Sites C & E Canada Water

Canada Water (Developments) Ltd

Financial Viability Assessment (FVA)

January 2013

Sites C & E, Canada Water

London Borough of Southwark

Financial Viability Assessment (FVA) in support of a Planning Application for redevelopment

January 2013

for Canada Water (Developments) Ltd

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Confidentiality

This Report is confidential to the London Borough of Southwark and their appointed viability advisors for this scheme. We request that the report should not be disclosed to any third parties under the Freedom of Information Act 2000 (section 41 and 43(2)) or any equivalent future iteration of this Act or alternative, or otherwise disclosed without the prior approval in writing from DS2 or Canada Water (Developments) Ltd.

This Report must not, save as expressly provided for in the fee letter be recited or referred to in any document, or copied or made available (in whole or in part) to any person without our express prior written consent. Please refer to full Confidentiality Statement at Appendix One.

1 Introduction

1.1 This Financial Viability Assessment ("FVA") has been prepared by DS2 in order to examine the commercial viability of the proposed development of Sites C & E in Canada Water ("the site"). The site is located within the London Borough of Southwark ("LBS").

1.2 A part-detailed part-outline planning application, designed by a team comprising Macreanor Lavington, David Chipperfield, Claus en Kaan and Vogt Landscape architects has been submitted by Tibbalds Planning Consultant on behalf of Canada Water (Development) Ltd ("the Applicant") to LBS.

1.3 Subject to the necessary consents the proposals will deliver a development of very high design quality, containing a mix of new retail, leisure, employment and residential uses surrounding a new public square.

1.4 The project will deliver a range of regenerative benefits including in excess of 1,000 new homes including affordable housing, new employment and leisure space, financial payments for the Mayoral Community Infrastructure Levy and other obligations secured through the S106 agreement.

1.5 DS2 has been instructed by the Applicant to undertake a thorough review of the development economics and robustly demonstrate the maximum level of affordable housing and additional financial obligations, including the Mayoral Community Infrastructure Levy ("CIL"), that can be supported without impeding the commercial viability of the project and subsequent chances of delivery in accordance with national, regional and local planning policies.

1.6 This FVA is supported by a series of development appraisals and accompanying evidence that demonstrates the commercial viability of the proposal following a robust viability methodology and rationale which is clearly set out in this report.

Structure

1.7 In order to present our methodology, rationale and subsequent findings the report has been structured as follows:

- Site description, ownership & proposals – summary of the location and nature of the existing asset with a description of the development proposals that are the subject of the planning application;
- Planning policy – review of the key national, regional and local planning policies concerning the delivery of affordable housing subject to development viability;
- Viability methodology – description of the methodology employed within the wider context of best practice for FVAs;
- Site Value – analysis in relation to the proposed Site Value for the financial appraisals;
- Development timings – description of the current proposed programme subject to a satisfactory planning consent being obtained;
- Development value – review of the residential and commercial values alongside additional revenue streams that comprise the scheme GDV;
- Development costs – review of the development costs for the proposed project;
- Present day appraisal – summary of the financial appraisal outputs;
- Sensitivity analysis – review of the sensitivities attached the major present day costs and values into the 15% affordable housing development appraisal;
- Outturn appraisals – summary of the financial appraisal residual outputs with cost inflation and property value growth assumptions;
- Affordable housing – summary of the affordable housing outputs; and
- Concluding statement –statement with the formal affordable housing offers and concluding rationale.

Outputs

1.8 In order to accurately illustrate the commercial viability of the proposed scheme this FVA includes the following scenarios:

- 15% mixed tenure affordable housing in Site E delivered in 2019/20 with £8,392,190 in financial obligations and £4,154,850 in Mayoral CIL;
- 10% mixed tenure affordable housing in Site E delivered in 2016 with £8,392,190 in financial obligations and £4,154,850 in Mayoral CIL; and
- 100% private scheme with a £20 million commuted payment payable in four separate payments to be ring-fenced for affordable housing elsewhere in the borough plus £8,392,190 in financial obligations and £4,154,850 in Mayoral CIL.

1.9 A list of supporting information accompanying this report is provided in the appendices at the front of this FVA.

Financial Modelling

1.10 We have used Argus Developer software to demonstrate project viability. Argus is bespoke development appraisal software that uses a residual valuation approach to demonstrate residual land and profit outputs.

