The valuation of buy-to-let and HMO properties

RICS guidance note, England, Scotland and Wales

2nd edition

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1 Introduction

1.1 Purpose and scope of the paper

There has been a major shift in the UK housing market that has led to an increased bias to private renting, both out of choice and out of need. These changes have their roots in tenure-neutral housing policies that have been adopted since the 1980s, the impact of which has been amplified by the general undersupply of homes and the affordability challenge faced by homebuyers.

From a base of almost 2 million households in 1996, 4.4 million households now call the private rented sector home and standards are much higher. Growth has slowed since 2018 as regulatory and taxation changes have taken effect, although appetite for investment in the private rented sector remains strong given favourable returns compared with other investment opportunities. A shift towards a higher proportion of professional landlords has also been seen over this period.

The creation of buy-to-let has helped to shape a private rented sector that is fit for purpose and provides choice, value and flexibility for tenants. Demand from tenants continues to be high and is expected to increase.

The expansion of buy-to-let has created significant challenges for valuers in this market. The purpose of this guidance note is to provide sufficient background information and guidance to ensure consistency in the assessment of residential investment properties to include:

- single residential units
- houses in multiple occupation and
- multi-unit blocks.

The guidance is applicable to valuers who are instructed by lenders and private clients. Information has been specifically included to assist the valuer when acting for a lender as it is recognised that most instructions tendto be for secured lending purposes.

Legislation affecting the private rented sector has increased the regulation that residential landlords must comply with, resulting in increasing costs. The level of control and enforcement exercised by local authorities in their management of standard buy-to-let and houses in multiple occupation (HMO) continues to increase, and the powers they have are now more widely applied in terms of HMO licensing, management regulations and planning control. It is essential that valuers acting in this specialist market have a good understanding of all relevant factors that influence both capital and rental value.

Valuers should be aware that, in the case of borrower default, the lender may choose to appoint a Law of Property Act (LPA) receiver of rent, and at that point, it is expected that the property will be capable of being let at or above the level of rent assessed initially and without significant expenditure to maintain the property in a lettable condition. Where applicable, an appropriate level of regulatory compliance should be in place for HMOs. All this assumes no significant changes in market conditions and that the landlord has adequately maintained the property during the interim.

It is important to emphasise that this guidance note is not prescriptive. Its application therefore needs to take account of a wide variety of market conditions and circumstances. Valuers should be aware of its contents and use them to guide their general approach in adopting the most appropriate valuation methodology while allowing for circumstances affecting the property being valued. In particular, refer to the current edition of *RICS Valuation – Global Standards* and the mandatory Valuation Practice Statements (VPS 1-4), which cover the terms of engagement, inspections and investigations, valuation reports and the bases of valuation(including any assumptions or special assumptions).

1.2 Property

RICS Valuation – Global Standards UK National Supplement, UK VPGA 13.6 Buy-to-let refers to the main buy-to-let categories, however, the *RICS Valuation – Global Standards UK National Supplement* is currently under review with a new edition due to publish in 2023. The following content in section 1.2 of this guidance note supersedes UK VPGA 13.6 in the UK National Supplement, until a new edition is published.

The property categories defined in the 1st edition of this guidance note have been updated as follows:

Category 1: a single individual residential unit let to a single household on a single assured shorthold tenancy (AST) – Private Residential Tenancy Scotland – where it neither forms, nor is intended to form, part of a portfolio*

Category 2: A small house in multiple occupation (HMO) comprising a residential property let on a single AST to a group of individuals or on separate ASTs with up to a maximum of six tenants sharing communal facilities.**

Category 3: Larger licensable houses in multiple occupation (HMOs) with seven or more tenants and multiple units with an element of shared facilities held on a single title. These may be let on a single AST to a group of individuals or on separates ASTs.

These categories of property together with any building comprising a mix of self-contained units and HMO accommodation should only be valued after confirmation of direct terms of engagement with the instructing lender/client and with reference to the lender's specific guidance.

Rationale for change – Category 2 above replaces the previous shared house definition for up to four individuals and has been introduced to better align with the categories used for planning purposes: Small HMOs that accommodate between three and six people (C4 use class).

*Category 1 may include properties that are subject to selective licensing – see section 3.3.2 below.

**Category 2 may include properties that are subject to additional and selective licensing schemes and where there are five or more tenants, mandatory licensing. See sections 3.3.1 and 3.3.2 below.

1.3 Overview of the sector

Buy-to-let is a mature product that has weathered two major financial shocks – the global financial crisis and the COVID-19 pandemic – as well as significant fiscal and regulatory changes.

The private rented sector is the UK's second largest housing tenure, accounting for 19% of households in 2021, up from 10% recorded in 2001, and is now above the provision of social housing at 17%. Renting is no longer seen as a last resort, or a sector dominated by students and younger generations, it is now a tenure of choice as well as need. People of all ages and backgrounds are actively choosing to live in the private rented sector as it provides greater flexibility and better suits their lifestyle requirements. The buy-to-let market has played a crucial role in the development of the private rented sector since the mid-1990s, having enabled a market to diversify and meet the needs of a changing demographic. It has allowed more private landlords to enter the market and it has encouraged competition, which in turn has increased the level of quality across homes in the sector.

As the buy-to-let market has evolved, the proportion of portfolio landlords has grown, helping to professionalise the private rented sector and raise standards. In 2021, UK government data showed that while 45% of landlords have one rental property, this represents just 21% of properties within the private rented sector. A further 38% own between two and four properties, representing 31% of the sector, with the remaining 17% of landlords owning five or more

properties, representing 48% of the private rented sector.

This concentration of stock towards portfolio landlords has coincided with rising standards in the private rented sector. Landlords have made tangible improvements to the sector. Homes are newer, larger, warmer and more energy efficient than they were 25 years ago, and tenants have more choice, as well as greater protections.

1.4 Broader issues affecting the market

In a drive to increase home ownership and grow the number of first-time buyers, the UK government introduced measures to curb buy-to-let house purchases in 2016. In April that year, a 3% stamp duty surcharge was introduced, while a phased ending of mortgage tax relief from 2017 was also announced. Additionally, the Prudential Regulation Authority introduced more stringent underwriting rules for portfolio landlords (those with four or more properties) in 2017, which required lenders to take a more specialised approach that considered the strength of the portfolio overall, rather than just the individual property.

A supervisory statement, SS13/16, Underwriting standards for buy-to-let mortgages was released by the Bank of England Prudential Regulation Authority (PRA) in September 2016:

This outlines the minimum standards that firms should use to underwrite mortgage contracts, which includes:

- **Affordability testing**: To constrain the value of the loan that a lender can make for a given income. Among other things, the lender should consider all costs associated with renting out the property where the landlord is responsible for payment and any tax liability associated with the property.
- **Interest rate affordability stress test**: Lenders should consider the likely future interest rates, mainly over a minimum period of five years from the start of the mortgage term contract.
- **Portfolio landlords**: The PRA has confirmed a standard definition of a portfolio landlord. Landlords will be portfolio landlords where they have four or more mortgaged buy-to-let properties across all lenders in aggregate. The PRA expect lenders to implement a specialist underwriting process that accounts for the complex nature of the borrower and their portfolio of properties.
- **Risk management**: The PRA requires that firms have robust risk management, systems and controls in place specifically tailored to their buy-to-let portfolios. These should include risk appetite statements governing how core risks will be identified, mitigated and managed and monitoring of portfolio concentrations and high-risk segments.

1.5 Financial services regulation and buy-to-let properties

A buy-to-let loan is essentially a business transaction. It is the borrower's intention to let property in which they are investing to generate a return, and in the long-term, they aim to make capital growth.

Consumer buy-to-let subject to regulation

There are some situations where borrowers do not seem to be acting in a business capacity. Examples of this may be where the property has been inherited or where a borrower has previously lived in a property but is unable to sell it so resorts to a buy-to-let arrangement. In these cases, the borrower is a landlord because of circumstance rather than through their own active business decision. The government's view is that such borrowers are consumers and would need to be covered by an appropriate regulatory framework. It is expected such instances to represent a

small proportion of total buy-to-let transactions.

A framework by the FCA has been effective from March 2016 for those in the mortgage industry lending to or advising customers who fit the definition of 'consumer buy-to-let'.

1.6 Regulation and the private rented sector

It is a common misunderstanding that the private rented sector is unregulated. The sector is heavily regulated and, according to the National Residential Landlords Association (NRLA), landlords must comply with a wide range of rules governing the sector – more than 50 Acts of Parliament and 70 sets of regulations.

Regulation already gives local authorities the power to introduce local licensing schemes for the private rented sector, and places statutory obligations on landlords to check, among other things:

- tenant immigration status
- appropriate electrical gas and fire safety regulations and
- energy efficiency obligations.

