes by the end of last year
- unemployment protection scheme
- mortgage rates of 5-8% provided by the federal state bank Caixa (from domestic savings)
- LTV of 50%-100%
- exemptions/reductions in property taxes.

Property valuations

In Brazil, there are few RICS chartered surveyors and there is no nationwide source of data. Historically, valuations were relatively unimportant because there were few mortgages, lending against property was limited and many properties were self-built.

Valuations for tax (stamp duty) purposes (IPTU – *Imposto predial e territorial urbano*) are unreliable, as they are often carried out separately and may bear no relation to the sale price of a property. Valuations for banks are provided by private companies, with build quality, location (especially in relation to poor areas and slums), infrastructure provision such as water, electricity and sanitation, title documentation, security from crime and affordability taken into consideration.

As the market evolves, it will become more formal and institutionalised. The country's first database of commercial real estate valuations was due to be published at the end of last year and a database of residential values is in the preliminary stages.

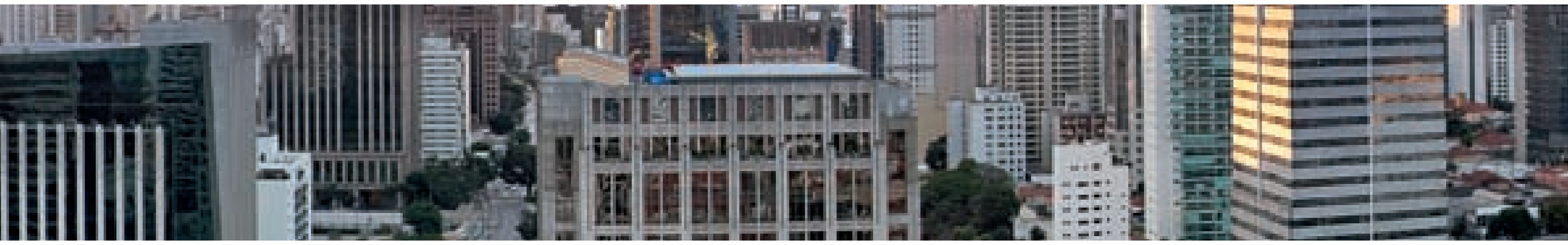
These changes have resulted in a great leap in lending activity in the residential sector. Loans were expected to total R$136bn (£51bn) by the end of last year (2010) and to rise to R$455bn (£172bn) by 2015.

Funding mechanisms

Funds for mortgages are obtained mainly through the government-subsidised and guaranteed Housing Finance System (*Sistema Financeiro de Habitação*, or SFH) funded by private savings. The free market is another source of finance, used primarily by middle and upper-income households. In 1997 a new, parallel system was created, the Real Estate Finance System (*Sistema Financeiro Imobiliário*, or SFI), which is increasingly important as a source of funding for commercial, rather than residential, development.

The Housing Finance System

The SFH is the government-regulated mortgage system, designed to promote the construction and purchase of residential properties, particularly in the low-end sector. The interest rate is capped at 12% p.a. and amortisation periods vary between 15 and 25 years. The resources for this system come from:
(i) the Brazilian Severance Pay Fund (FGTS)
(ii) savings deposits.



The mortgage market

Mortgage lending in Brazil is low: 2% of GDP in 2004 (compared to 86% in the UK, 66% in the US); perhaps 5% today. The background to this is Brazil's 40-year battle with inflation, which culminated in a period of hyper-inflation between 1980 and 1995 when inflation hit 2,076% (1994). Accumulated inflation between 1961 and 2006 has been estimated by some economists at 14,200,000,000,000%, or 14.2 quadrillion. In such catastrophic conditions, many borrowers withheld payment of both principal and interest on the grounds that interest charges were unreasonable. Meanwhile, a weak regulatory framework meant it took lenders up to seven years to foreclose. It also allowed developers who got into trouble with one development to bail themselves out by using the finance from others, which spread the contagion and put other buyers at risk.

Since that period, the regulatory framework has been put in place to protect the rights of both lenders and buyers. In 2003, changes to real estate guarantees gave lenders much more security and motivation for lending by withholding ownership from buyers until they had paid off their mortgages in full. At the same time, the foreclosure process was speeded up, so that a bank can now sell a property before eviction and the borrower is responsible for paying taxes and fees until foreclosure. Furthermore, since 2004, the principal debt has been uncontested and must always be paid, and the interest payment, if it is contested, is held by the courts.

Since 2002, all developments in Brazil have had to be carried out as separate entities, or 'special purpose companies', so that, in the event of the developer going bankrupt the project, funding and all the assets can be taken over by the Development Commission and the investors are protected. This prevents developers from using the funds from one development to complete another.

The FGTS is made up of mandatory contributions by employers equivalent to 8% of their payrolls and is managed by Caixa bank. Each employee on the payroll has an individual account and the right to withdraw money to cover certain situations, such as retirement, illness, unemployment and the purchase and renovation of property. Withdrawals totalled R$47.8bn in 2009 (R$15.7bn in the first four months of last year), of which R$5.7bn (11.9% of the total) was related to the purchase and renovation of properties.

To be eligible for finance through the FGTS, a homebuyer must be buying a newly-finished home, or building a home, to a maximum value of R$80,000 (£30,160) – R$130,000 (£49,000), depending on the city where the unit is located. The buyer must also contribute at least 5% of the unit price. In the case of units already built or under construction, the unit price cannot exceed R$500,000 (£188,500) and financing is limited to 90% of the unit price.

