

## APPENDIX 1

# The Relationship Between Commercial and Industrial Land Values

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SHOP AND OFFICE buildings of similar quality command such varied rents and prices, even at the local level, that the value of commercial land has proved intractable to generalisation at the regional and national levels.

This fact is recognised in the Inland Revenue Valuation Office's *Property Market Report* which, according to the preface of the Autumn 1985 issue, 'incorporates views and records information about the property market from the 160 District Valuers throughout England and Wales', and, in the words of the Chief Valuer, has 'access to an unequalled pool from which to draw for independent analysis and informed comment on all aspects of the property market.' This six-monthly Report therefore contains charts summarising the regional distribution of land values in the residential, industrial and agricultural sectors. Yet it is unable to provide one for commercial land. The reasons for this are given on page 29:

District Valuers are asked to comment generally on the activity in and market for land for office and shop development in their areas. This is perhaps the most difficult of all questions to answer. Sites are rarely purchased clearly. Rather, they tend to be an assemblage of various interests and ownerships acquired over possibly lengthy periods.

Attempts to identify meaningful prices to try and establish patterns and trends for the purposes of this report have long since been abandoned. It might in any case be argued that land does not have a value, merely a price that is scheme specific and even peculiar to a particular developer.

Whatever the view of the Valuation Office this study could not refrain from attempting to place an aggregate value on commercial land simply because of the difficulty of the task. Its returns are no different in kind from those of other sites, so the asset value of British land would be incomplete without it.

One way to tackle the problem was to judge the multiple by which the value of a hectare of commercial land on average exceeds the value of a hectare of industrial land, and then to proceed from the regional averages for the latter to posit the regional averages for the former.

Evidence for this relationship was published in the *Property Market Report*. The Central Statistical Office commissioned a sample survey by District Valuers of industrial and commercial property values in England and Wales as at December 31, 1985. The summarised results appeared in the Spring issue for 1987. We argue in Chapter 8 that the site value findings are a considerable underestimate. What matters for our present purpose, however, is the extent to which the under-estimate varied between sectors.

The main reasons for thinking that there was variation are the surprising facts that the survey found "little variation" in the proportion of site value to site and buildings value between different types of buildings, and that nevertheless it found the proportion for factories and mills (35.9%) to be greater than the overall average (31%). One would expect the proportion to be larger in the commercial than the industrial sector because it occupies relatively central, high value locations without containing buildings of comparable greater value. Offices, it is true, are at least twice as expensive per square metre as shops, factories and warehouses to build, and contain more floorspace per hectare, but they are also particularly prone to depreciation.

Two factors may account for the unexpectedly low values put on commercial sites. First, the degree of obsolescence of many office buildings may have been under-estimated — this is commonly the case, according to recent research — which lowers their site value residuals. Second, the requirement to value sites at existing use rather than full development use may have been more limiting in the commercial sector, where the scope for achieving high land values is much greater.

Supporting evidence for a higher multiple between commercial and industrial values than implied by the DV survey comes from the CSO's own tentative calculations (see Chapter 8) and the Whitstable Site Value Rating survey. In the former, the aggregate land value of private sector non-residential buildings and civil engineering works in the UK in 1985 was calculated as 35.6% of the combined value of land and buildings by subtracting capital stock estimates from balance sheet valuations. This proportion was higher than in the DV survey despite including Scotland and Northern Ireland, which would certainly have lowered it, and also North Sea oil and gas installations, which were counted as having no land value at all. Differences in treatment of depreciation are unlikely to explain the difference as the capital stock estimates assume remarkably long economic lives for buildings.

In the Whitstable survey the aggregate annual rental value in February 1973 of land used for commercial purposes was found to be 15% greater than the aggregate annual rental value in mid-1972 of commercial land and buildings together as indicated by the revaluation for normal rating purposes (The Land Institute 1974: 25). For industrial sites, however, the former was found to be just less than half of the latter. Both sectors in the town were considered to have 'depressed land values' at the time, and commercial land values had not risen dramatically in the intervening months. It is therefore clear that the land value proportion of property values was much greater in the commercial sector.