As part of the levelling-up proposals for the UK, the government have announced a new white paper to be published in spring 2022 to consult on introducing a legally binding Decent Homes Standard in the private rented sector, which will include a National Landlord Register and bring forward other measures to reset the relationship between landlords and tenants, including the ending of section 21 'no fault evictions'. Attention will be focused on rogue landlords to ensure penalties are designed to avoid repeat offences.

This white paper principally refers to the private rented sector in England and regulatory differences apply in Scotland, Wales and Northern Ireland, some of which are summarised in section 6 of this guidance note.

2 Instruction

2.1 Clarity of instruction

A lender client should provide appropriate guidance as to the basis of valuation to be adopted for buy-to-let valuations. This should be separate from the lender's standard residential valuation policy for owner-occupied homes. It is important that the valuation guidelines clearly set out the lender's expectations in terms of approach and methodology to be applied, though this does not discharge the responsibility on the part of the valuer to ensure that the valuation is not misleading (see RICS Valuation – Global Standards (Red Book Global Standards)). The instruction should provide sufficient detail and clarity to enable valuers to assess the property having regard to the lender's published property criteria and risk appetite.

2.2 The lending process

The lender will assess the affordability of a mortgage based on the expected monthly income generated from letting the property to a tenant.

Buy-to-let mortgages are, therefore, underwritten having regard to the level of rental income that the proposed security can achieve. Some lenders may also have additional minimum income requirements for the applicant(s) derived from other sources of employment and this may vary dependent on product criteria.

Professional landlords may be assessed differently when all their income is from a property portfolio.

The accuracy and sustainability of the rent assessed by the valuer is, therefore, critical to the underwriting process. Lenders will apply an interest coverage ratio (ICR) calculation to determine the maximum amount of the loan based on the rental income confirmed in the valuation report.

This rent should be based on the definition of market rent in the Red Book Global Standards and not simply an approval or confirmation of the rent passing unless the comparables support that level of rent.

The ICR calculation is designed to ensure that the rental income is sufficient to service the proposed loan amount, pay taxes and maintain the property during the mortgage term and forms part of the PRA supervisory statement outlined in section 1.4 of this guidance note. The gross rental income from the property should exceed the interest coverage ratio requirements as defined in the selected product criteria, subject to an absolute minimum coverage of 125% for lower rate taxpayers and Limited Companies. For higher rate taxpayers, most lenders adopt a figure in excess of 140%. The coverage for HMOs tends to be at a higher rate to reflect increased costs. Affordability calculations and stress testing are subject to regular review and enhancement by lenders to account for economic and government policy changes.

Once a buy-to-let loan has been offered, the application moves through the completions process, at which point the solicitors may be expected to confirm that all relevant statutory consents are in place and licensing provisions adhered to, as applicable. Alternatively, some lenders may rely on an indemnity policy. It is, therefore, essential that valuers report clearly and concisely any legal or regulatory matters that need to be verified, to enable solicitors to make the appropriate checks prior to the submission of the report on title and satisfy the lender's requirements based on their specific instructions. Where the property has been appraised using an income approach and the capital value of the security is reliant on the rental income being achievable on a sustainable basis, it is critical that any issues that could potentially result in enforcement action by the local authority or prevent the continued use of the property in its existing arrangement are identified in the valuation report. Recommendation for further enquiries should be made accordingly. Valuers should be familiar with the HMO guidance issued by local authorities, which is normally on their websites and to be able to advise if a property appears to be generally compliant. Valuers should also realise that having a HMO licence does not guarantee that a property is fully compliant with the local authority's requirements. Licences may be issued initially based on the landlord's assessment of the property and completion of the application form on a self-certification basis. Until the house has been inspected by an environmental health officer it may not be known if it is fully compliant and the valuer should, therefore, form their own judgement

2.3 Instruction content

The valuation instruction should provide sufficient information to allow an appropriately qualified and experienced surveyor to carry out the valuation having regard to the specialist nature or market of the property to be valued.

All categories of property as defined in section 1.2 of this guidance note will be valued only after confirmation of direct terms of engagement with the instructing lender/client and referring to the lender's/client's specific guidance.

In addition to the standard instruction details, critical information contained on the instruction should ideally include:

- the rental information (gross rent or adjusted gross rent) and
- the basis of letting (single unit or multiple occupation)

to allow the valuer to assess, in addition to the capital value, the correct level of rental income that the property is capable of generating on a sustainable basis. The rental value is critical to the lender's underwriting process and is a key component in the loan that can be advanced against a property.

The valuation reporting format should be suitable for the type of appraisal to be carried out and allow the valuer scope to comment on all relevant factors having regard to the fact that the

property will be let during the mortgage term and the rental income relied on to service the loan.

The instruction should meet the minimum requirement for the terms of engagement as set out in the RICS Valuation – Global Standards with the aim to clearly identify the following points (and where the property is not a standard house or flat, allow the opportunity for a valuer with the necessary specialist skills and experience to be appointed to carry out the instruction):

- applicant details
- full address
- tenure details
- leasehold terms if applicable/known (lease length, ground rent and service charge)
- the type of valuation required and report to be completed
- the lender's guidelines to be applied (separate document)
- access details – vendor/landlord/managing agent's name and contact details (as applicable)
- purchase price or estimated value
- proposed loan amount
- rent passing or estimated rent and frequency
- number of tenants/nature of occupancy – single unit/sharers/multiple occupation
- the service level agreement (SLA) that applies and
- any intentions of the applicant (proposed works) if applicable.

2.4 Service level agreements (SLAs)

Having regard to the instruction content in section 2.3, any SLA between the lender and the valuer should reflect the potential complexity of a case and allow the appropriate time required to gain access to a tenanted property. The SLA should also allow the valuer adequate opportunity to carry out a full inspection and assessment of the accommodation and prepare the valuation, which, in the case of more complex forms of property, may take longer to complete due to the methodology applied and the need to carry out additional research, including comparable yield analysis, where applicable.

Valuers accepting the instruction should be familiar with the buy-to-let market, to include HMOs if applicable, and have sufficient local market knowledge and experience to carry out the appraisal to provide both a capital and rental assessment.

Valuers should report positive and negative factors and it is fundamental to recognise that the assessment and sustainability of the rental value provided is as important as the capital valuation. Accurate and full reporting, including the condition of the property for letting purposes, is essential information for the lender, subject to any guidance issued. Lenders should consider the suitability of their reporting format for a HMO to identify all the risks and appoint a suitably experienced valuer to carry out appraisals of those HMOs that are subject to more stringent regulation and compliance.

2.5 Home Survey

In the case of a Home Survey instruction, valuers should consider carefully if the property falls within the Home Survey standard. Assessment of a more complex residential investment property may require a different skill set and the valuer should be familiar with properties of this nature and the local market.

3 Inspection

Inspection of properties should be in accordance with the Red Book Global Standards, VPS 2 Inspections, investigations and records and *RICS Valuation – Global Standards: UK national supplement*, UK VPGA 11, section 11.3, where the property has been purchased singularly as a buy-to-let investment.

3.1 Single houses and HMOs

Single buy-to-let properties are well understood and have similar characteristics to a single owner-occupied house.

The Housing Act 2004 introduced the current definition of a house in multiple occupation (HMO):

- an entire house or flat, which is let to three or more tenants, who form two or more households and whoshare a kitchen, bathroom, or toilet
- a house that has been converted entirely into bedsits or other non-self-contained accommodation and that is let to three or more tenants, who form two or more households and who share kitchen, bathroomor toilet facilities
- a converted house, which contains one or more flats that are not wholly self-contained (i.e. the flat does not contain a kitchen, bathroom and toilet) and which is occupied by three or more tenants whoform two or more households
- a building that is converted entirely into self-contained flats and the conversion did not meet the standards of the Building Regulations 1991 and more than one-third of the flats are let on AST (section257 of the *Housing Act* 2004)
- the property must be used as the tenants' only or main residence and it should be used solely or mainly to house tenants. Properties let to students and migrant workers will be treated as theironly or main residence.

Where the property has been converted into a HMO, there will be additional factors to consider relating to both condition and value. Appropriate allowance should be made in the time allocated to carry out the inspection and subsequent market research. More complex residential investment property will take longer to appraise than a standard single unit so that all relevant factors can be fully assessed while on site.

The lender will expect the property to be in a lettable condition when the loan completes so that the rental income is readily available to service the loan. Reference should be made to the lender guidance, but this typically requires the accommodation to be presented to a satisfactory standard and to meet the expectations of the target tenant market for the area in which the property is located.