Further, the homebuyer must live in the city where the property is located, have contributed to the fund in the last three years, and not own another property in the same city.

Unemployed individuals also have access to the FGTS for the acquisition of a property, on condition that they reside permanently in the city where the property is located, have no other property in the same city, and have funds deposited in the FGTS from periods of employment in the past.

Savings deposits contribute to the SFH through a central bank requirement that 65% of all private savings in commercial banks are allocated to the residential mortgage system – 80% to the SFH and 20% to the free market – to finance loans to homebuyers and homebuilders. For loans obtained outside the SFH, banks are free to set contract conditions, such as interest rates and amortisation terms.

Free market
The free market is funding contracted at market rates, typically higher than the SFH interest rate. It has two components:
(i) the bank's own portfolio
(ii) 20% of the 65% of savings account deposits allocated to the residential mortgage system. The free market provides funding for residential and commercial properties, mainly at the upper end of the market.

Although much smaller than the SFH, the free market has also been expanding, with loans to individuals totalling R$2.8bn in May last year, up 51.1% on the same month the previous year. These loans have been posting year-on-year growth above 29% since April 2007 (above 34% except for the month of December 2009, at the height of the global financial crisis).

Real Estate Financial System (SFI)
The SFI was created in 1997 to regulate the acquisition and securitisation of real estate credits and ensure the market was strong enough to sustain all funding needs in the long term. Whereas SFH is essentially a government scheme, the SFI can operate as a private system similar to the system in the US. The most important innovation of the system was the creation of securitisation companies: entities that issue a new type of mortgage-backed security, the CRI (Certificates of Real Estate Receivables).

CRIs are used by companies to get new credit on the back of delivered receivables. They are the securities that will most likely gain in importance in the sector in the medium to long term as a new source of funding. All real estate companies have large accounts receivable on their balance sheets. In the current market, homebuilders have succeeded in selling their receivables at par value, and in general the yield is equivalent to the IGP-M inflation index (Brazil's broadest measure of inflation) plus 12% per year.

Overall perspective
The Brazilian real estate market acquired a more mature, formal and institutional framework in 2003/4 when:
- developers and commercial banks started to believe in the effectiveness of the new regulatory framework, specifically the ability of lenders to repossess assets on delinquent loans
- banks started looking for the creation of long-term assets, such as mortgages, once the healthy macroeconomic fundamentals and confidence in political stability began to take effect.

At the same time, capital markets became more interested in the real estate sector. This led to a wave of developers and property companies listing their stocks on the Brazilian stock exchange, Bovespa, which resulted in US$15bn (£5.7bn) being raised between late 2005 and mid-2007. The new capital, plus the more professional management and transparency that comes with listing, boosted motivation to meet customer needs and grow the market.

The 2007/2008 global financial crisis actually acted as a spur to the market, thanks to the federal government taking an aggressive stance on entry-level, low-income residential housing and implementing substantial subsidies, increasing the state-owned banks' exposure to the property sector and reducing paperwork and other legal constraints.

As a consequence of this three-stage process of change, the landscape of the property market looks completely different today. Foreign investment is a daily reality, with large institutional players having direct exposure to the market, while house prices have adjusted materially in response to the improvement in affordability. Until 2005/2006, loan to value was just 40% to 45% and maturities up to 15 years; nowadays 70% to 80% and maturities of 25 to 30 years are the norm.

The total volume of constructions under way at any one time, and consequently the importance of the sector in terms of overall economic growth, has increased. The size of the players has also changed materially. Prior to the wave of listings, most companies were family owned. Increasingly, the listed companies are expanding nationally through partnerships. They are also expanding their project pipelines to meet shareholder expectations of top-line growth. The market capitalisation of listed property-related stocks was just R$12bn (£4.5bn) in 2007, compared to R$80bn (£30.2bn) now.

This growth phase has been led by homebuilders, with mall operators (developers who also manage the properties) slightly behind them. More recently the rest of the property segment has been gaining relevance and sophistication. But the reality is that lending to property companies is still very limited, short term (around 10 years) and relatively high cost at interest rates of 10-14%. (The exception is the mall segment, where locally owned companies can access Brazilian Development Bank finance.) As a result, there is no speculative development; everything is built to order. This means that there are no ready-made empty properties to buy.

Valuation of property is still very subjective in Brazil. Property companies tend to hire the same consultancy company to evaluate their properties, undermining the credibility of valuations. For their part, banks have not developed very sophisticated valuation methods because relatively few properties are financed and loan to value ratios are low. In many cases, there are few 'good' comparables, and the banks focus simply on expected cash flows and to what extent they will cover the interest rate and notional repayments.

As Tomás Awad (previously equities strategist at the Brazilian bank Itaú, now a partner in Landix Real Estate Investments) explains: "All in all, the Brazilian real estate industry is in its early- to mid-stage of development, and this is very clear when we look at the valuation methods being applied, as well as the financial tools available. But we should expect the evolution of the market to track what happened in all developed markets; there are no significant legal or market constraints to limit it."

