PRIMARY CARE PREMISES VALUATION ISSUES:

Confusion between Initial Rents and CMRs

Background

Following the economic downturn in 2008 and the subsequent squeeze on government spending, tighter NHS budgets have resulted in smaller and fewer new primary care premises schemes coupled with an understandable downward pressure on Initial Rents for such new schemes.

This downward pressure has, ironically, come at a time when NHS specifications for new buildings have risen and other statutory requirements affecting new buildings (Building Regulations and BREEAM) have actually increased the costs of providing new premises.

The above has resulted in a position where PCTs are often not able to afford new primary care centres at the CMR and will fund only those schemes where the Initial Rent is "subsidised" by some other element of the transaction (e.g. sub-market land costs, a large pharmacy premium etc.). These Initial Rents are often misquoted as being CMRs.

Distinguishing Initial Rents from CMRs

The rent for a new scheme (i.e. an Initial Rent) is appraisal-based. It is different to the CMR and indeed the NHS (GMS – Premises Costs) Directions 2004 acknowledges this distinction (Direction 32 stating that the lower of the CMR and the lease rent will be reimbursed).

In RICS Guidance Note 60, *Valuation of Medical Centres and Surgery Premises*, the difficulty in properly analysing a CMR from an Initial Rent is highlighted in paragraph 4.7.3, which advises valuers, when analysing comparable evidence from new projects, that they must be aware that some of these rents can be above or below the general level of Market Rent, particularly if they resulted from a development appraisal where there were significant abnormal costs or subsidies associated with the development, or where the rental levels have been influenced by the alternate use of the site or property.

In the current situation, where there is still a demand for better quality property yet a clear shortage of NHS funding, it is not surprising that PCTs are giving the greatest favour to projects where the rents are subsidised. The problem is that, over the last couple of years, there have been so many of these subsidised Initial Rents that many valuers are now seeing them as representative of the CMR. In turn, it is fuelling their misconceived belief that primary care centre rents are falling in line with other commercial property.