The fact that a property is let at the point of inspection, albeit in poor condition, does not mean that the property is capable of being re-let in that state to a new tenant. In this scenario the lender needs to be made aware that the rent passing is not capable of being achieved on a sustainable basis without investing in the property to bring it to an acceptable standard. In the case of a remortgage, the lack of maintenance may be an indication of the way in which the landlord manages the property and is unlikely to change, whereas a purchaser may be looking to upgrade the security once the transaction completes and prior to letting.

Depending on the lender's criteria, certain essential repairs required to make the property lettable and that have a material impact may be dealt with by way of a retention.

Consideration should be given to sections 3.2 and 3.3 of this guidance note to determine whether the property appears generally compliant with all relevant legislation. The scope of the inspection for mortgage purposes is not sufficient to confirm full compliance with all regulatory aspects but

the property should display reasonable signs of conformity with the legal requirements.

Market rent should be the figure that is attainable on the date of inspection reflecting the condition of the property on that date with no assumptions regarding repairs or improvements for instance, to the kitchen or bathroom, unless otherwise instructed by the lender. See also Red Book Global Standards, VPS 4, sections 5 and 8.

3.2 Regulation

Local authorities are frequently extending their level of control as permitted by legislation and taking enforcement action where appropriate.

All buy-to-let propositions including single residential units are increasingly subject to regulation including the *Homes (Fitness for Human Habitation) Act* 2018 and selective licensing.

3.2.1 Homes (Fitness for Human Habitation) Act 2018

Homes (Fitness for Human Habitation) Act 2018 aligns to all new and existing tenancies from March 2020. The property must be fit for human habitation from when the tenancy is granted and must remain fit during the term of the tenancy. This allows tenants to act directly, in the form of court action for compensation without the need for a Housing Health and Safety Rating System (HHSRS) assessment or expert witness testimonies.

The defect must result in a judge ordering that the property is unfit to be lived in. The courts will consider the following criteria:

- repairs
- stability
- damp
- internal arrangement
- natural lighting
- ventilation
- water supply
- drainage and sanitary conveniences
- facilities for preparation and cooking of food and for the disposal of wastewater and
- (most importantly) hazards under the HHSRS.

This means anything considered to be unfit for purpose can be brought before the courts without investigation by the local authority as was previously the case. If the courts find that the landlord is in breach of contract then the landlord can be held liable with penalties for failing to comply, including compensation, injunctions, and damages.

3.2.2 The Management of Houses in Multiple Occupation (England) Regulations 2006

The Management of Houses in Multiple Occupation (England) Regulations 2006 place the following duties on landlords to maintain their HMOs and to carry out safetymeasures:

- provide information to the occupier
- take safety measures
- maintain a good water supply and drainage
- supply and maintain gas and electricity
- maintain common parts, fixtures, fittings, and appliances

- maintain living accommodation and
- provide waste disposal facilities.

Occupiers also have the following duties:

- not to hinder or cause damage
- to dispose of rubbish as per instructions and
- otherwise comply with landlords' reasonable instructions in respect of fire safety.

Here is a sample of local housing authority expectations in a **larger** HMO (typically five or more occupants):

- class A or D mains-linked smoke detectors
- protected escape route must not pass through a higher risk area and must be kept clear of obstructionsand combustible materials
- doors leading onto the escape route should be fire-resistant for 30 minutes with intumescent strips/smokeseals
- the stairs must lead directly to the final exit without passing through a risk room
- the staircase enclosure must be of sound, conventional construction throughout the route
- if the property has a carbon-burning appliance, a carbon monoxide alarm must be installed
- one bath or shower for up to five tenants
- bathroom should not be more than one floor away
- for five people one toilet must be separate from the bathroom but can be in a second bathroom
- for six to ten people, two separate toilets are required, one can be in a bathroom
- at least 0.5m length of kitchen work surface space for each tenant
- at least one single cupboard storage space for each tenant
- fridge/freezer must be in one room
- exit doors should have thumb turn locks
- room size requirements (see section 3.2.3 below).

3.2.3 HMO minimum room sizes

These standards apply where some or all facilities are shared, including HMOs let on the following basis:

- non-cohesive – occupiers live independently of others, such as single room lettings or bedsitaccommodation (kitchen facilities in own room)
- cohesive – occupiers forming a group such as students, professional persons and others who interactsocially.

Where part of the property is not accessible during the inspection, any assumptions made regarding room sizes should be clearly stated in the valuation report.

The Licensing of Houses in Multiple Occupation (Mandatory Conditions of Licences) (England) Regulations 2018 introduced new minimum bedroom sizes.

Minimum room sizes apply to all HMOs:

- single occupancy rooms: 6.51m^2
- double rooms: 10.23m^2 and
- ceiling height: 1.5m.

Local authorities, however, can impose their own requirements, which in many cases supersede the national requirement. Valuers must be familiar with the information published on the local authority website in the areas in which they operate.

For measurement purposes usable space covers the floor area once deductions for chimney breasts have been taken into account. Ceiling height is also factored into the equation. Care should be taken with door swing calculations. Where the space immediately behind the door is no wider than the door itself, this will be considered an unusable space, and will be excluded from the measurement of the floor area of the room. Any bedroom less than 6.51m2should be disregarded from the rental and capital assessment.

Valuers must also check the relevant local authority amenity space standard requirements, as these will sometimes impose larger room sizes than the current minimum requirement. In addition, these amenity standards set out different minimum room sizes depending on the provision of separate shared living accommodation, or whether cooking facilities are included in the room itself. They also define how large the kitchen and shared living room should be depending on the number of occupiers. If a room is not large enough then there is a significant risk that it might have to be taken out of use, with clear implications on both the capital and rental assessment of the security.

The Regulation allows local authorities to enforce minimum bedroom size standards. If a licence holder fails to comply with the bedroom standards by letting a room to or permitting it to be occupied by more persons than is allowed under the condition in the licence, they will commit an offence and be liable to an unlimited fine if prosecuted or alternatively a financial penalty of up to £30,000 imposed by the Local Authority. The condition will not be breached by temporary arrangements, such as visitors sleeping on an occasional or temporary basis.

Particular care should be taken in respect of fully self-contained units where some local authorities are treating them as flats, and they may be subject to larger space standards. Increasing attention is being applied to the impact of psychological harm due to inadequate room sizes and consideration given to the ability to incorporate a list of basic furniture which is required for independent living.

The local authorities can also enforce (via Part 1 of the Housing Act 2004) using the Housing Health and Safety Rating System (HHSRS) risk-based methodology for assessing hazards, including crowding and space. Smaller units may be occupied by vulnerable members of society and local authorities will carry out enforcement if they perceive the units are detrimental to health. These factors and the high average HHSRS scores for crowding and space has led to a significant increase in the number of landlords who might be subject to enforcement under the Housing Act 2004, compared to statutory overcrowding (see section 3.2.4 below). It is, therefore, essential to be familiar with local authority requirements.

3.2.4 Statutory overcrowding

The statutory overcrowding standard is contained in Part X of the Housing Act 1985 but the standard has not been updated since 1935. Overcrowding is viewed as having a detrimental impact on an occupier's physical and mental health and is believed to be more common in rented accommodation. The COVID-19 pandemic has highlighted the risk of psychological harm associated with inadequate rooms sizes and overcrowded housing.

A dwelling is defined as overcrowded in section 324 of the *Housing Act* 1985 when the number of

people in a dwelling contravenes a 'room standard' (section 325) or a 'space standard' (section 326).

The room standard

'The room standard is contravened when the number of persons sleeping in a dwelling and the number of rooms available as sleeping accommodation is such that two persons of opposite sexes who are not living together as a married couple or civil partners must sleep in the same room.

For this purpose

(a) children under the age of ten shall be left out of account, and

(b) a room is available as sleeping accommodation if it is of a type normally used in the locality either as a bedroom or as a living room.'

The space standard

'The space standard is contravened when the number of persons sleeping in a dwelling is in excess of the permitted number, having regard to the number and floor area of the rooms of the dwelling available as sleeping accommodation.

For this purpose

(a) no account shall be taken of a child under the age of one and a child aged one or over but under ten shall be reckoned as one-half of a unit, and

(b) a room is available as sleeping accommodation if it is of a type normally used in the locality either as a living room or as a bedroom.

The permitted number of persons in relation to a dwelling is whichever is the less of

(a) the number specified in Table I in relation to the number of rooms in the dwelling available as sleeping accommodation, and

(b) the aggregate for all such rooms in the dwelling of the numbers specified in column 2 of Table II in relation to each room of the floor area specified in column 1.

(c) No account shall be taken for the purposes of either Table of a room having a floor area of less than 50 square feet.'