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Related competencies include: T041, T069

Room for improvement

In the second part of a series on real-life defects that can be overlooked during inspections, Philip Santo reviews a report on a conservatory, a feature of many homes that surveyors neglect at their peril

Many surveyors will recall the basic timber-framed, single-glazed conservatories of 20 or so years ago that were, quite reasonably, treated as outbuildings and considered unimportant for the purposes of inspection and reporting. More recently, however, the conservatory has become an integral and important feature of many families' living space, not only as a 'garden room', but in many smaller houses, as significant additional accommodation. Homeowners now expect their conservatories to be habitable and trouble-free throughout the year.

The inspection mindset of too many surveyors, however, has not recognised this transition. Even though the HomeBuyer Report (HBR) format includes a specific section for comment on conservatories, there is still a temptation to dismiss them as ancillary structures that do not merit the same level of inspection as the main building.

This modern bungalow **(1)** was a case in point. The surveyor was impressed by the overall presentation of the property and various alterations that had been carried out by the sellers. The relatively modest rear conservatory **(2)** was described as an outbuilding and the report made no comment on its condition.

Soon after the new owners moved in, however, it became clear that all was not well. Patio slabs had been laid over an earlier surface, leaving an inadequate improvised drainage channel around the conservatory base **(3)** which became easily blocked and allowed water into the conservatory.

The owners also found sections of the conservatory frame rapidly deteriorating, revealing extensive areas of rot **(4 and 5)**. Although recent redecoration might have concealed these during the original inspection, there is no doubt that more thorough scrutiny would have revealed defective areas.

Further consideration would have identified other areas of poor detailing, such as at the junction of the roof with the main building **(6)**. In short, the inspection and report had not met the standard the client had been entitled to expect.


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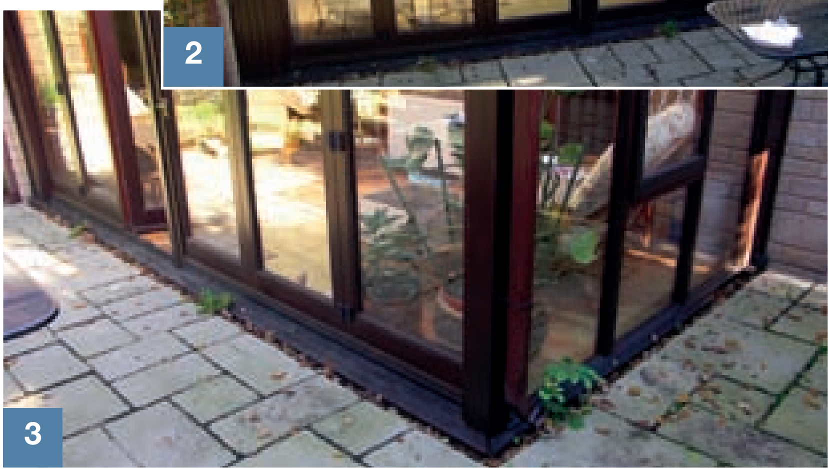
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There is still a temptation to dismiss conservatories as ancillary structures that do not merit the same level of inspection as the main building

Conservatory structures should be critically appraised in the same methodical manner as any other part of the building, with careful attention to the structural design and integrity of the entire frame, the standard of the fittings and finishes and the relationship with both the main building and the site. This does not mean that a report in the HBR format need amount to anything much more than a sentence or two, but the condition rating and advice to the client should be informed by a suitable level of assessment on site.

There is one other feature observant readers might have noticed: a radiator on the back wall of the conservatory **(2)**. Technically, any conservatory with permanent heating should be treated as part of the main building, requiring the structure to meet the full building regulation requirements for a habitable room. This opens a whole new can of worms, deserving of an article all of its own.

1 **The site slopes steeply upwards behind the bungalow. A former double garage has been converted to living accommodation (the rendered section)**

2 **The timber-framed, double-glazed conservatory was clearly intended for year-round use**

3 **Rainwater from downpipes serving the main roof and the conservatory roof was expected to drain towards the right, along a narrow, improvised channel between the conservatory and the patio slabs laid after the conservatory was built**

4 **This area of badly rotted joinery beside the rainwater drainage channel close to the house wall (see the right-hand side of pic 3), might have been freshly painted just before the original inspection, but should have been noted during a critical examination**

5 **Rotted sections at the top of the timber frame were also visible and accessible and should have been seen in the original inspection**

6 **Poor detailing at the junction of the conservatory roof and the main building should have sounded a warning about the standard of construction**

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Related competencies include: T006

The practical approach

Fifteen months after the launch of AssocRICS, residential property practitioners in the UK have two new routes of entry to RICS, with two more to come. David Dalby reviews the progress of this important qualification

When RICS took the decision in 2008 to replace the TechRICS qualification with one that more accurately reflected the changing patterns of work practice and the way surveying students learn their professional skills, it quickly became apparent that the emphasis needed to shift from academic qualifications to assessment of practical competence.

Thus the Associate entry level qualification AssocRICS was born. Its aim is to encourage more members into the organisation, particularly younger candidates, to ensure that there is a healthy influx of new blood into the profession and to provide employers with a pool of skilled and technically competent professionals to ensure they are able to meet the future needs of their clients and their businesses.

The first pathways to be launched, in September 2009, were Quantity Surveying and Construction, followed in November of that year by the first of the residential routes: Residential Survey & Valuation and Residential Estate Agency.

In total, five pathways have been launched to date, with a further seven in the pipeline for launch this year. Each offers a clear and streamlined application and assessment process utilising a web-based platform to allow candidates to progress at their own pace and in their own time. While the UK market is being targeted initially, the intention is to make this qualification available worldwide in due course.

