Editorial: The strategic management of public sector facilities - The capital charging process
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Over its first two volumes, the Journal has developed as a forum for sharing professional knowledge at the very highest levels. Accordingly, it encourages feedback from its readers, not just anecdotally, but in the form of more considered responses to specific topics and individual articles. We believe that such feedback, based on your practical experience of facilities management issues 'in the front line', is integral to the development of new thinking and best practice in the industry and the Journal. In making this offer, I thought I would offer my own thoughts (without a solution) on a practical problem arising in the management of UK central government property assets, and directly invite readers to comment on solutions. Although UK based, the principle remains grounded in general public sector property and facilities management, and comments from all readers around the world are most welcome.

Decisions on the creation, acquisition and disposal of capital assets are normally done after a 'Green Book' option appraisal which focuses on selecting the option which provides the highest net present value, or the lowest net present cost where the assets are valued on the basis of 'opportunity cost'. The day to day management of assets is governed by the capital charging system. This system reflects the opportunity cost of capital tied up in land and buildings through a capital charge of 6 per cent plus depreciation of the buildings levied on the basis of the value to the user represented by the Existing Use Value (EUV) or, for specialised buildings, the Depreciated Replacement Cost (DRC).

Capital charging is a system that has operated in UK Central Government since 1998–99. In the National Health Service, a fundamental change took place from 1 April 1991 in that capital is no longer a free good in the NHS, Central Government bodies pay an annual capital charge of 6 per cent of the Existing Use Value of the asset valued under the RICS (1995) *Appraisal and Valuation Manual* (the Red Book) and depreciation on the buildings. This is a measure of the opportunity cost of the assets and stops them being treated as free goods. Thus, property managers receive clear economic signals of the real costs of holding assets to encourage them to manage their resources efficiently (HM Treasury, 1996) in the absence of a market. Rented assets are excluded as their opportunity cost is reflected in the rent.

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Asset valuations

Asset valuations are governed by the Accounting Standards Standard FRS 15, which looks at assets from the perspective of the user. For the purposes of the accounts, the appraiser is required to look at the current value of the asset to the business. This is the current cost or value to the business, which is the lower of the replacement cost or recoverable amount. The 'replacement cost' is a deprival value. It is the cost of purchasing, at the least cost, the remaining service potential of the asset at the balance sheet date. It is an 'entry value'. The Recoverable Amount is 'the greater of, the Value in Use, the present value of the future cashflows obtainable as a result of the assets continued use, including those from its ultimate disposal' or the Net Realisable Value which 'is the amount at which an asset could be disposed of, less any direct selling costs'. It is an 'exit value'.

This usually requires the valuer to give advice on the replacement cost or the net realisable value. This leads to an EUV for non-specialised properties or, in the case of specialised assets, a DRC valuation. This is a more subjective approach to value. The philosophy behind this and the definitions are set out in the Red Book.

The valuer may indicate where there is a significant discrepancy between EUV and Open Market Value (OMV), perhaps to the presence of a Special Purchaser, but this is only an addendum to the accounts, for information. Much of the day to day decision making and management is taken on the basis of the relatively subjective valuations of EUV and DRC. Only when a property is declared surplus and the requirement to dispose of the asset looms do many assets receive an open market valuation. In some cases, particularly with highly specialised assets, this can produce a sharp fall in the value of the asset which needs careful accountancy treatment.

The decision to disinvest is normally taken by government organisations on operational or running cost grounds, rather than pure economic ones, and the main valuation data available to decision makers are EUV or DRC valuations.

My questions are:

- To what extent is the current system that is in place in the UK efficient and effective in practice?
- Are there systems of which readers are aware or they have considered that are more simple and efficient, enabling the public sector to take advantage of the market forces that drive efficiency in the private sector?

We look forward to reporting in future Editorials readers' comments on this and the other topics raised in the Journal.

Michael Pitt
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