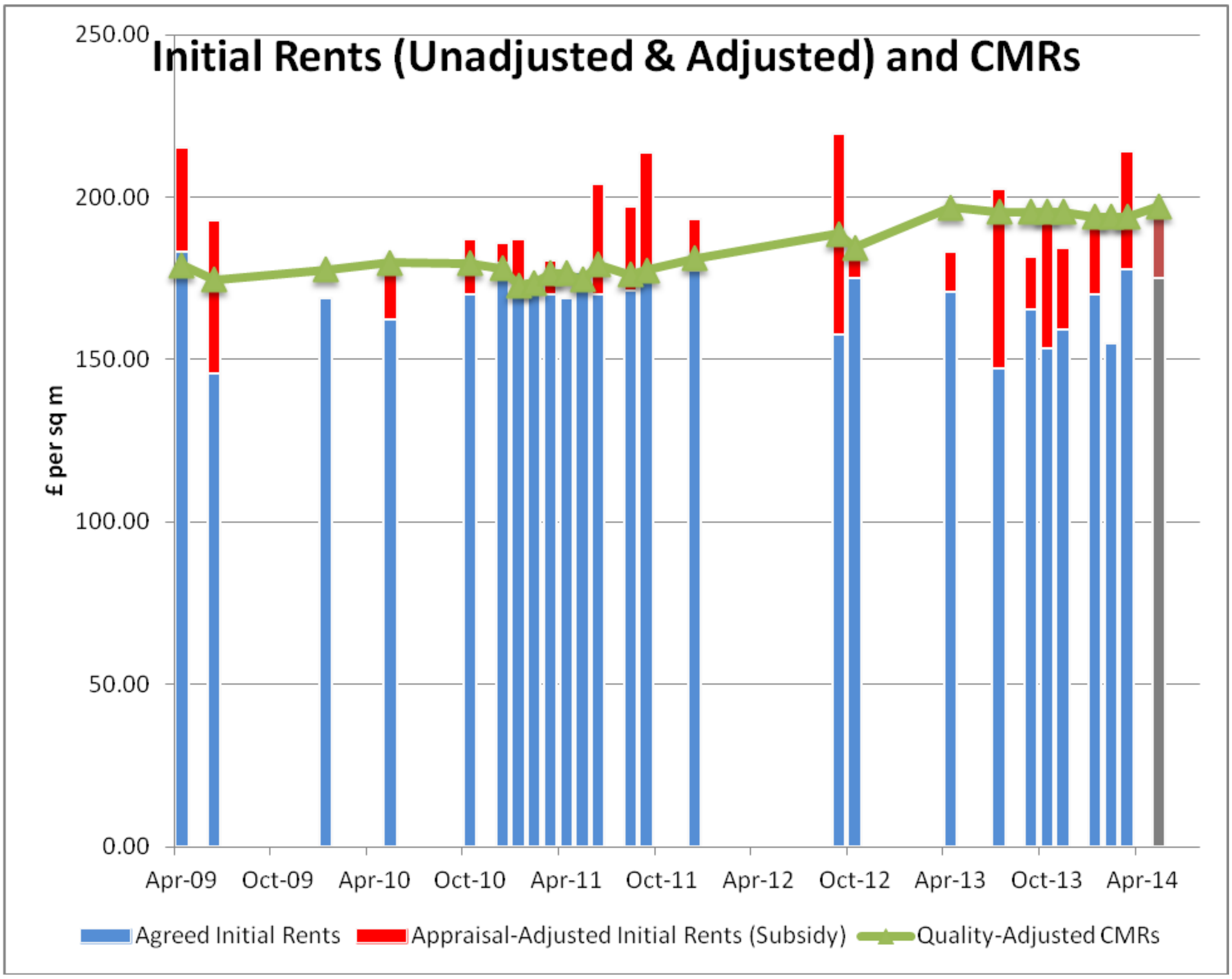
John Hearle of Aitchison Raffety comments, "It is vital that any valuer does not take any Initial Rent at face value but identifies any subsidy present. Over the last couple of years, Initial Rents on a vast number of projects have been subsidised and should not be regarded as a true market value."

Example

In a recent instance, during rental negotiations for a new medical centre, the DV stated that rents were static or falling and that there was a "tone" of values for the region which set a rental ceiling. The DV had come to such (incorrect) conclusion because he had failed to analyse and adjust the "headline" Initial Rents agreed in the region (indicated in blue on the graph below).

However, when the circumstances of each scheme were investigated fully with input from the parties concerned (the developers and investors), it became clear that Initial Rents were able to be agreed at lower levels only because of the presence of "subsidies" (e.g. a pharmacy rent/premium, a s.106 receipt, a PCT capital contribution, low land value etc.). These subsidies are shown in red on the graph. The analysis shows that, without such subsidies, the Initial Rent would clearly have needed to be higher to make those schemes viable.

Moreover, the DV had wrongly assumed those unadjusted Initial Rents to be CMRs. Therefore, in order to highlight the distinction, an assessment of the CMR for each building was carried out. In this case, a 2006 property with a settled 2009 rent review was used as a "benchmark" comparable and the other properties were adjusted for quality and specification to show the corresponding CMR (green line) as distinct from the Initial Rent.



Alistair Blacklaws of Matrix Medical explains, "As you would expect, the CMR line has risen to reflect improvements in specification and in particular the new 2010 Building Regulations which has added costs of 10-15% alone."

Summary

The clear message is that developers and their advisors should ensure that where a rental offer is acceptable (and a subsidy is present) but is being labelled as a "CMR", it should be accepted only on the basis of it being an Initial Rent and NOT a CMR. Ideally, an analysis of the subsidy element should be placed on file and a copy sent to the District Valuer. This procedure should also ensure that Initial Rent evidence to be used in rent review negotiations is also appropriately adjusted.