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The Value of Surgeries in Today's Property Market

November 2018

This firm regularly undertakes valuations of doctors' surgeries, predominantly for partnership purposes. We are sometimes also asked to review valuations provided by other firms, and it is interesting to observe the trends in valuations – particularly in those repeat valuations relating to the same property.

In recent years, the valuation of surgery premises has generally increased significantly and I am often asked: why? In the main, the answer is *interest rates*, which remain historically low; and whilst interest rates have increased recently, the increase was very modest.

It follows that the investment yields used in the valuation of surgeries (along with most commercial properties) also remain low, and have tended to reduce further as the long term forecast for interest rates remains generally at low levels. This means that investors are prepared to accept a lower yield, i.e. rent as a proportion of market value (or purchase price), as the rental income is still higher than would be achieved from other forms of investment, such as putting money in a deposit account (this also means it is a good time to consider selling surgeries, but that is another topic).

Whilst most valuations of surgeries are not due to a transaction of the property as an investment, it is the potential that the property can be sold to an investor that underpins the valuation for partnership purposes.

Having said that, when a property is sold as an investment, there is a lease is place under which the rent is paid to the landlord. With partnership and assets, rarely is a lease in place – therefore, if the property is to be sold as an investment, there needs to be a lease granted, which in turn needs to be approved by the NHS. The valuation exercise needs to take into account the cost of creating that lease and, moreover, the time taken to draft a lease and seek approval from NHS.

Accordingly, the valuation for partnership purposes tends to be lower than if the property was to be sold as an investment property, typically by way of a sale and lease back transaction.

The following table provides a guide to the yields achieved for different types of surgery premises in the market when surgeries are sold:

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Grade	Description	Yield Range
Grade A & Portfolios	New purpose built	4.0% - 4.5%
Grade B	Slightly older purpose built	4.5% – 5.5%
Grade C	Older purpose built (refurb & extend) House conversions with extensions	5.5% – 6.5%

The other component to the valuation is the rental income. Over the last ten years or so, surgeries have generally seen very modest increases in rental income, with District Valuers tending to resist increases in rent, in line with other types of property. Often without there then being much comparable evidence relating to doctors' surgeries, it is often not considered worthwhile pursuing the matter to dispute resolution. This perpetuates the situation of very modest levels of rental growth; however, the situation is changing.

Change is being brought about through the desire for new medical centres to be built, and the corresponding levels of rent that need to be agreed between the parties to make the new medical centre viable.

Land values have increased (because the land can be used for an alternative form of development that may be more lucrative) and costs of construction have increased significantly.

In order for a new medical centre to be financially viable, the level of rent required today is significantly more than was required even as recently as five years ago. This is partly why the Department of Health are keen to fund premises by way of capital payments, as a one-off bullet payment to fund the construction of a medical centre as opposed to committing to full revenue cost immediately the medical centre opens.

The current means for the capital funding of medical premises is generally under the Estates & Technology Transformation Fund, but there is also increased funding available for improvements, extensions and refurbishment of premises, by way of improvement grants.

When a valuation is undertaken for partnership purposes, this needs to reflect the funding of the premises, with the main rental income being the notional rent together with any other rental income from other parts of the premises, such as community staff, pharmacy or the

occupation other parts of the premises.
With regard to notional rent, with rent reviews occurring every three years there is often a rent review outstanding or the next rent review is shortly due. Either way, the valuer needs to have regard to the extant rental income as received, and also needs to provide opinion as to the outcome of the outstanding rent review and/or the outcome of the next rent review. A lower yield tends to be applied to the extant rental income (since this is established and is considered to be secure income) with a higher yield applied to the additional rent that the valuer considers is likely to be achieved as result of the rent review.

This assumes that the valuation of the surgery is being undertaken assuming the property is continuing to be used as a surgery. Sometimes valuations are required based on an alternative use of the property, typically for residential development, and the resulting valuation figure can be significantly different. The appropriate basis for valuation should be stated in the Partnership Agreement but, if not, this needs to form part of the instruction for the valuer.

The valuation based upon existing use needs to consider the suitability for the premises for the provision of primary care. This needs to take into account the location of the property, the specification and condition of the property, and how this meets the current needs of primary care. It must also consider the flexibility of the premises and how it may be extended or reconfigured (if appropriate) to meet future needs. This all needs to be considered in the context of the profile of the incumbent practice in terms of the range of services provided, patient list size and age profile of the partners.

Even though the valuer may be asked to undertake a valuation based on existing use, as indeed may be stipulated in the Partnership Agreement, it is sometimes apparent that the property is no longer suitable for primary care or is not considered suitable for the long term provision of primary care. In such instances, the valuer needs to revert to the client to advise as such, and it may sometimes be necessary to provide valuations based both on existing use, and possible alternative use of the property.

It is for this reason that advice should be sought from suitably experienced valuers. Often future problems are stored up when valuers who do not have the necessary expertise in primary care properties, undertake valuations.

I will be glad to discuss your requirements for valuations with you and often liaise with solicitors when Partnership Agreements are being drafted to ensure that appropriate wording is included in those documents.