TABLE I	
Number of rooms	***Number of persons***
1	2
2	3
3	5
4	7.5
5 or more	2 for each room
TABLE II	
Floor area of room	***Number of persons***
110 sq.ft. or more	2
90 sq.ft. or more but less than 110 sq.ft.	1.5
70 sq.ft. or more but less than 90 sq.ft.	1
50 sq.ft. or more but less than 70 sq.ft.	0.5

Overall, Part X of the *Housing Act* 1985 comprises a very low, prescriptive standard, which includes

living and dining rooms as often being suitable as bedrooms. Using this Act rather than Part 1 of the *Housing Act* 2004, would maintain the use of a dated legislative system which does not adequately reflect modern day standards.

3.2.5 The Housing Health and Safety Rating System

In addition to the controls mentioned, non-compliance in terms of property fitness will be assessed by the local authority using the Housing Health and Safety Rating System (HHSRS), which is a risk-based approach. The HHSRS controls the standard of all properties, particularly tenanted HMO properties, which are susceptible to tenant complaints. The HHSRS assessment is based on the risk to the potential occupant who is most vulnerable to that risk. There are 29 housing hazards (summarised in the table below) and HHSRS assesses the effect that each may have on the health and safety of current or future occupants of the property.

The valuer should have an **awareness** of the HHSRS and the way in which it may be applied by an environmental health officer acting on behalf of the local authority, but it is not expected that a formal assessment will be undertaken as part of an inspection for valuation purposes. Any such assessment would be the subject of a separate instruction to a suitably qualified individual.

Excess cold or heat	Falls	Fire	Hot surfaces
Damp/mould	Carbon monoxide	Radiation	Electrical
Noise	Lead	Asbestos	Intruders
Crowding/space	Explosions	Domestic hygiene	Food safety
Personal hygiene, sanitation and drainage	Biocides/volatile organic compounds	Contaminated water	Structural failure
Inadequate lighting	Uncombusted fuel/gas	Entrapment	Poor ergonomics

The HHSRS enforcement framework is determined by the presence of a hazard above or below a threshold set in the regulations. Hazards above the threshold are defined as Category 1 hazards and those below as Category 2 hazards. The council must take enforcement action to deal with Category 1 hazards and may take action to deal with Category 2 hazards. Enforcement action includes:

- improvement notice
- prohibition order
- hazard awareness notice or
- remedial action.

A consultation exercise was undertaken in February 2019 and showed that, while there was considerable support for the strong link between health and housing that the HHSRS provides, simplification of the assessment process would be welcomed by all stakeholders.

The intention is to make the system easier to understand for landlords and tenants, correct the disconnect between the HHSRS and other legislative standards, and facilitate the effective enforcement of housing standards by local authorities. It will also address whether some hazard

profiles can be removed or combined to improve the guidance given to landlords and tenants. It will identify a simpler means of banding the results of HHSRS assessments so that they are clearer to understand and better engage landlords and tenants. The UK government review is due to complete within the next two years.

For more information, see the Housing health and safety rating system (HHSRS) guidance.

3.2.6 Fire safety (excluding risks associated with external wall systems on multi storey multi occupied residential buildings)

The introduction of the Housing Act 2004 and the Regulatory Reform (Fire Safety) Order 2005 (as amended) has placed responsibility on landlords, property managers and 'responsible persons' in charge of buildings, for fire safety provisions in multiple occupied housing.

The definitive guidance on fire safety for residential housing is provided by the Housing fire safety: Guidance on fire safety provisions for certain types of existing housing. This guidance is subject to review and it is expected that updates will be issued during 2022.

This guidance helps to manage the relationship between the *Housing Act* 2004 and the *Regulatory Reform (Fire Safety) Order* 2005 (FSO) by offering advice and assistance to enforcers, landlords, managing agents and tenants, among others, on ways to make residential buildings safe from fire, regardless of which legislation is relevant. All valuers operating in this area of valuation should be aware of this industry guidance. It is not expected that a valuer carrying out an appraisal for mortgage-lending purposes will confirm full compliance but simply identify that the property displays evidence, from a visual inspection, of standard fire protection equipment, including, for example:

- hard-wired smoke alarms
- heat detectors
- fire doors leading from high-risk rooms onto a protected fire escape route and
- emergency lighting in large HMOs.

As noted above, this paper does not cover risks associated with cladding, but valuers should be aware that the Fire Safety Act 2021 (FSO) became law in April 2021.

The *Fire Safety Act* clarifies the parts of a premises that apply under the FSO.

The FSO applies to all non-domestic premises in England and Wales (including multi-occupied residential buildings such as blocks of flats, although individual flats are excluded).

Responsibility for complying with the FSO falls on the Responsible Person, which may be the freeholder, management company or managing agent depending on local arrangements.

The new legislation clarifies that where a building contains two or more sets of domestic premises, the FSO applies to:

- the building's structure and external walls (including windows, balconies, cladding, insulation and fixings)
- and any common parts
- all doors between domestic premises and common parts such as flat entrance doors (or any other relevant door).

In addition, the Building Safety Bill is expected to become law in 2022 and establishes a Building Safety Regulator to implement and oversee a stringent regime for higher-risk buildings.

New measures proposed in the *Building Safety Bill* are intended to:

- ensure there are clearly identified people responsible for safety during the design, build and occupation of a high-rise residential building
- establish a Building Safety Regulator to hold to account those who break the rules and are not properly managing building safety risks, including taking enforcement action where needed
- give residents in these buildings more routes to raise concerns about safety, and mechanisms to ensure
- their concerns will be heard and taken seriously
- extend rights to compensation for substandard workmanship and unacceptable defects
- drive the culture change needed across the industry to enable the design and construction of high-quality, safe homes in the years to come.

3.3 Licensing

3.3.1 Mandatory HMO licensing

Part 2 of the Housing Act 2004 as amended by the reforms contained in The Licensing of Houses in Multiple Occupation (Prescribed Description) (England) Order 2018 details the licensing requirements for mandatory HMOs as follows:

- a mandatory licence is needed where a property has five or more tenants forming more than one household irrespective of the number of storeys and who share facilities such as a toilet, bathroom, or kitchen
- licensing is now extended to flats with five or more occupiers above and below business premises
- licensing includes up to two purpose-built HMO flats in a block but purpose-built flats containing three of more self-contained units are excluded
- the licence may be granted subject to conditions and is to be displayed at the property
- the licence is personal to an individual who will be the 'most appropriate person'. This is normally the person in control of the property and can be the managing agent
- there is a 'fit and proper person' test for the new HMO licence holder
- the licence specifies the number of permitted occupants – it, therefore, influences the rental assessment and capital value where the value reflects the capitalisation of a sustainable rent
- failure to comply is a criminal offence and can also result in a rent repayment order, loss of accelerated
- section 21 grounds for possession and a possible management order allowing the local authority to take control of the property.

3.3.2 Additional and selective licensing

Additional and selective licensing schemes are increasingly being implemented by individual local authorities, although there may be a lack of consistency between the authorities. They bring additional categories of HMOs into the licensing regime that fall outside mandatory licensing including shared houses/flats, and single residential units. These can often be in high density rental areas but also where there are perceived social issues, including areas around universities.

- **Additional licenses** are issued under Part 2 of the *Housing Act* and include a HMO

suitability assessment. If the local housing authority consider an area is being impacted by a significant shift across from family homes to HMOs and consequently there is a need to license certain HMOs that are not subject to mandatory licensing (such as HMOs with less than five tenants, section 257 of the *Housing Act* or purpose-built flats situated in a block comprising three or more self-contained flats) it can designate a specific area as subject to additional HMO licensing. This must be introduced in line with the statutory requirements under Part 2.

- **Selective licenses** are issued under Part 3 of the *Housing Act* and landlords do not have to satisfy a test that the property is suitable for multiple occupation.

Selective licensing applies to an area that is, or is likely to become, an area of low demand for housing and is experiencing a significant and persistent problem caused by anti-social behaviour attributable to occupiers of privately rented properties and some or all of the private sector landlords are failing to take appropriate action.

Selective licensing can be introduced by a local authority (subject to conditions) if the area satisfies one or more of the following conditions:

- low housing demand
- a significant and persistent problem caused by anti-social behaviour
- poor property conditions
- high levels of migration
- high level of deprivation
- high levels of crime.

Separately, some areas operate informal accreditation schemes, particularly in university cities where landlords and their properties are approved by the particular university or local authority for letting to students.

Find out more about licensing in a particular area on the Gov.uk website.

The local authority may not inspect the property when a licence is granted but will do so within five years. The existence of the licence does not, therefore, necessarily mean that the property is compliant, but at the point of inspection by the local authority environmental health officer, the property will be assessed against the HHSRS.

