

13. NON-CURRENT ASSETS (continued)

The Partnership has a £60 million bank facility with RBS and HSBC expiring in September 2016. £2 million of this facility has been voluntarily repaid and cancelled during the year, leaving drawn debt at £58 million at 31 March 2014. The loan amortises to £51.1 million by September 2016, with amortisation starting in June 2014.

The average cost of debt of the facility in the year was 5.1%. Interest rate derivatives are in place covering 50% of the drawn debt at a pre-margin cost of 1.05%. There is a margin ratchet based on the Partnership's income cover which ranges between 250 bps and 400 bps.

The Partnership loan has a loan to value covenant which requires the gross loan to the value of the Partnership's investment property assets to be no more than 55%. The loan is non-recourse to the Group.

The Group has an option to acquire the property assets within the Partnership exercisable at 31 March 2014 (subject to an IRR hurdle being achieved) and at 31 March 2015 (with no IRR hurdle). The option has been deferred at 31 March 2014, and has been assessed to have nil value at 31 March 2014. The Directors have considered the rights the option bestows on the Group and have concluded that as at 31 March 2014, the option does not allow the Group to direct the relevant activities of the Partnership and accordingly continues to account for its investment in the Partnership on an equity accounting basis.

14. VALUATION OF INVESTMENT PROPERTY

	Deemed cost £000	Revaluation on deemed cost £000	Valuation £000
Freehold stores*			
At 31 March 2013	372,190	328,315	700,505
Transfer to surplus land	(1,330)	–	(1,330)
Capital Goods Scheme adjustment	1,186	(1,186)	–
Movement in year	1,457	25,728	27,185
At 31 March 2014	373,503	352,857	726,360
Leasehold stores			
At 31 March 2013	15,911	29,189	45,100
Movement in year	288	4,642	4,930
At 31 March 2014	16,199	33,831	50,030
Total of open stores			
At 31 March 2013	388,101	357,504	745,605
Transfer to surplus land	(1,330)	–	(1,330)
Capital Goods Scheme adjustment	1,186	(1,186)	–
Movement in year	1,745	30,370	32,115
At 31 March 2014	389,702	386,688	776,390
Investment property under construction			
At 31 March 2013	23,782	(6,505)	17,277
Movement in year	5,860	(834)	5,026
At 31 March 2014	29,642	(7,339)	22,303
Valuation of all investment property			
At 31 March 2013	411,883	350,999	762,882
Transfer to surplus land	(1,330)	–	(1,330)
Capital Goods Scheme adjustment	1,186	(1,186)	–
Movement in year	7,605	29,536	37,141
At 31 March 2014	419,344	379,349	798,693

* Includes one long leasehold property

Notes to the Financial Statements (continued)

Year ended 31 March 2014

14. VALUATION OF INVESTMENT PROPERTY (continued)

The Group has classified the fair value investment property and the investment property under construction within Level 3 of the fair value hierarchy. There has been no transfer to or from Level 3 in the year.

The freehold and leasehold investment properties have been valued at 31 March 2014 by external valuers, Cushman & Wakefield LLP ("C&W"). The valuation has been carried out in accordance with the RICS Valuation – Professional Standards, published by The Royal Institution of Chartered Surveyors ("the Red Book"). The valuation of each of the investment properties and the investment properties under construction has been prepared on the basis of either Fair Value or Fair Value as a fully equipped operational entity, having regard to trading potential, as appropriate.

The valuation has been provided for accounts purposes and as such, is a Regulated Purpose Valuation as defined in the Red Book. In compliance with the disclosure requirements of the Red Book, C&W have confirmed that:

- > The members of the RICS who have been the signatories to the valuations provided to the Group for the same purposes as this valuation have done so since September 2004;
- > C&W have been carrying out this bi-annual valuation for the same purposes as this valuation on behalf of the Group since September 2004;
- > C&W do not provide other significant professional or agency services to the Group;
- > In relation to the preceding financial year of C&W, the proportion of the total fees payable by the Group to the total fee income of the firm is less than 5%; and
- > The fee payable to C&W is a fixed amount per store, and is not contingent on the appraised value.

Market uncertainty

C&W's valuation report comments on valuation uncertainty resulting from low liquidity in the market for self storage property. C&W note that, although there were a number of self storage transactions in 2007, the only significant transactions since 2007 are:

1. The sale of a 51% share in Shurgard Europe which was announced in January 2008 and completed on 31 March 2008;
2. The sale of the former Keepsafe portfolio by Macquarie to Alligator Self Storage which was completed in January 2010;
3. The purchase by Shurgard Europe of the 80% interests held by its joint venture partner (Arcapita) in its two European joint venture vehicles, First Shurgard and Second Shurgard. The price paid was 172 million Euros and the transaction was announced in March 2011. The two joint ventures owned 72 self storage properties; and
4. The purchase of Selstor, Sweden, by Pelican Self Storage/M3 Capital in the fourth quarter of 2012.

There have been ten single store market transactions in the UK since 2010. C&W state that due to the lack of comparable market information in the self storage sector, there is greater uncertainty attached to their opinion of value than would be anticipated during more active market conditions.

Valuation methodology

C&W have adopted different approaches for the valuation of the leasehold and freehold assets as follows:

Freehold and long leasehold

The valuation is based on a discounted cash flow of the net operating income over a ten year period and notional sale of the asset at the end of the tenth year.