The range of routes into AssocRICS recognises the different combinations of practical skills and vocational qualifications that candidates have to offer, as shown in Figure 1.

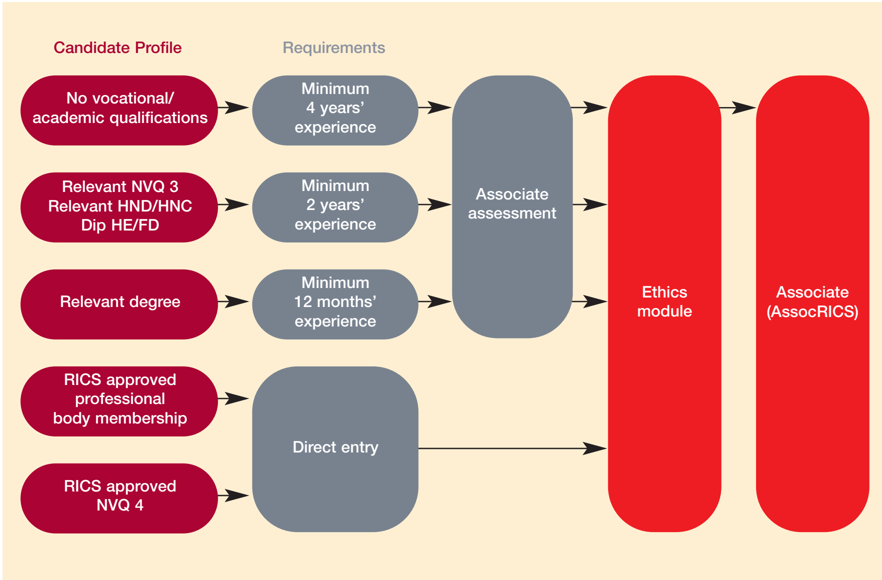

Figure 1: Routes to Associate qualification

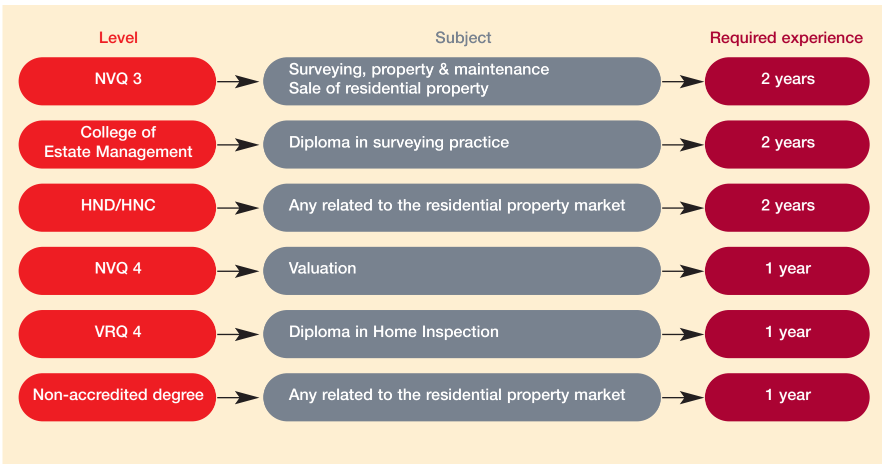

Figure 2: Routes to Residential Associate qualifications

Full membership

One of the criticisms of the old TechRICS qualification was that it did not provide a route to full membership that did not include a cognate degree. For most employed surveyors, studying for a degree full- or part-time is out of the question. The Associate qualification addresses this by providing a more flexible route to full chartered membership of RICS (MRICS) for those willing and able to work at a more advanced level. This route calls for four years' relevant work experience combined with 900 study hours (equivalent to six modules) from an RICS-accredited degree course. Associates who meet these requirements are eligible to enrol for the APC final assessment.

The Residential pathways

To achieve AssocRICS, the assessment process requires candidates to show competency in six areas specific to their chosen pathways. For **Residential Survey & Valuation**, these competencies are:

- Valuation
- Measurement of Land & Property
- Inspection
- Property Records/Information Systems
- Building Pathology
- Legal/Regulatory Requirements

For the **Residential Agency pathway**, there are four mandatory competencies, plus two optional ones from a list of four.

The mandatory competencies are:

- Inspection
- Measurement of Land & Property

The range of routes into AssocRICS recognises the different combinations of practical and academic skills that candidates have to offer

- Market Appraisal
- Property Records and Information Systems

Optional (two out of four):
- Sale & Purchase
- Property Finance & Funding
- Leasing/Letting
- Property Management

These options reflect the fact that prospective members may work in a sales agency environment, a lettings firm, or a mixed practice covering both.

In addition, all candidates in all pathways are required to complete the online RICS ethics module, to prove their knowledge and understanding of the RICS Rules of Conduct, and satisfy their assessors that they are competent in 'softer' skills in eight areas:
- Client Care
- Communication & Negotiation
- Conduct Rules, Ethics & Professional Practice
- Conflict Avoidance, Management & Dispute Resolution Procedures
- Data Management
- Health & Safety
- Sustainability
- Team Working

In the spring, two further pathways will be launched that will be of interest to both candidates seeking a career in the residential sector and employers working in the sector. The first, **Residential Property Management**, reflects the growing call for improved standards and professionalism in this sector, and the importance of the rental market in addressing the UK's housing needs. It is designed to provide a qualification for candidates working in both the public and private sector and, like all Associate pathways, requires proof of competence in six specific pathways relating to the specialist area of ❯❯

Feedback

Michael Ridgell AssocRICS is the first person to obtain Associateship through the Residential Survey & Valuation pathway. He is 41, lives in South Devon and is also doing an MSc degree in Historic Building Conservation through the University of Bath. His passion is Devon stone cottages and his ambition is to specialise in surveying and helping to conserve and restore them.