1.11 The model is able to demonstrate the economics of development, such as the subject project. Albeit we would note as explained in the Royal Institution of Chartered Surveyors (RICS) Valuation Information Paper 12[1], the sensitivities attached to development appraisals, particularly on projects with a timeline as envisaged, are considerable.

Authority

1.12 This report has been prepared having regard to the London Plan and recent amendments, LBS adopted and emerging planning policy, the RICS Guidance Note entitled 'Financial Viability in Planning' and generally accepted principles of undertaking FVAs of which DS2 have considerable experience.

1.13 This FVA is the culmination of nine months' work with the Applicants and their project team in appraising the commercial viability of the various pre-application scheme iterations.

1.14 This report has been compiled by Pascal Levine MRICS, a Partner at DS2 and the site has been visited on a number of occasions most recently in December 2012.

[1] RICS Valuation Information Paper 12, Valuation of Development Land

2 Site Description & Ownership

2.1 A detailed site description and thorough analysis of the proposals is contained within the Design & Access and Planning Statements that have been submitted with the planning application. A summary of the site description and proposals are however included below.

Location

2.2 Canada Water is located on the Rotherhithe peninsula in south east London. Historically, the area was home to the Surrey Docks, which by the end of the Second World War covered an area of about 186 hectares, 85% of the peninsula.

2.3 By the late 1960s, the docks had closed and after lying derelict for a decade, the London Docklands Development Corporation (LDDC) was given responsibility for developing the area. Around 90% of the docks were filled in and some 5,500 new homes built, alongside new open spaces, retail, leisure and industrial development.

2.4 Canada Water is two stops east of London Bridge on the Jubilee underground line and one to the west of Canary Wharf. The site also benefits from a range of other public transport services and has a high PTAL rating.

2.5 The two subject sites are known as sites C and E and are located within the Rotherhithe ward. They are immediately east of Canada Water station and Surrey Dock. Various site plans are included within the appendices of this report.

Site C

2.6 Site C is 2.31 hectares and is currently occupied by two large retail units occupied by Decathlon. These sheds were erected in the 1980s with 224 surface car park spaces and associated servicing areas.

2.7 The retail warehouses are let to Decathlon by way of two leases expiring in 2028, with tenant break options in December 2016 and 2022. We understand that Decathlon have no intention of exercising the break clauses in the respective leases. The two long leases held by Decathlon are held under Title references TGL181138 and TGL181139. Copies are attached as Appendix Two.

Site E

2.8 Site E occupies an area of 0.78 ha and is located to the immediate east of Surrey Quays Road and to the south of Canada Street adjacent to Harmsworth Quay. Site E comprises a single, detached retail warehouse unit with a total gross internal area of just under 2,000 sqm.

Ownership

2.9 The land edged in red shown in Title document reference TGL215017 included as Appendix Three is owned freehold by Canada Water (Developments) Limited, a subsidiary of Sellar Design and Development.

2.10 The land has been acquired by Investec Private Bank from Conrad Phoenix (Canada Water) Ltd. Sellar Design and Development are acting in partnership with the bank to deliver Sites C & E as an exemplar mixed use development.

2.11 Site E is held under Title reference TGL218564, a copy of which is attached as Appendix Four. The Title is in the name of Conrad Phoenix (Canada Water) Ltd albeit we understand that the ownership has recently been transferred to Canada Water (Developments) Limited.

3 Planning Application

3.1 The planning application is a hybrid being part-detailed and part-outline. The proposal is for a highly sustainable residential led mixed use development comprising five buildings. The application responds directly to LBS's aspirations and visions set out in the Canada Water Area Action Plan (CWAAP).