3.4 Housing and Planning Act 2016

Part 2 of the Housing and Planning Act 2016 refers to rogue landlords and property agents and allows a banning order to be made where a landlord or property agent has been convicted of a banning order offence. A database of rogue landlords and property agents has been established and the Act allows a rent repayment order to be made against a landlord who has committed an offence. Those offences include breaches of licensing requirements under the Housing Act 2004 and breaches of improvement orders and prohibition notices, as well as breach of a banning order under the 2016 Act. The Act also makes amendments to the Housing Act 2004 to provide that a financial penalty may be imposed by a local authority as an alternative to prosecution in relation to certain offences under the 2004 Act. A landlord or managing agent who is subject to a banning order cannot hold a HMO licence.

Part 3 of the 2016 Act deals with abandoned property in England and sets out the procedure that a landlord may follow to gain possession of a dwelling without the need for a court order. A private landlord may give a tenant notice that brings the tenancy to an end on that day if:

- a certain amount of rent is unpaid

- the landlord has given a series of warning notices and neither the tenant nor a named occupier or depositpayer has responded in writing to those warning notices before the date specified in the notices.

4 Valuation

4.1 Background and skills

The previous sections in this guidance note set out the legislative and other matters that valuers should be aware of before embarking on a buy-to-let or HMO valuation. In particular, valuers should:

- have sufficient knowledge of residential rental and capital valuations
- be familiar with the buy-to-let market in the locality of the property
- have a thorough understanding of the regulations affecting the HMO sector of the market
- be aware of the local authority's policy requirements on HMOs (which can vary according to the authority)
- be aware of any areas designated under article 4 directions (see section 4.7 of this guidance note)
- be aware of any area-wide selective or additional licensing schemes that can apply to both buy-to-let and HMO properties
- be aware that the valuation will assume, unless otherwise stated, that there are no restrictions to letting the property on standard residential terms.

While automated valuations models (AVMs) are being adopted on a modest scale for both capital and rental valuations of private rented sector homes, they have not been considered as part of this guidance note and valuers should refer separately to their client's instructions and guidelines if undertaking an appraisal based on AVMs.

The use of remote valuations, which do not require the valuer to physically attend the property, is gaining traction and valuers and clients must agree the approach and special assumptions to be applied under these circumstances.

The following circumstances are typical of the types of instruction/valuation reports that valuers may face. They are not exhaustive and are provided to assist valuers in the methodology that might be adopted in varying situations.

4.2 Single residential units

These comprise either a single flat or house, let (or proposed to be let) on a single assured shorthold tenancy (AST). These are the most common buy-to-let propositions, where a straightforward market approach valuation methodology will normally be used in arriving at both the capital and rental valuation. It is accepted that in certain areas, which now contain predominately tenanted accommodation, that the comparables available may only come from other investment property transactions that have taken place. In all cases, consider the current edition of the RICS guidance note Comparable evidence in real estate valuation. The capital valuation should be based on the special assumption of vacant possession unless otherwise agreed with the client in writing.

4.3 Small HMOs

These are typically dwellings in an area that comprises both investment- and owner-occupied houses, or in some cases just investment properties (high density student areas in university towns being an example). Facilities are normally communal and there are no significant conversion works

other than basic fire safety compliance and individual locks on doors. The occupancy will be on a single AST with multiple joint tenants, or with individual ASTs. The property will, therefore, fall within the definition of a HMO (three or more tenants forming two or more households sharing facilities) but may not be licensable. Here the valuer will probably have sufficient comparable evidence to apply a market approach methodology (as for a single unit). In certain areas, with a high density of other investment property, it is accepted that most of the comparable evidence will be investment property, with little evidence of owner-occupied sales. The rental assessment, however, can reflect the income received from multiple occupation, assuming this is sustainable, subject to any overriding guidance issued by the lender and assuming compliance with local authority requirements. Again, the valuation methodology will reflect the local market.

While the assumption has been made that small HMOs can be valued using the market approach, it is accepted that the valuer may wish to analyse the comparables on an investment basis. The rationale applied should include a comment on the method chosen.

4.4 Large houses in multiple occupation

In planning terms, a small HMO with up to six occupants falls into the C4 Use Class and larger HMOs with more than six occupants are considered *sui generis*. For further information, see the Planning portal.

4.4.1 General considerations for the valuation of all HMOs

HMOs can be particularly complex in terms of valuation methodology and compliance Refer to section 4.1 of this guidance note before accepting instructions to provide a report on any HMOs.

It may be possible to value the property having regard to comparable evidence of other similar investment properties being sold in the locality, where such evidence is readily available. This may well demonstrate that there is no significant premium attributable to the HMO use over and above the value as a single-family house. However, in many circumstances, where, because of the alterations and adaptions carried out, the property is not directly comparable with other properties in the area, an investment valuation could be considered.

For properties in mixed investment/owner-occupied areas any valuation would be expected to fit in with the tone of values in the area (making any reasonable and appropriate adjustments for extra facilities and adaptations). The extent of works required to convert a building into a HMO is fundamental when considering its value. If minimal work is required, it is logical that the property does not necessarily have an independent value as a HMO and should be assessed as a private dwelling with a modest premium for the work done. This is because the property is not particularly specialised compared to other similar asset classes. In other words, subject to planning consent, an investor could purchase a cheaper property in the same street and convert this to a HMO for a lower cost.

The following sections provide more detail on the different circumstances that valuers may face in dealing with HMOs, but are not exhaustive.

4.4.2 Area predominately owner-occupied but subject property used as HMO

Valuers may well come across a situation where, for example, a four-bed terraced house is used as a five-bed HMO with a licence and appears to be fully compliant. Other houses in the vicinity may be either owner-occupied or let as single-family units. Where the area is not subject to an article 4 direction, nor any form of additional licensing, valuers should consider the methodology to be adopted for both the rental and capital value. In such circumstances, where the evidence suggests limited demand for HMOs (the register of HMO licences on the local authority website may provide a steer) it is likely that there will be little evidence to suggest any premium value attached to the HMO. In such cases it is unlikely that an investor would pay any more than the vacant possession value in the locality (with perhaps a little additional value for any well-considered

expenditure to comply with a licence, if applicable). In certain areas it is possible that the value of a HMO may be lower than the surrounding owner-occupied stock. In those circumstances, local market knowledge should be applied.

4.4.3 House in mixed owner-occupied/HMO locality

Older properties (Victorian/Edwardian) are often converted to take advantage of the student letting market. Some conversions of, for example, former two-bed/two reception room houses with roof spaces converted to provide additional letting rooms are typical, so valuers need to be aware of the sizes of the rooms, irrespective of the number that are occupied or let (see section 3.2.2 of this guidance note for more information about minimum room sizes to comply with HMO regulations). Assumptions made regarding the size/standard of any room that is not accessible for inspection should be clearly stated. Assuming that there is a HMO licence in place or pending, valuers need to consider the methodology to be adopted for assessing the rental value and the capital value. There are several considerations for valuers in such cases. For example, with regard to the size of the rooms, are there issues around the sustainable number of occupiers? Just because there is a HMO licence in place or pending, it should not be assumed that the property is fully compliant, as there is a five-year period within which the local authority can inspect the property. In these circumstances the number of occupiers could be restricted to fewer than the number of bedrooms.

From a practical point of view (subject to client requirements), it is likely that, for properties in mixed owner- occupied/HMO localities, valuers may wish to take two approaches:

- an investment approach by capitalising the sustainable rent and
- a vacant possession approach based on local market evidence in the locality.

The valuer should also take account of any costs of compliance with HMO regulations.

4.4.4 HMO in areas subject to article 4 direction

Local authorities continue to make more use of article 4 directions (see section 4.7 of this guidance note) and other powers at their disposal, to control the type of residential market in certain locations, especially in areas close to hospitals and universities.

Take, for example, a large Edwardian house with an established lawful use/C4 consent as a HMO, in an area subject to an article 4 direction. In such areas there may be evidence of sales of HMOs on an investment basis with sales of owner-occupied properties of a similar size at lower values because they cannot be converted into HMOs without planning permission. An article 4 direction may well mean that no intensification of HMOs would be allowed.

In such circumstances scarcity value may apply if a HMO with established use/C4 consent and licence as necessary is in place, especially if it is fully compliant. In those circumstances valuers may consider an income approach by capitalising the sustainable rent (excluding utility costs) at an appropriate yield based on local market evidence. Alternatively, if there is comparable sales evidence that demonstrates an uplifting in value or premium for properties benefitting from established HMO use, this can be reflected in the valuation.