Michael Ridgell

Q: What motivated you to do the AssocRICS qualification?

AssocRICS is a stand-alone qualification that actually means something and a stepping stone to MRICS. I did not have a cognate degree, but I did have experience in surveying and construction that I could bring to the assessment. It also allowed me to work and study at the same time.

Q: Tell us about your experience of AssocRICS

I found it a useful process in various ways. It made me revisit some subject areas in which I needed to brush up my knowledge and it really tested me. It made me look at the standard of my work and consider if there were aspects that I could improve. This is not an easy qualification and shouldn't be seen as such.

Q: What do you think of the managed learning environment (MLE)?

The system is straightforward, provided you read the instructions carefully. I found the instructions clear and the process of uploading evidence was relatively simple. There were a few minor areas in which the software could have been clearer, but on the whole it was user-friendly. I liked the fact that you could revisit and amend anything you had uploaded at any point.

Q: What advice would you give others considering taking the qualification?

I devoted a lot of time to compiling each of the 24 evidence files. Try to see your presentation from the point of view of the person assessing your work, who has to wade through 24 files, each containing dozens of pages.

Start with the basics: are the files clearly labelled? Have you made it clear what each file is intended to demonstrate? Use a contents page and reference this to the pages of each file. Adopt a system that is uniform, so that each file is easy to read through. If your supervisor is helping you with a particular task, devise a witness testimony statement for him to complete and sign. Is your handwriting clear enough for someone else to read?

It is important to have a good mentor or supervisor with whom you can discuss the assessment criteria. It is surprising how much that can clarify the criteria along the way.

work. Of these, three are mandatory, with candidates choosing the others from a list that covers the different areas of activity in this diverse area. The mandatory competencies are:

- Property Management
- Property Management Accounting
- Maintenance Management
- Relationship Management and Dispute Handling

Two optional subjects must be chosen from:

- Landlord and Tenant
- Housing Management and Policy
- Applied Sustainability
- Property Records/Information Systems
- Risk Management

AssocRICS in **Building Surveying** has been identified as a specialist area where highly competent, technically skilled professionals are needed, to undertake a supporting role and develop skills leading to full chartered status. The Associate pathway for Building Surveying will be launched this year.

Further information on the Associate qualification, including detailed candidate guides, can be found on the website: *www.rics.org/associates*

Where are we now?

Bearing in mind the depth of the economic downturn and its impact on business costs and recruitment, the results for the first year of the new qualification are encouraging. More than 500 candidates have enrolled, as shown above. The first Associate in Residential Survey & Valuation, Michael Ridgell, has completed the process and given us some valuable feedback (see previous page). His comments confirm that the qualification is fulfilling a long-felt need among practitioners without cognate degrees and that the process is manageable, as well as challenging, stimulating and rewarding.

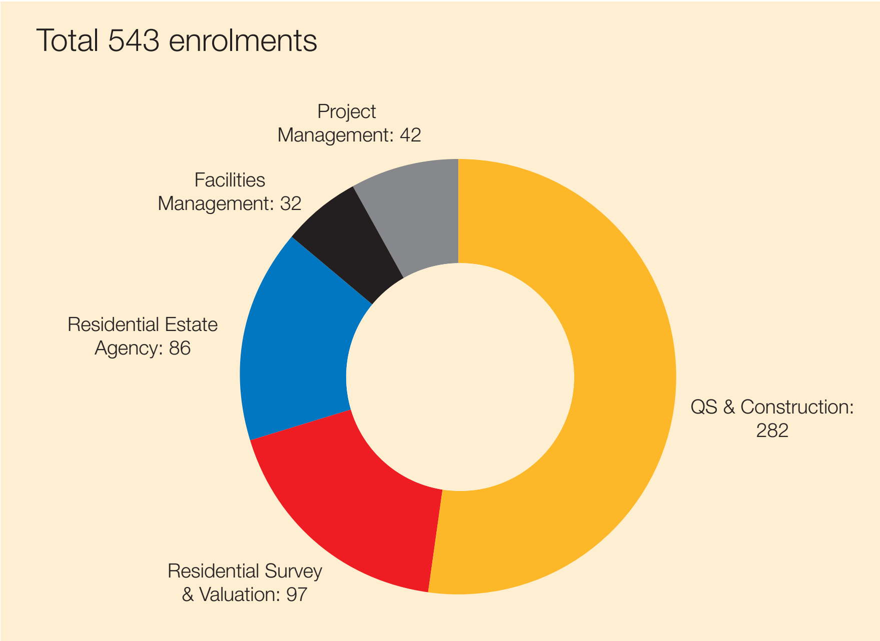

Figure 3: Enrolment by pathway

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The council tax conundrum

When is a property an HMO for council tax purposes, and who pays? Lawyer Perdeep Rullay clears up the confusion

When landlords decide to increase the marketability of their properties by accommodating more than one household, they fall into the regulatory realm of HMOs. The definition of an HMO varies according to the purpose of the definition. Under the Housing Act 2004, an HMO is a property let to three or more occupiers who do not form one household. For planning purposes, a similar definition applies, but is relevant only when there is a material change of use of the property. Where liability for council tax is concerned, the definition is different and very specific.