3.2 For the purposes of the planning application these buildings are referred to as C1, C2, C3, C4 and E1. The description of development as included in the Planning Statement that accompanied the application is as follows:

"Application made under the provisions of the Town and Country Planning Act 1990 (England and Wales), accompanied by an ES under the Environmental Impact Assessment Regulations 2011 seeking Outline permission for the demolition of all existing buildings and the erection of 5 buildings (C1-C4 and E1) ranging from 5 to 40 storeys (150.86 AOD) and comprising a maximum overall floor space of up to 137,612.4sqm GEA. This includes a maximum of up to: 97,541.4sqm of residential accommodation (Class C3) (equating to up to 1,046 residential units), 12,308.9sq.m Class A1 Retail Store (including 10,178sq.m (net) sales area, 745 sqm. ancillary office accommodation and 308 sqm ancillary café); 4,335sqm of other ClassA1/A2/A3/A4 floorspace); 2,800sqm of office space floor space (Class B1), up to 658sqm of health centre floorspace (Class D1) and up to 698.2sqm. of cinema floorspace (Class D2); 19,271.8sqm ancillary parking, plant and storage accommodation, including the provision of basements to provide vehicle and cycle parking, circulation, servicing and plant areas; new vehicle and pedestrian accesses and new public amenity space and landscaping including new public square".

3.3 We have included the following plans as Appendix Five (issued separately on a CD and not attached to this report) of this FVA and these drawings also accompany the Planning Statement:

- MLUK-297_L-001_Site Location Plan
- MLUK-297_L-002_Existing Site
- MLUK-297_L-010_Indicative Phasing Plan
- MLUK-297_L-011_Indicative_Basement Phasing Plan
- MLUK-297_L-012_ParameterPlan_Layout Ground
- MLUK-297_L-013_ParameterPlan_Layout Basement

- MLUK-297_L-014_ParameterPlan_Layout Upper
- MLUK-297_L-015_ParameterPlan_Building Heights
- MLUK-297_L-016_ParameterPlan_Land Use Distribution
- MLUK-297_L-017_ParameterPlan_Public Amenity Space
- MLUK-297_L-018_ParameterPlan_Private Amenity Space
- MLUK-297_L-019_ParameterPlan_Access

3.4 Also included in Appendix Five are a set of detailed floor plans for the buildings as included within the application.

3.5 In summary, the planning application incorporates the following phases:

- Phase One - A mixed use building (C1) ranging in height from 5 to 17 storeys, comprising anew Decathlon store (12,103 sqm GIA), 235 residential dwellings, 173 sqm (GIA) of mixed retail space, basement car parking, storage and plant areas and associated landscaping;
- Phase Two – two mixed use buildings; an eight storey building (C2) comprising 112 residential dwellings and 1,892 sqm (GIA) of mixed ground floor retail space and a 16 storey building (C3) comprising 190 residential units, mixed retail (753 sq m GIA) and a cinema (640 sqm GIA), a linked basement between phases 2 and 3 and associated car parking works;
- Phase Three – A mixed use 40 storey tower comprising 273 residential dwellings and 709 sqm (GIA) of mixed retail, a linked basement between phases 2 and 3 and associated landscaping works; and
- Phase Four – A mixed use development comprising up to 21,999 sqm (GIA) of residential floor space and up to 236 residential dwellings; up to 507 sqm (GIA) of mixed retail; up to 2,460 sqm (GIA) of mixed commercial space; a health centre of up to 573 sqm (GIA); basement car parking, storage and plant and associated car parking.

3.6 In relation to the detailed Reserved Matters required:

- Phase one is submitted in full detail and no matters are reserved;
- Phase two and three are submitted in outline. Detailed approval is ought for layout, scale and appearance of the buildings and the means of vehicular access. Reserved matters will be sought at a later date for the layout of the basement, individual layouts of the buildings and landscaping; and
- Phase four is submitted in outline with layout, scale, access, appearance and landscaping all reserved for subsequent approval.

3.8 The proposed total floorspace is as follows (figures are rounded to the nearest whole number):

Table 1: Canada Water Proposed Floorspace January 2013		
Land Use	**Maximum GIA (sqm)**	**Maximum GEA (sqm)**
Residential (C3)	90,337	97,541
Office (B1)	2,460	2,800
Decathlon Retail Store (A1)	12,103	12,308
Other Retail (A1 – A4)	4,035	4,334
Cinema (D2)	640	698
Health Centre (D1)	573	658
Parking, Plant & Storage (ancillary)	18,775	19,271
Total	**128,924 (sqm)**	**137,612 (sqm)**

3.9 This can also be disaggregated into the maximum floor space for each building as Table Two illustrates (similarly, the figures are rounded):

Table 2: Canada Water Proposed Floorspace by Building January 2013		
Building	**Maximum GIA (sqm)**	**Maximum GEA (sqm)**
C1	42,263 (fixed)	46483.1
C2	14,110	14648.2
C3	18,411	19141
C4	26,371	27431
E1	27,769	29,907
Total	**128,924 (sqm)**	**137,612 (sqm)**

3.10 Each building contains a mix of uses and Appendix Six contains an extract from the Tibbalds Planning Statement with the respective components.