Assumptions

- A) Net operating income is based on projected revenue received less projected operating costs together with a central administration charge of 6% of the estimated annual revenue subject to a cap and a collar. The initial net operating income is calculated by estimating the net operating income in the first 12 months following the valuation date.
- B) The net operating income in future years is calculated assuming either straight-line absorption from day one actual occupancy or variable absorption over years one to four of the cash flow period to an estimated stabilised/mature occupancy level. In the valuation the assumed stabilised occupancy level for the 54 trading stores (both freeholds and leaseholds) open at 31 March 2014 averages 81.1% (31 March 2013: 81.5%). The projected revenues and costs have been adjusted for estimated cost inflation and revenue growth. The average time assumed for the 32 established stores to trade at their maturity levels is 29 months (31 March 2013: 32 months); for the 22 lease-up stores, the period to maturity is 36 months (31 March 2013: 43 months).
- C) The capitalisation rates applied to existing and future net cash flow have been estimated by reference to underlying yields for industrial and retail warehouse property, yields for other trading property types such as student housing and hotels, bank base rates, ten year money rates, inflation and the available evidence of transactions in the sector. The valuation included in the accounts assumes rental growth in future periods. If an assumption of no rental growth is applied to the external valuation, the net initial yield pre-administration expenses for the 32 established stores is 7.0% (31 March 2013: 6.8%) rising to a stabilised net yield pre-administration expenses of 7.8% (31 March 2013: 8.1%). Also on a no growth and pre-administration expenses basis the 22 lease-up stores have a net initial yield of 5.5% (31 March 2013: 4.9%) rising to 7.8% (31 March 2013: 8.4%) on stabilisation.
- D) The future net cash flow projections (including revenue growth and cost inflation) have been discounted at a rate that reflects the risk associated with each asset. The weighted average annual discount rate adopted (for both freeholds and leaseholds) is 11.0% (31 March 2013: 11.2%).
- E) Purchaser's costs of 5.8% (see below) have been assumed initially and sale plus purchaser's costs totalling 6.8% are assumed on the notional sales in the tenth year in relation to the freehold stores.

14. VALUATION OF INVESTMENT PROPERTY (continued)

Short leasehold

The same methodology has been used as for freeholds, except that no sale of the assets in the tenth year is assumed but the discounted cash flow is extended to the expiry of the lease. The average unexpired term of the Group's seven short leasehold properties is 16.8 years (31 March 2013: 15.7 years).

Investment properties under construction

C&W have valued the stores in development adopting the same methodology as set out above but on the basis of the cash flow projection expected for the store at opening and after allowing for the outstanding costs to take each scheme from its current state to completion and full fit-out. C&W have allowed for holding costs and construction contingency, as appropriate. One scheme does not yet have planning consent and C&W have reflected the planning risk in their valuation.

Immature stores: value uncertainty

C&W have assessed the value of each property individually. However, two of the stores in the portfolio are relatively immature and have low initial cash flow. C&W have endeavoured to reflect the nature of the cash flow profile for these properties in their valuation, and the higher associated risks relating to the as yet unproven future cash flow, by adjustment to the capitalisation rates and discount rates adopted. However, immature low cash flow stores of this nature are rarely, if ever, traded individually in the market, unless as part of a distressed sale or similar situation. Although, there is more evidence of immature low cash flow stores being traded as part of a group or portfolio transaction.

Please note C&W's comments in relation to market uncertainty in the self storage sector due to the lack of comparable market transactions and information. The degree of uncertainty relating to the two immature stores is greater than in relation to the balance of the properties due to there being even less market evidence that might be available for more mature properties and portfolios.

C&W state that in practice, if an actual sale of the properties were to be contemplated then any immature low cash flow stores would normally be presented to the market for sale lotted or grouped with other more mature assets owned by the same entity, in order to alleviate the issue of negative or low short term cash flow. This approach would enhance the marketability of the group of assets and assist in achieving the best price available in the market by diluting the cash flow risk.

C&W have not adjusted their opinion of fair value to reflect such a grouping of the immature assets with other properties in the portfolio and all stores have been valued individually. However, they highlight the matter to alert the Group to the manner in which the properties might be grouped or lotted in order to maximise their attractiveness to the market place.

C&W consider this approach to be a valuation assumption but not a Special Assumption, the latter being an assumption that assumes facts that differ from the actual facts existing at the valuation date – and which, if not adopted, could produce a material difference in value.

C&W have not assumed that the entire portfolio of properties owned by the entity would be sold as a single lot and the value for the whole portfolio in the context of a sale as a single lot may differ significantly (either higher or lower) from the aggregate of the individual values for each property in the portfolio, reflecting the lotting assumption described above.

Valuation assumption for purchaser's costs

The Group's investment property assets have been valued for the purposes of the financial statements after deducting notional purchaser's cost of 5.8% of gross value, being the maximum amount for notional purchaser's costs as if they were sold directly as property assets. The valuation is an asset valuation which is entirely linked to the operating performance of the business. They would have to be sold with the benefit of operational contracts, employment contracts and customer contracts, which would be very difficult to achieve except in a corporate structure.

This approach follows the logic of the valuation methodology in that the valuation is based on a capitalisation of the net operating income after allowing a deduction for operational cost and an allowance for central administration costs. Sale in a corporate structure would result in a reduction in the assumed Stamp Duty Land Tax but an increase in other transaction costs reflecting additional due diligence resulting in a reduced notional purchaser's cost of 2.75% of gross value. All the significant sized transactions that have been concluded in the UK in recent years were completed in a corporate structure. The Group therefore instructed C&W to carry out a Red Book valuation on the above basis, and this results in a higher property valuation at 31 March 2014 of £834.2 million (£35.5 million higher than the value recorded in the financial statements). The valuations in Big Yellow Limited Partnership are £4.8 million higher than the value recorded in the financial statements, of which the Group's share is £1.6 million. The sum of these is £37.1 million and translates to 26.0 pence per share. We have included this revised valuation in the adjusted diluted net asset calculation [see note 12].