The law

The obligation to pay council tax follows a hierarchy of liability as set out in section 6 of the Local Government and Finance Act 1992, which places the liability of the occupier above that of the owner. However, where the property is an HMO, the hierarchy is displaced and the obligation passes directly to the owner of the building under Regulation 2 of the Council Tax (Liability for Owners) Regulations 1992. The definition of an HMO under these regulations is a dwelling which:

(a) was originally constructed, or subsequently adapted, for occupation by persons who do not constitute a single household

(b) is inhabited by a person who – or by two or more persons, each of whom –

- is a tenant of, or has a licence to occupy, **part only of the dwelling**
- has a licence to occupy, but is **not** liable (whether alone or jointly) to pay rent or a licence fee in respect of the dwelling as a whole.

Correct application of the law

The definition of an HMO for council tax purposes was examined in the High Court in *Goremsandu v London Borough of Harrow* [2010] EWHC 1873 (Admin).

G let her property to four tenants under a series of tenancy agreements commencing in October 1999, with the last fixed term of a renewal – which by that time had been granted to only three of the original tenants – expiring on 31 December 2007. The tenants were on a joint and several tenancy agreement, with each paying a share of the rent directly to the landlord. The tenants surrendered the property on 1 February 2008. The property was originally let furnished, but G had agreed with the tenants that items of furniture would be stored in the conservatory. The doors to the conservatory were locked to ensure the security of the furniture.

The tenants were initially held liable for more than £11,000 in council tax by the London Borough of Hillingdon (LBH) in accordance with the standard hierarchy of liability. The tenants had paid only a proportion of the amount while they were in occupation and, on vacating the property, the LBH was informed that the conservatory had been locked throughout the tenancy. As there was a substantial balance of tax to be recovered, the LBH sought to recover the money from G, as the tenants had paid rent for 'part only of the dwelling', which meant the property was deemed to be an HMO.

G appealed the decision of the LBH to the Valuation Tribunal (VT), which decided that the property had indeed been occupied under a HMO arrangement. G appealed the VT's decision to the High Court. The High Court held that the council and the VT had failed to properly

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consider the terms of the tenancy agreement and also had not applied the proper test. On analysis, the rent was paid to occupy the entire house as provided for in the tenancy agreement and the fact that the tenants were not able to gain access to or use the conservatory did not change that position. The furniture had been provided with the property and the decision to store it in the conservatory was made by the tenants. They were entitled to demand the key for the conservatory from G at any time and to store or use the furniture elsewhere. The fact that rent was paid in shares was simply an administrative arrangement. The court also emphasised that the tenancy agreement itself should be considered as the main evidence in any case of this type. The council and the VT should not seek to look behind it without very good reason. Accordingly, the decision of the VT was overturned.

Conclusion

Landlords and agents should be aware that owners have no obligation to pay council tax when the tenancy makes the whole premises available to all the tenants together. If the tenants are being let individual rooms in a larger property, or the landlord has reserved some part of the property for his own use, then the liability for council tax falls on the owner. In such cases, it is wise to ensure that the tenancy agreement contains some provision that ensures tenants are required to reimburse the landlord.

It should also be remembered that there is a strict time limit for appeals to the VT. If that window is missed, there is no other route of appeal. If the owner is taken to the magistrates' court for non-payment of council tax, he or she may not use the opportunity to appeal the obligation to pay. (Incidentally, the VT is to be merged with the Tribunal Service as part of the UK government's programme of efficiency savings.)

Perdeep Rullay is a Solicitor at PainSmith Solicitors, a specialist landlord and tenant firm based in Hampshire

Related competencies include: T050, T070

Harnessing the PRS

Can local authorities increase the supply of private rented accommodation, improve standards, promote sustainability and reduce the cost of preventing homelessness? Jim McLaughlin reports on a local lettings agency model that ticks all the boxes

Since the economic crisis started, volumes of new housing development have shrunk dramatically, waiting lists for council housing have expanded (1.7m families at last count, according to CLG figures) and permanent council accommodation stocks have continued to decrease. In this context, local authorities are struggling to provide accommodation for those in need and to promote better standards in terms of both properties and property management in the PRS.

A changing business model

Until recently, local authorities bridged the gap between demand and supply by placing their homeless clients in temporary accommodation through private sector leasing (PSL) schemes. Under these schemes, a local authority would lease a property from the landlord for an agreed number of years, guaranteeing the rent and taking over the management of the property. The format was very popular among landlords, as they could hand over the management of their properties to the council and count on guaranteed rental returns. However, subsidy payments cost £539m in 2007/8.

Inevitably, the previous government put pressure on local authorities to reduce the use of temporary accommodation and find more cost-effective housing solutions that returned the property-management function to landlords under ASTs. The challenge facing local authorities is to design AST options that meet the need while fulfilling the commercial objectives of the PRS. For this, they need a housing model that protects vulnerable tenants and their landlords and encourages long tenancies.