Residential Accommodation

3.11 In terms of residential accommodation the buildings comprise the following mixes:

- Building C1 comprises 16 x studios, 66 x 1 bed, 106 x 2 bed, 41 x 3 bed and 6 x 4 bed dwellings equating to 235 units in total.
- Building C2 comprises 28 x 1 bed, 56 x 2 bed, 28 x 3 bed dwellings equating to 112 in total;
- Building C3 comprises 38 x studios, 38 x 1 bed, 76 x 2 bed, 38 x 3 bed dwellings equating to 190 in total;
- Building C4 comprises 78 x 1 bed, 30 x 1 bed, 87 x 2 bed, 78 x 3 bed dwellings equating to 273 units in total; and
- Building E1 comprises 10 x studios, 3 x studios (FA), 78 x 1 bed, 9 x 1 bed (FA), 64 x 2 bed, 29 x 2 bed (FA), 29 x 3 bed, 29 x 3 bed (FA), 8 x 4 bed dwellings equating to 236 units in total.

3.12 In terms of residential accommodation there will be a maximum of 1,046 dwellings. Table 3 illustrates the breakdown in terms of unit types and percentages.

Table 3: Canada Water Proposed Residential Areas January 2013 (residential units / percentage by building)

Building	Studios	1 bed	2 bed	3 bed	4 bed plus
C1	16 / 7%	66 / 28%	106 / 45%	41 / 17%	6 / 3%
C2	0	28 / 25%	84 / 75%	0	0
C3	38 / 20%	38 / 20%	76 / 40%	38 / 20%	0
C4	0	108 / 40%	87 / 32%	78 / 28%	0
E1	13 / 5%	87 / 37%	93 / 39%	35 / 15%	8 / 3%
Total	**67 / 6.4%**	**327 / 31.3%**	**446 / 42.6%**	**192 / 18.4%**	**14 / 1.3%**

3.13 The residential accommodation will meet, and in many cases exceed, the minimum space standards as required by the Mayor's Housing SPD adopted in 2012 and LBS's own Residential Design Standards adopted in 2011. Residential accommodation will meet Lifetime Homes Standards with the exception of six townhouses. 11% of the dwellings will be wheelchair adaptable to Greenwich Standard for residents who are wheelchair users.

3.14 The proposal allows for up to 470 car parking spaces of which 250 will be allocated for the new Decathlon store and 220 for residential purposes.

3.15 In terms of the Decathlon provision, 170 spaces will initially be provided in the basement of Building C1 for the Decathlon users with 80 temporary spaces on the cleared area to the south of the first phase. 84 Decathlon spaces will then be provided within the basement under buildings C2, C3 and C4 with the balance at surface level.

3.16 The residential car parking spaces will be provided at basement level under buildings C2, C3 and C4. Access is provided via a ramp next to building C4. Some 1,801 cycle spaces are proposed, 1,700 of which are for the residential accommodation.

The Decathlon Store

3.17 In October 2010, the previous owners of Site C, Conrad Phoenix (Canada Water) Ltd, secured a detailed planning consent (ref. 09/AP/1783) for the redevelopment of the site.

3.18 The consent included the erection of six buildings varying in height from 4 to 10 storeys comprising 430 residential units (Class C3), a new replacement retail store of 9,104sq m, 1,287sq m of other Class A1/A3/A4/A5 space, 644sq m of office space, 528sq m of community space, access, basement car parking for 340 cars, public realm, landscaping and communal spaces.

3.19 The consent cannot be implemented due to viability constraints and the fact that the retail space contained within the scheme is not acceptable to Decathlon, who intend to remain trading from the site under a secure lease until at least 2028.

3.20 In order for development to proceed, the Applicant has entered into an agreement with Decathlon to provide them new premises. The costs of the decanting exercise and temporary works will be borne by the Applicant.