These lines of evidence justify us in assuming a greater commercial site value total than that recorded in the DV survey. Subtracting the survey's £44bn capital value of factories, mills and warehouses, excluding rateable plant and equipment, from the grand commercial and industrial total of £173bn leaves £129bn for the capital value of commercial property. Assuming that factories and warehouses had 36% of their value in their sites, the aggregate industrial site value was £15.84bn. Assuming also that commercial properties on average had 45% of their value in their sites (increasing the survey's finding by just over 50%), the aggregate site value becomes £58.05bn. Applying the areas of land calculated for each sector in Chapter 4 (Table 4: VII), 93,000 ha and 40,050 ha respectively, we find that industrial land was worth on average £170,000/

ha and commercial land £1.449m/ha, giving a ratio of 1 to 8.5.<sup>1</sup>

As a check, if we were to divide the rough site value totals of shops, offices and restaurants (£46.5bn) and of factories and covered warehouses (£15.84bn) by the available floorspace figures (132mm<sup>2</sup> and 369mm<sup>2</sup> respectively) we would expect to find a smaller multiple, other things being equal, because the office area is greater relative to the industrial area due to its being multi-storey. However, the ratio is still 1 to 8.2.

Assuming there is a discrepancy to explain, and that the floor-space statistics are essentially accurate, this suggests that either the commercial acreage was over-estimated (deflating unit values) or the industrial acreage under-estimated (inflating unit values), and that, either way, the industrial to commercial land value multiplier should be greater. If the former is the case then the commercial land value aggregate calculated would not be affected anyway; if the latter, then it would be an under-estimate (as would the industrial aggregate). So it seems safe to conclude that using this method the commercial and industrial land value of Great Britain can only be exaggerated if the regional industrial values to which the ratio is applied are too high, or if the industrial and commercial site value totals are misaligned.

For industrial land values we must rely on the accuracy of Table 7: IV. This produces a mean value almost two-thirds greater than the value derived from the DV survey. This may well measure the shortfall between existing use values and full development values in the industrial sector.

As for the sectoral alignment, the oft-quoted pioneering survey by Vallis may at first sight appear to cast some doubt upon it. Using the year books of the Estate Exchange and auction results published by *The Estates Gazette*, Vallis charted the trend of urban land values in England from 1892 to 1969 for each of three sectors. He found that in the mid 1960s — when the gap between the two was certainly smaller — the ratio of the median values recorded for industrial and commercial land was 1 to 21 (£27,500/ha to £576,000/ha). Unless the sector area figures used above are nowhere near the truth, then this flatly contradicts the CSO's findings.

In this matter, however, it is certainly Vallis's results which are far less reliable. The total number of industrial and commercial land

transactions used in the survey was 1,025 spread out over 77 years, as opposed to 2,600 properties valued by District Valuers concentrating on one day. 638 industrial land transactions were recorded (half in the 1960s), 25% of which were in Greater London and a further 30% in the South East. 387 commercial land transactions were recorded (one-tenth in the 1960s), 73% of which were in Greater London and a further 11% in the South East. Quite clearly the English median value for commercial land was an inflated one (35% of observations were actually in central London), whereas the industrial median was far more representative of England as a whole (only 1% of observations were in central London). Vallis admitted that the overall bias towards London and the South East 'is a weakness of the survey, but the available data made it unavoidable'.

By contrast, the CSO was able to 'ensure a regional mix of properties in line with the distribution of industrial and commercial property throughout England and Wales'. This involved valuing 800 factories and 1,800 commercial buildings in 100 DV areas. It was not a scientific random sample but it was far less constrained than Vallis's.

The most comprehensive survey of property values is that undertaken for rating purposes by the District Valuers. However, this assesses annual rental values of land and buildings together, so even if an up-to-date valuation were available nothing more could be learnt from it without a survey of capital and site values as well. In the CSO-commissioned survey, therefore, the District Valuers have provided us with as much information as we can hope for in the absence of a more comprehensive national land valuation.

The rule of thumb that we have established of a 1 to 8.5 ratio between average industrial and commercial land values may be taken as applying at the national level — the level at which it was calculated — but we would not expect it to apply at the regional and district levels as well. The Cities of London and Westminster undoubtedly contain a disproportionate share of the nation's commercial land value, so we must look more closely at the prices which apply there.