Unfortunately, the main responsibility of local authorities in relation to the local PRS has always been enforcement, so co-operation and partnership between the two do not come naturally. Better day-to-day interaction and a higher level of support for the PRS from local authority housing services are crucial if the sector is to be responsible for managing vulnerable tenants receiving local housing allowance. Local authorities need to reconcile their own legislative objectives and constraints with the commercial objectives and perceived business risks at the heart of the PRS.

The government challenge

The recent announcement by the coalition government that it is scrapping the previous government's plans to introduce the compulsory licensing of landlords and the regulation of letting agents presents a new challenge for local council housing services. The government is calling on councils to use the wide range of powers already at their disposal to tackle the minority of rogue landlords who fail to provide good quality accommodation and thereby blight local neighbourhoods. How do local authorities reconcile this with the need to make considerable cuts in frontline services?

Central to the CLG response to the 2008 Rugg Review into the PRS was the proposal that local authorities should develop 'local lettings agency' (LLA) models, based on Rugg's 'social lettings agency' concept, as the focus of their engagement with the PRS. CLG proposed putting tenancy sustainability at the heart of LLA models, to reduce the risks to low-income households of renting privately. At the same time, there was clearly also scope for such partnerships to address wider housing issues, including reducing the use of temporary accommodation, catering for potential loss of subsidies, reducing rehousing costs, promoting employment and training initiatives and building on and complementing choice-based lettings arrangements.

Settled Housing Solutions Consultancy Services has been working with several local authorities to develop these skills and help them construct meaningful and productive partnerships with their local PRS. One of the company's recent projects was the development of an LLA model for Central Bedfordshire Council.

Let's Rent

Central Bedfordshire Council Housing Service launched 'Let's Rent' in May last year, bringing together a wide range of interested parties, including the council's Housing Benefit Service, the Private Sector Housing Service, the antisocial behaviour team, local regulated lettings and managing agents and the Bromford Group's Floating Support Service. Inviting these key PRS delivery partners to contribute to the lettings and management process was seen as a way of 'professionalising' the council's PRS services and improving the sustainability of the tenancies and the quality of accommodation.

The housing service also reached out beyond the local PRS market to the national regulatory bodies – RICS, the Association of Residential Letting Agents (ARLA) and the National Approved Letting Scheme (NALS) – to ensure there would be a responsible regulatory framework for PRS partnership work.

Sharing the risk

The consultants talked to a number of the leading providers of PRS accommodation in the area to gauge their support for a new LLA model. Two messages emerged strongly: that the housing service would need

to recognise the local PRS market as a business activity if it hoped to attract well-regulated agents, and if the new housing model was going to be commercially viable and competitive in the local market, everyone directly involved in the day-to-day lettings and management operation of the project would need to share the risk.

To address these needs, the LLA business model incorporates a range of financial incentives and formalised processes to steer resources towards tenancy support and sustainment. The three key elements are a local housing allowance tenancy support and sustainment plan, rental arrears protection and tailor-made landlord insurance policies.

Better regulation

To ensure that everyone involved in Let's Rent performs lettings and property management functions to a uniform standard, a property accreditation element was included. All properties supplied are required to conform to the council's Property Accreditation Scheme Housing Fitness Standards. The letting agents are asked to register their properties and make them available for inspection at least once a year.

Further than that, all Let's Rent licensed lettings agents receive Housing Health and Safety Rating System (HHSRS) risk assessment training from Central Bedfordshire's Private Sector Housing Team officers to equip them to carry out property inspections. With lettings agents able to identify category one hazards and take action independently without the need for intervention by the housing team, the council is able to focus on dealing with the 'worst first' in terms of landlords in the local PRS market.

For its own peace of mind and to provide protection for both landlords and tenants, the council specified that all lettings and property management agencies involved in the scheme are required to register their companies with RICS, ARLA or NALS.

Reducing costs

The consultation with the PRS confirmed a willingness to forego upfront financial incentives provided there was a commitment by the council to steer all available resources and funds towards formalised plans to support and sustain tenancies for the full term of ASTs. The key areas of successful tenancy support are providing dedicated support officers, improving access to the council's Housing Benefit Service and providing rent-arrears indemnity. In addition, Settled Housing Solutions established arrangements with landlord insurance companies to provide rental protection and cover for properties and legal fees.

Improved communication and regulation means less time spent dealing with tenancy disputes, property management issues and enforcement action, which in turn cuts costs.

In practice

Marketing of the Let's Rent option is through regulated letting agents who target both landlords who have housed social tenants before and sceptical landlords who have been reluctant to enter this market due to the perceived risks. The agents then manage the properties on behalf of landlords for a competitive management fee. The incomes of landlords and agents is maximised through competitive market rents and a formal tenant referral and allocations process, which speeds up the rehousing process and minimises rental voids.

Rent arrears are safeguarded by the Tenancy Support and Sustainment Business Plan, which includes regular performance-monitoring meetings between the local authority and regulated letting agents, floating tenancy support for the most vulnerable clients to help them maintain their tenancies, a rent-arrears indemnity policy jointly underwritten by the local authority, and tailor-made landlord insurance policies. These policies pay out to landlords when genuine rent arrears have been identified and attempts to recover the loss from the tenants have been unsuccessful. Landlords and letting agents can expect long-term income streams, as experience has shown that tenants given access to high-quality accommodation generally stay.

Regulated letting agents can also promote the fact that they are approved partners of the local authority, thus gaining a marketing advantage in competitive local PRS markets. As they are also working with the council to promote better housing management and compliance with current PRS-related legislation, they are in a very strong position to influence the local authority's future housing strategies.