4.4.5 Sui generis HMO (more than six occupants)

In planning terms, larger HMOs, with more than six occupiers have their own use class (*sui generis*) and, therefore, are treated predominately on an investment basis, unless specifically agreed otherwise with the client. The planning position, compliance with the HHSRS, local authority requirements, market rent and adopted yield will be significant. Experience shows that many of these properties have been subject to an intensification of use and conversion to accommodate the higher levels of occupancy without formal planning consent being obtained. In such cases it would only be possible to regularise the situation by applying for a lawful development certificate

with evidence that the change of use to a large HMO took place more than ten years ago.

Valuers may be asked to report on a large house converted into, say, eight rooms or eight bedsits. The area is made up of mainly buy-to-let properties with few owner-occupied houses. The units, if bedsits, would not be capable of sale separately into the market.

It is important to note that if the property has been converted into self-contained bedsits or small flats it may still be classified as a HMO if it is not to a standard that complies with The Building Regulations 1991, as a minimum. In this scenario, the whole building may be classified as a HMO (see the definition in section 257 of the *Housing Act* 2004).

The methodology to be adopted for the valuation is likely to be an investment approach, capitalising the sustainable rent at an appropriate yield based on local evidence.

Where there is transactional evidence available it may be possible to compare the outcome of the investment calculation with the value of the property as a large house with vacant possession. In some instances, comparable investment sales of larger HMOs may also be available to analyse. For situations that are quite individual, valuers need to consider whether the property would actually transact at any higher investment value (compared with a 'bricks and mortar' value, whether for owner occupancy or otherwise). Be particularly careful where there is no demonstrated demand to support an investment methodology or where there is limited evidence at the level of investment value being sought.

4.5 Multi-unit blocks (excluding purpose designed investor only blocks)

These will be converted or purpose-built blocks of self-contained flats where it is proposed to secure a mortgage on the freehold title. Valuers should have an awareness of the legal requirements for conversions including the expectation in the market that a professional consultant's certificate or other suitable new build warranty is likely to be required by some lenders for recent conversions as well as the usual new home warranty on purpose-built blocks.

Refer to the lender's guidance notes for the required valuation methodology. In the absence of any such guidance, approach the valuation in two ways and then recommend the most appropriate for adoption:

- Firstly, the valuation will be based primarily on the capitalised rental income. Consider comparable sales evidence of other similar investment property in the locality where applicable.
- Secondly, where the property comprises individual units and the sum of the individual values more accurately reflects the overall value, then this approach may also be adopted. An example of this would be self-contained flats, which are capable of sale separately (possibly on a phased disposal basis, depending on lender guidance) with the sum of the individual values adjusted to reflect the fact that they are on one title. In these cases, an allowance should be made to reflect the fact that expense will be incurred in creating separate leasehold titles, holding the tenanted property and investor/developer profit, etc. to facilitate sale. The valuation form should allow for this type of reporting.

When considering the valuation methodology to be applied, valuers should have regard to the occupier profile and what is right for the area. There may be instances where all flats in the block are fully self-contained, but the development is only likely to sell to an investor as a single entity, in which case valuers should adopt an investment approach.

Valuers may be instructed to value the freehold of a multi-unit block where a number of the flats have been sold off on long leases. In this scenario, there should be a performing block management arrangement in place. Valuers should also be aware of enfranchisement provisions. Once 50% or more of the units are sold separately, the freehold then needs to be offered to the

leaseholders prior to disposal on the open market. Reference should be made to lender policy in this respect.

4.6 Rental value, sustainable rents and use of comparable evidence

The rental figure required is to be a market rent and should comply with RICS Valuation – Global Standards, VPS 4, Sections 5 and 8, that it is an unfurnished, six-month AST. The figure should be a sustainable rent and not one distorted by temporary factors of high demand, such as:

- seasonal workers
- holiday lets
- asylum seekers or
- other special cases.

It is acknowledged there are a variety of methodologies that may be applied to achieve market rent and for all rental valuations consideration must be given to the lender's instructions, so the rental value provided conforms to the client's requirements (see also section 2.3 of this guidance note)

Special care should also be taken with new build property, particularly in large developments and city centres where a similar 'new build' factor will apply to rent as it does to market value. Initial rent on such property will attract a new build premium that will not necessarily be obtainable after the first letting.

Valuers should also be aware of the impact of rental incentives in respect of properties suitable for buy-to-let investment. Guaranteed rents that are above market rent and cashbacks in lieu of rental income for several years may affect price. Valuers should consider these impacts and report accordingly. Also, if a property is likely to incur higher-than-average maintenance costs because of its age, type, existing condition or intensity of occupation this should be identified in the report, as the proportion of rent required for reinvestment will exceed normal levels and accordingly reduce net income.

Valuers should fully research, document and retain comparable rental evidence in the same robust way as they would for determining market value. If there is insufficient or limited evidence, they should either decline to provide a market rent figure, or clearly state the limitations of accuracy.

Allowances from gross rents and yield considerations

The valuer may choose to adopt either a gross or net yield approach for an investment calculation. Where properties that have been analysed for comparable yield evidence are similar, a gross yield may be appropriate. For more complex or individual properties, a net yield approach may provide a more accurate assessment and allow all relevant expenditure incurred by the landlord to be factored into the calculation.

Relatively high-gross rental generated from multiple occupation rents appears attractive, **but** a high management input and the incidence of other costs need to be factored in. Consider the following:

- health and safety plans/fire risk assessments/asbestos management plans
- application of management regulation standards in terms of work requirements
- HMO licensing: cost of application fee, any additional manager fee and work requirements
- costs associated with complying with fitness standards (HHSRS)
- achieving the minimum EPC rating
- the tenant profile can often require cash collections and landlord meter top-ups

- where utility costs are non-reclaimable (inclusive rents) or only partially reclaimable (tenant meter cards)this should be reflected in a deduction from gross rents
- in HMOs, council tax is often levied on the landlord (outside any void periods, properties occupied solelyby students in full-time education are not liable for council tax)
- relatively high maintenance costs are a common factor with old, large, converted properties
- high degree of wear and tear with intensive use/high density occupation
- it may also be appropriate to reflect quantitatively an allowance for one or two voids if the profile of theproperty, area and tenant indicates that this is appropriate
- insurance premiums may be higher than usual, depending on the area/tenant profile and the history ofclaims
- dealing with the local authority (for housing allowance payments) and redirecting payments directly tothe landlord can take time and can be reflected in management fees
- a restriction on occupation, e.g., small rooms, (see section 3.2.3 of this guidance note) also needs reflecting in the achievablerental value.

These considerations are in addition to the usual risk profile associated with the buy-to-let sector of the residential property market. Implicit tenant issues according to the local tenant profile and market are generally reflected in the yield. Such factors can include:

- the general high turnover of tenants with associated re-letting costs and voids
- costs associated with evicting tenants, which can arise more frequently and be expensive relative to low rent receipts per unit of accommodation
- landlords becoming involved with anti-social behaviour issues including complaints from other tenants, neighbours and the police
- a general high ongoing management requirement (this should be factored into the yield)
- the general state of the local market and the prospect of functional obsolescence is a risk that should be factored into the yield adopted
- housing allowance payments are different in each local authority and they can change. Some authorities may reduce rental income (reduced housing allowance payments) but the increase in the age threshold for one bed self-contained accommodation can potentially increase tenant demand in HMOs locally.

Valuers should be clear as to the basis of the reported market rent, that is, what is and what is not included in the quoted rent. Gross or net rent is usually not enough. Valuers should refer to the current edition of the RICS guidance note Comparable evidence in real estate valuation. It is important that valuers understand how the market rent has been arrived at by reference to the comparable evidence and what adjustments have been made to compare like-with-like. It is acknowledged that obtaining such detail on rental evidence can be difficult.

Valuers should also be careful not to double count when calculating a net rent, i.e., the matters that have been deducted from a gross rent to arrive at a net rent should not also be reflected in the yield adopted to capitalise that rent.

Valuers should fully appreciate the importance of the gross market rental value, making it clear it has been adjusted for inclusive utility costs and any other services provided such as broadband to give an adjusted gross rent. This is critical information for the lender as it is a key component in the lender's assessment of the maximum loan amount and affordability.

The valuation figures adopted should be based on evidence that can be validated through the various sources that are available in the market.

4.7 Planning – Town and Country Planning (Use Classes) Order 1987 (as amended)

Legislation in this area of housing continues to evolve and valuers should ensure they keep up-to-date, including with the latest changes to the Town and Country Planning (Use Classes) (Amendment) (England) Regulations 2020, which came into force on 1 September 2020.