The only direct evidence contained in the *Property Market Reports* comes from the Autumn 1986 issue in an article by the

Kensington and Chelsea District Valuer entitled 'The Changing Face of Kensington High Street'. It states that 'the old Town Hall was sold by the Royal Borough in July 1984 for £5.3m (£38.5m/ha). It achieved notoriety when a demolition gang moved in overnight just before a listing notice was due to be served by the GLC ... The current record for the High Street [is] held by one of the four shop units in the new development ... where a rent of £930/m<sup>2</sup> in terms of Zone A, (Zone A depth 9.1m) was obtained at the end of last year'. Apart from the four ground floor shops the redevelopment included three floors of offices, which 'have recently been let at a rental of £180/m<sup>2</sup>'.

The borough borders the west side of the City of Westminster and is situated on the ridge of high office rents which continues westwards along the M4. The prime rents cited were about half those current at the peak of the ridge at its eastern end in the City of London. The peak rents in Westminster, in the Mayfair and St. James' areas, would have been about one-third greater than those in Kensington. As for shops, the peak rent cited was about half the peak level in Westminster, at the western end of Oxford Street.

As the buildings themselves do not vary much in value they tend to be an equalising influence upon rents. The underlying sites must therefore vary in value more than the values of the sites and buildings together quoted above. Taking the £40m/ha site value of Kensington Town Hall (which allows for demolition) suggests that peak commercial land values in Westminster were, say £100m/ha, and in the City, say, £160m/ha. Translating these peaks into averages requires guesswork, so let us assume that the averages outside the City of London were one-third the peak, and inside, in view of the more uniform intensity of development, two-thirds the peak. This means that average land values in Westminster were about £33m/ha, and in the City about £106m/ha.

Confirmation of the figure for the City may be gained by the residual method of valuation. We have sounder figures here on which to base our calculations than we have for the rest of the country. The City planners impose a 4-to-1 plot ratio on new developments, which means that generally they cannot rise above four storeys. We also know from the City planners that building costs are in the region of £1,200/m<sup>2</sup> gross internal floor area,

including air conditioning. And we know fairly accurately from the Hillier Parker *City of London Office Rent Contour Map* for September 1985 that average rents were about £270/m<sup>2</sup> effective (net) area. So a hypothetical hectare (10,000m<sup>2</sup>) of modern office structure with 85% effective plan area would have rented for £9.18m p.a.

Investment yields along the £270/m<sup>2</sup> contour line were about 6%, according to the Autumn 1985 *PMR* (Dawson House on Jewry Street, just inside the contour, was reported as purchased at an initial yield of 5.75% compared with 4.75% for prime City yields and a 6.41% value weighted average yield for Inner London). The capitalised value of the structure would therefore have been £153m. The cost of building the structure would have approached £48m. This suggests a capital value for the hectare site of about £105m. That is near enough the number we originally calculated.

## NOTES

1 It might be argued, looking at Table 8: IX, that the industrial land area has been relatively over-stated for the purposes of this calculation (which excludes vacant land). However, this possibility is unlikely. It is more probable that the industrial area in Table 4: VII has been under-stated, and/or the developable but vacant industrial land belongs in the category 'Some mineral workings/dereliction', which has also been under-stated. The figure for the latter (20,000 ha) is notional, because in none of the land use surveys consulted was this area separately identified. Waste land as a whole forms an indeterminate category straddling both urban and rural definitions. The Second Land Utilisation Survey deals with it more specifically than the others, and the treatment suggests that much urban wasteland lies outside the 'settlement supercategory'. Its *Field Mapping Manual* states that 'Derelict land may develop into reverted land if it is left long enough for vegetative growth to obliterate all traces of masonry, paving or quarry outcrops' (Coleman and Shaw 1980: 56). Derelict land is classified as settlement; reverted, or 'rough land', is not. 178,000 ha of rough land was recorded in England and Wales in the 1963 survey, a substantial proportion of which must have been vacant urban land. None of this land is included in column 1 of Table 4: II, nor therefore in Table 4: VII.