A better future

Implementing an effective LLA model produces mutual benefits. Experience has shown that incentives are more effective than enforcement when it comes to promoting good housing management in the PRS, and demonstrating the financial benefits of working in partnership with a local authority is the most effective way of encouraging landlords and letting agents to raise their game. Those who don't, and who continue to provide a poor service, become marginalised and attract the attention of local authority enforcement services.

Central Bedfordshire Council is on target to rehouse more than 80 households through Let's Rent in the first year. Every 100 tenancies will save the council £108,000 a year in rehousing costs. And the combination of a regulatory framework with an investment business model can achieve a wide range of broader objectives, including more choice-based letting and better standards in the PRS. Ultimately, this housing solution promotes PRS as a choice of tenure that is just as attractive to home-seekers as home ownership and public sector housing.

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Related competencies include: T040, T041

Positive energy

Do energy performance ratings affect home-buyer behaviour? Early research in the Netherlands indicates that they are beginning to do so, as Stephen Brown reports

Governments around the world are trying to work out how to encourage people to reduce their carbon emissions as part of their overall climate-change strategies. In the EU, the main piece of legislation aimed at driving energy efficiency in buildings is the Energy Performance of Buildings Directive (EPBD), adopted in January 2003 and transposed in the UK in 2007 as the Energy Performance of Buildings (Certificates and Inspections) (England and Wales) Regulations. In terms of the directive, Member States must have minimum standards for the energy performance of new and existing buildings, have a system of certification in operation and ensure that boilers and air-conditioning systems are inspected regularly.

A key element of the EPBD is the issuing of energy performance certificates (EPCs) for both residential and commercial buildings, to inform consumers about energy consumption in buildings and provide home buyers with a means of comparing the energy consumption of different properties. From an economic perspective, EPCs have obvious potential value for property investors and tenants, since the energy savings flowing from more energy-efficient buildings may be capitalised in lower operating costs and higher property values.

So, the policy is in place, but does it actually work?

A recent report published by RICS as part of its research programme on the economics of sustainability in the built environment examines whether the EPBD has affected home-buyer behaviour in the Netherlands. This is one of the first studies on the impact of EPCs on the residential market and was carried out by Dirk Brounen of Erasmus University in Rotterdam and Nils Kok of Maastricht University. The Netherlands was a good place to start, since EPCs were introduced in early 2008, a year before the date prescribed by the EU, so there is more useful evidence to be gathered there.

Another reason for studying the Dutch market was that home buyers are allowed to sign a waiver that relieves sellers of the obligation to provide an EPC. Until recently, it was a seller's market in the Netherlands, so buyers would offer the waiver to increase their chances of a successful purchase. The semi-mandatory status of energy performance certification created a basis for studying patterns of adoption of EPCs, as well as the impact of certification on the housing market.

The findings

One of the first trends revealed by the study related to the adoption rate of EPCs: when they were introduced at the beginning of 2008, 25% of houses sold had EPCs, but by September 2009, this had dropped to 7%. The researchers also analysed which properties were most likely to have EPCs, using ratings records kept by the Dutch Department of Economic Affairs and data held by the National Association of Realtors on housing transactions. This phase of the study showed that around one third of the houses sold had a 'green label' (a good EPC rating of A, B or C), while a quarter had a 'red label' (a poor rating of E or lower; D is considered average). Clearly, there is plenty of room for improvement.

The researchers then examined what impact EPCs had had on house prices in the previous two years. Here, they found a positive correlation between energy efficiency and transaction price: homes with green labels sold at an average premium of 2.7% relative to otherwise comparable dwellings with non-green labels. Furthermore, the price premium for energy efficiency varied according to the level of energy efficiency described by the label. For example, a dwelling with an A label sold at a premium of 12.1% over a comparable dwelling with a G label. Interestingly, this corresponds quite closely with the present value of prospective savings on utility bills resulting from lower energy consumption.

This research provides encouraging early evidence that EPCs have the potential to add value. The fact that home buyers in the Netherlands are willing to pay a premium for homes labelled as more efficient, and that price variations can be related directly to the specific outcomes of EPCs, supports the case for making such data more widely available in the UK. This will enable prospective purchasers to make informed decisions based on proper information about the relative energy efficiency of homes they are considering buying, and to compare them with other homes in the area.

It may be a slow process, but EPCs can help to make energy performance issues more transparent and provide an effective signalling device, which should lead, in time, to energy efficiency having a direct impact on property values.

Stephen Brown was Head of Research at RICS until September 2010

On the economics of EU Energy Labels in the Housing Market, by Dirk Brounen and Nils Kok, is available to download from *www.rics.org/research*

Related competencies include: M009, T083

Two things to worry about?

...Part E <u>and</u> the new 'party wall bypass' in Part L?

It may not be as bad as you think.

The Robust Details Handbook has been updated to include insulation fill to a large number of the cavity masonry separating walls, ready for the new thermal calculations.

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Please call our advice line on 0870 240 8209 or visit www.robustdetails.com for more information, or to order a new handbook

- Robust details are universally accepted by building control bodies in England and Wales as an **alternative to the pre-completion sound testing of new dwellings**.
- Using robust details allows credits for enhanced performance to be claimed under the Health and Wellbeing section of the **Code for Sustainable Homes** (CSH), without the need for testing.

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