Planning controls to be considered in the valuation of HMOs are as follows:

- change of use in England from a single residential unit (Use Class C3) to a small HMO, up to and including six sharers (Use Class C4) falls under permitted development
- moving from C4 to C3 is also a permitted change of use
- local authorities can elect to use an article 4 direction order (subject to a 12-month notice period) to withdraw these permitted development rights in a particular area, which will result in the need to obtainplanning consent for this change of use
- in addition, the local authority may require the landlord to register and established use at the time thearticle 4 direction order comes into effect
- planning consent is still required for the change of use to larger HMOs (more than six sharers) being in the*sui generis* planning use class
- some local authorities may make exceptions on occupancy numbers if the property is effectively stillcapable of being occupied by a group of tenants living as a single household
- the above requirements are in addition to the fact that HMOs, by their very nature, often involve internalalteration/redesign and the possibility that extensions have been added over previous years, for which normal statutory planning and building regulations documentation would be required for the present physical form of the building
- the lack of paperwork for planning and building regulations consents could indicate issues of non-compliance or, at the very least, affect future saleability if adequate documentary evidence is not available
- a lawful development certificate may be required to prove an established planning use
- separate departments of the local authority deal with:
  - planning
  - building regulations
  - HMO standards/licensing

Approval from one department does not imply compliance with another.

When assessing a property in an area where there is an article 4 direction order, a property already let (prior to implementation of the order) with up to six tenants as a ‘small’ (in planning terms) HMO may continue to be rented on that basis so long as it is not subsequently re-let as a single unit. The property may, therefore, command a premium over and above the value of a neighbouring house currently in single occupancy if the local authority refuses consent for change of use for that property from C3 to C4.

5 Matters for further consideration

5.1 Buildings insurance GB1-22-016456

Valuers should ensure that the reinstatement cost given reflects the full cost of rebuilding the property, including fixtures and fittings, domestic outbuildings and garages, terraces, walls and fences all included as part of the property or for which the owner may be legally responsible. For

HMOs, appropriate allowance should be made for additional facilities, such as multiple kitchens and bathrooms. The figure quoted should also allow for site clearance, professional fees, removal of debris charges and any local authority costs.

The lender will expect to be alerted to areas that are associated with flooding (see section 5.2 of this guidance note) coastal erosion, or any other factors that may potentially affect the structural stability of the building and the buildings insurance cover.

The reinstatement cost is usually calculated using the BCIS Rebuild Online. The reinstatement value given may reflect the more complex nature of the property or multiple unit configuration with additional allowances having been made. The lenders/applicants should be made aware that in some circumstances these allowances may be inadequate and are advised to obtain specialist advice from a chartered quantity surveyor.

5.2 Leasehold property ground rents and onerous restrictions

Ground rents on leasehold properties can be fixed or escalating. The lease will specify when the ground rent is reviewed, on what basis, and by how much it increases. Some modern leases can contain escalating ground rents, which may result in onerous and substantial increases. Ground rents are, therefore, not straightforward and can have an impact on the market value of the property. The valuer should make appropriate enquiries and consider the impact, if any, on the capital value of any leasehold property and should be considered alongside lender criteria.

The issue of escalating ground rents is of particular concern on new build sites, where investment value can be created by drafting leases in a manner that secures a ring-fenced income stream for future freehold owners. This can take the form of shortening of the lease term, imposing escalating reviews, tightening of the regularity of rent review clauses, introduction of notice fees for alterations and other income generating provisions. Such clauses may have implications for the market value of an investment property and, again, valuers should make appropriate enquiries as to lease terms and consider the impact on market value and suitability for mortgage purposes.

The *Leasehold Reform (Ground Rent) Bill* currently passing through Parliament will put an end to ground rents for new, qualifying long residential leasehold properties in England and Wales. It is intended that this will lead to fairer, more transparent homeownership for thousands of future leaseholders.

This is the first of a two-part legislation to reform the leasehold system. The Bill focuses specifically on ground rent clauses within future long residential leases, and further leasehold reform is to follow later in this Parliament.

This Bill will mean that if any ground rent is demanded as part of a new residential long lease, it cannot be for more than one peppercorn per year meaning that future leaseholders will not be faced with financial demands for ground rent. The Bill bans freeholders from charging administration fees for collecting a peppercorn rent.

Many buy-to-let landlords invest in one or more single leasehold unts within residential blocks where onerous lease provisions (and high services charges) could impact the value and performance of their investment.

Valuers should, therefore, keep themselves appraised on the progress of the forthcoming legislative changes.

5.3 Climate change

Mortgage lenders have strengthened their green propositions to encourage landlords to add energy efficient properties into the private rented sector. The energy efficiency of the private rented sector has improved significantly over the past ten years, but it is recognised that more needs to be done as the UK moves towards a carbon net zero target.

The first step is encouraging changing buying behaviour so that more properties with EPC ratings A-C are added to the sector. The next step will be to upgrade existing homes in the private rented sector, and lenders are looking at ways they can support landlords in achieving that.

Across the wider market, lenders are to commit to back book average of grade C by 2030.

See the RICS website for further information on wider RICS-related activity and thought leadership in relation to sustainability.

5.3.1 Flooding

Valuers of properties in the residential lettings market should be aware of an important exclusion to the historic commitment of insurers to provide policy cover on residential properties at risk of flooding.

The Flood Re scheme came into force in April 2016. This offers insurance protection for flood risk properties via a levy on household insurance policies for most owner-occupier residential properties. However, the scheme excludes certain types of property occupation such as properties occupied under residential tenancies.

Landlords and/or tenants will, therefore, have to purchase flood insurance in the open market, if it is available, at whatever price and excess level insurers set for the flood risk profile of the particular property. In some cases, insurance may not be available or may be uneconomical.

Valuers should consider this, and any effect on value when doing a valuation for buy-to-let or HMO properties that may be in a flood risk area.

5.3.2 Energy Performance Certificates

From 1 April 2020 all properties with existing tenancies are required to have an EPC rating of E or above.Exemptions may apply if the costs to bring the property up to standard involved are prohibitive.

It is further proposed that the minimum rating will change to C by 2025/2026 for new tenancies and by 2028 for existing tenancies.

As the energy efficiency of domestic properties and in particular, rented homes, is raised through the proposed uplift in the statutory minimum EPC ratings, valuers will be increasingly required to understand the implications, both in terms of the upgrading costs to achieve compliance, and any quantifiable difference in value that may in due course, be seen in better rated properties. Consideration will need to be given to the EPC rating of the subject property and that of the comparables adopted. There will also need to be a recognition of the effect that the rating changes might have in recommending a property as suitable security for a buy-to-let mortgage. It is acknowledged this is an area of significant change that will gradually evolve.

5.4 Financial crime

Financial crime is prevalent in the buy-to-let and HMO investment market, therefore, valuers should be familiar with some of the potential indicators, such as:

- introducer-made appointments
- no borrower name on instruction
- instructions issued at weekends
- evidence of connections between the seller/estate agent and introducer/broker/financial adviser/lettingagent
- selling or letting agent out of area from the property
- telephone number for the borrower being the same as that for the introducer

- application as HMO but HMO requirements not met and/or property is in an area where there would beno demand
- instruction doesn't indicate that the property is a HMO, but it meets the requirements and there arelocks on all the doors
- estimated rental income and/or market value is based on the property being a HMO, but property should bevalued on an AST basis and, therefore, estimated values are too high
- high capital value based on rental figures that are not realistic
- high capital value based on rental figures that are achievable, but the property is in poor condition
- high occupancy levels that are not realistic, resulting in false income levels.

This is not an exhaustive list and valuers should keep an open mind. However, if an issue is suspected then valuers should ensure that they make the appropriate suspicious activity report (SAR) to their lender client. Currently, official SARs are made to the National Crime Agency under legislative obligations. However, it is recognised that valuers and lenders have introduced informal referral or reporting arrangements around financial crime.

Property hijack

A trend has been identified in respect of buy-to-let properties that are at high risk of take-over as the owner does not occupy the property. This is especially high if the property is owned unencumbered, or the owner is recently deceased, which the valuer may not be aware of. A typical example is a fraudster gaining access to the property on a six-month AST and then impersonating the owner. In this instance it is more likely to be a buy-to-let remortgage application but can be sold on as a purchase as both the 'new' borrower and 'new' seller will have fraudulent documents.

Anti-money laundering

RICS have published a professional statement on Countering bribery and corruption, money laundering and terrorist financing (effective from 1 September 2019)

This professional statement sets out mandatory requirements for RICS members and regulated firms in relation to bribery, corruption, money laundering and terrorist financing.

Modern slavery

There are practical and financial risks for landlords when victims of slavery are living at their properties. Landlords may become victims of illegal subletting, with criminal gangs renting properties to let them out again or house their victims. In addition, some forms of modern slavery may involve activities such as cannabis cultivation, which can cause significant damage to property and invalidate insurance, potentially incurring significant expense. Landlords can be criminally liable if they are aware illegal activity is taking place and do not report it or takes step to prevent it.

Some examples of identification of modern slavery:

- Are occupants of the property able to communicate on their own behalf?
- Do they allow others to speak for them when spoken to directly?
- Do occupants of the property act as if they were instructed by someone else?
- Do occupants of the property appear withdrawn or frightened?
- Is there evidence of poor living conditions, subletting or over-crowding?
- Are the people occupying the property the same as those named on the tenancy agreement?

- Is the person paying the rent different to the person occupying the property?
- Does one person pay rent on behalf of other occupiers and is that person named on the tenancy agreement?
- Has somebody offered to pay the full cost of the tenancy upfront?

5.5 Refurbishment products

Where a valuation instruction is issued on a refurbishment product loan, the valuer should refer to the lender's specific guidance regarding the basis on which the property is to be assessed.

5.6 Reporting

Reporting formats vary between lenders but should be suitable for the type of property being appraised and allow valuers sufficient scope to report fully on all relevant aspects of the property outlined in this guidance note.

6 Scotland, Wales, and Northern Ireland

6.1 Scotland

Scotland has a different legal system and a different approach and legislation for the letting of residential property. The references in this guidance note are based on legislation and practices adopted in England, and do not necessarily apply in Scotland. While the general approach to the valuation of residential property for buy-to-lets and HMOs is similar, it is vitally important when carrying out a valuation of such property that the valuer is fully familiar with the current Scottish legislation.

The Private Housing (Tenancies) (Scotland) Act 2016 came into force in Scotland on 1 December 2017 and introduced an end to fixed term tenancies and 'no fault' evictions. Tenants can now give 28 days' notice to leave. A new tenancy granted after 1 December 2017 will be a private residential tenancy, as long as:

- the property is let as a separate dwelling – this includes the renting of a bedroom in a property
- the tenant lives in it as their main home or
- it is not excluded under the Schedule 1 of the 2016 Act (includes shops, licenced premises, agricultural land, student lets, holiday lets and social housing).

The following brief list includes some of the key points to consider when assessing a Scottish buy-to-let property:

- all landlords in Scotland must to be registered
- the deposit under a private residential tenancy must be lodged with a statutory authorised party
- gas safety certificates must be produced yearly, and electrical safety certificates must be produced every five years
- under the new fire and smoke alarm standard, which applies from February 2022, every home in Scotland must have interlinked fire alarms
- the right to rent, introduced in England and Wales from 1 February 2015, does not apply in Scotland
- for assured and short assured tenancies, the landlord is required to provide a tenant information pack. This gives various details about: the tenancy, the property

(including copies of certificates for gas safety, electrical safety, energy performance and permitted number of occupants that can live in the property), the landlord and details of the landlord's and tenant's responsibilities

- a HMO is a property rented by at least three unrelated people forming more than one household who share a bathroom or toilet and kitchen (also known as a house share)
- a large HMO (in licensing terms) has at least five tenants living there, forming more than one household. The property is at least three storeys high, and facilities are shared.
- HMOs with more than six persons and multi-occupied flats with more than three persons will generally require planning permission in addition to a licence. Otherwise, the expectation is that planning permission is not needed but a licence is.
- HMOs must be licensed.

6.2 Wales

Part 1 of the Housing (Wales) Act 2014 came into force on 23 November 2015 and requires all landlords, agents or managing agents of residential rental properties in Wales to register with Rent Smart Wales. Applicants have 12 months to comply with the legislation. The applicant(s) may be expected to provide the lender with a copy of the registration from Rent Smart Wales either prior to offer (where registration is complete) or otherwise provide a copy of the submitted registration application (together with a copy of Rent Smart Wales acknowledgement) if subject to a current application. A landlord who self manages and is not licensed to carry out property management activities commits an offence and is liable on conviction to a fine.

From 15 July 2022, the Welsh government plan for the Renting Homes (Wales) Act 2016 to change the way all landlords in Wales rent their properties. The Act requires a written statement of occupation contract clearly setting out the rights and responsibilities of landlords and those renting from them. The occupation period is for a minimum of six months. Landlords must ensure that the property is fit for human habitation. The Act protects tenants from eviction for merely complaining about the condition of the property. Under this legislation, landlords can repossess abandoned properties without a court order. (This is only a brief outline and not an exhaustive list of the Act's full provisions.)

Welsh local authorities can require landlords to obtain planning permission to change the use of a property from a single household (C3) to a house in multiple occupation with between three and six unrelated tenants (C4). However, the change of use from a small HMO (C4) back to a single household (C3) will be permitted development.

Where an investment property comprises seven or more tenants, the landlord would have to apply for planning permission as a *sui generis* HMO (defined as 'of its own class') depending on the living arrangements of the seven or more tenants and whether they form a single household.

6.3 Northern Ireland

The Houses in Multiple Occupation Act (Northern Ireland) 2016 came into effect on 1 April 2019. It is now it a statutory requirement for all HMOs in Northern Ireland to be licensed unless the property is covered by a temporary exemption notice.

The HMO Licensing Scheme replaced the HMO Registration Scheme, formerly managed by the Northern Ireland Housing Executive. Any HMOs that were registered in accordance with the statutory Registration Scheme were converted to licences on 1 April 2019.

A house in multiple occupation (HMO) is defined in section 1 of the *Houses in Multiple Occupation Act (Northern Ireland)* 2016as living accommodation in a building or part of a building (for example, a flat) that is occupied by three or more persons forming more than two households as their only or main residence.

In accordance with article 3 of The Planning (Use Classes) Order (Northern Ireland) 2015 , HMOs have been established as a *sui generis* use class and consequently owners of HMO accommodation are required to have planning consent.

The local authority may only grant a licence if:

- The occupation of the living accommodation as a HMO would not constitute a breach of planning control.
- The owner of the living accommodation, and any managing agent, are fit and proper persons.
- The proposed management arrangements for the living accommodation are satisfactory.
- The granting of the licence will not result in overprovision of HMOs in the locality in which the living accommodation is situated.
- The living accommodation is fit for human habitation and is suitable for occupation as a HMO by the number of persons to be specified in the licence or can be made so suitable by including conditions in the licence.

Appendix A: Valuer's checklist

Valuers should (in no particular order):

- have suitable experience of the rental market and property type to which the valuation instruction relates, particularly if it is specialist (section 2.4)
- be familiar with the client's requirements/expectations and consider any guidance notes provided by a lender (section 2.1)
- ensure service level agreements reflect the potential complexity of the property to be valued and the valuation methodology to be applied (section 2.4)
- recognise when the property fits the definition of a HMO and consider the implications for a landlord in terms of compliance and cost (section 3.1)
- have knowledge of the regulatory standards that apply to rented accommodation and the additional requirements that are relevant to houses in multiple occupation (section 3.2)
- appreciate that on inspection by a local authority environmental health officer, a property will be assessed against the Housing Health and Safety Rating System (HHSRS) (section 3.2.5)
- be familiar with the basic fire safety protection measures required in rented accommodation (section 3.2.6)
- consider whether the room sizes are adequate to be classed as lettable accommodation and recognise that published standards may not always be consistent between different local authorities (section 3.2.3)
- keep up-to-date with changes in relevant legislation and local authority requirements as published online (section 3.2.2)

- assess if the property requires a licence. A mandatory licence will be needed where a property has five or more tenants sharing facilities (section 3.3.1)
- know if a local authority has introduced discretionary/additional or selective licensing schemes (section 3.3.2) and/or article 4 direction orders within the value's area of operation (section 4.4.4)
- provide clear and concise advice to enable appropriate legal enquires to be made during a lender's completions process to ensure the property conforms to all relevant legislation (section 2.2)
- be aware that a use class change from a single dwelling to a HMO with up to six sharers (C3 to C4) is permitted if there is no article 4 direction order, but more than six tenants may require *sui generis* consent (section 4.7)
- remember that an independently assessed and sustainable rental valuation is critical to a lender's underwriting process (section 2.2)
- recognise that any enforcement action by a local authority that reduces the rental income could adversely affect the value of the client/lender's security (section 2.2)
- be aware of the minimum requirement for an E rating or above on EPC certificates and proposals for a minimum C rating for new tenancies from 2025 (section 5.3.2)
- keep up-to-date with future regulatory/legislative changes affecting the private rented sector and their likely impact for landlords operating more complex forms of residential investment property (section 1.6)
- apply the most appropriate valuation approach having regard to any guidance included with the valuation instruction in addition to the information in this guidance note (section 4)
- where possible, value the property based on market approach (section 4.3)
- when it is necessary to apply an income approach because of the individual nature or complexity of a property, ensure yields applied are supported by comparable evidence and always carry out a logic check to ensure the valuation assessed is consistent with the tone of values in the area (section 4.4.3).