3.21 Decathlon will pay the Applicant a premium for the lease totalling [redacted] on completion of the store, located in Building C1 and further detail can be provided on this transaction if required.

3.22 However, in summary there are two key considerations to this transaction. Firstly, the cost of provision of the new store to the Applicant in relation to the core build costs, professional fees and finance is in excess of £20 million. Secondly, there will be no long term rental income and as such the investment value of the new property, based on the rental income and their covenant strength, is estimated to be in the region of £20-£25 million is lost.

3.23 Accordingly, the aggregated impact of the cost of provision and loss of investment value leaves a significant hole in the appraisal, even accounting for the [redacted] premium as noted above. It is important to re-state that without Decathlon's agreement development cannot take place.

4 Planning Policy

4.1 The Tibbalds Planning Statement being submitted to support the application provides a detailed review of the planning policy context.

4.2 The following summary provides a review of the key national, regional and local planning policy guiding the delivery of affordable housing, and other planning obligations, with reference to the importance of considering development viability and balancing the requirements of delivering planning obligations with the risks of non-delivery.

<u>National Policy</u>

4.3 The Government's National Planning Policy Framework ("NPPF") was published in March 2012. The NPPF replaces the need for PPS3 (Housing), previously central Government guidance for Housing.

4.4 The NPPF introduces development viability as a material consideration in the determination of planning applications. Paragraphs 173 to 177 are entitled '*Ensuring Viability and Deliverability*'. In particular, the second half of para. 173, NPPF states:

'To ensure viability, the costs of any requirements likely to be applied to development, such as requirements for affordable housing, standards, infrastructure contributions or other requirements should, when taking account of the normal cost of development and mitigation, provide competitive returns to a willing land owner and willing developer to enable the development to be deliverable'.

4.5 The definition of affordable housing, previously in Annex B of PPS3 has been replaced by a new definition with the Glossary (Annex 2) of the central Government Guidance:

Social rented, affordable rented and intermediate housing, provided to eligible households whose needs are not met by the market. Eligibility is determined with regard to local incomes and local house prices. Affordable housing should include provisions to remain at an affordable price for future eligible households or for the subsidy to be recycled for alternative affordable housing provision. Social rented housing is owned by local authorities and private registered providers (as defined in section 80 of the Housing and Regeneration Act 2008), for which guideline target rents are determined through the national rent regime.

It may also be owned by other persons and provided under equivalent rental arrangements to the above, as agreed with the local authority or with the Homes and Communities Agency. Affordable rented housing is let by local authorities or private registered providers of social housing to households who are eligible for social rented housing. Affordable Rent is subject to rent controls that require a rent of no more than 80% of the local market rent (including service charges, where applicable).

Intermediate housing is homes for sale and rent provided at a cost above social rent, but below market levels subject to the criteria in the Affordable Housing definition above. These can include shared equity (shared ownership and equity loans), other low cost homes for sale and intermediate rent, but not affordable rented housing. Homes that do not meet the above definition of affordable housing such as "low cost market" housing may not be considered as affordable housing for planning purposes.

<u>Regional Policy</u>

4.6 The London Plan (July 2011) defines affordable (social and intermediate) housing at Policy 3.10. The London Plan definition is in accordance with the NPPF.

4.7 Policy 3.11 requires Boroughs to set an overall target for affordable housing provision within development proposals, taking into account a number of key criteria, including viability.

4.8 The London Plan states that Council's overall targets for the amount of affordable housing provision should be based on an assessment of all housing needs and a realistic assessment of supply and as such is less prescriptive than previous versions of the Plan.

4.9 The London Plan advocates the use of the GLA Development Control Toolkit (Three Dragons Toolkit) by developers, landowners and determining authorities in viability discussions, although many Local Authorities and their advisors are willing to accept other bespoke appraisal software with their prior agreement.

4.10 In regards viability, and enabling the prospects of delivery, Policy 3.12 of the Plan states that development viability should be assessed on a site by site basis taking into account a number of factors including the need to encourage rather than restrain development. The policy reads:

A – The maximum reasonable amount of affordable housing should be sought when negotiating on individual private residential and mixed use schemes, having regard to:

(a) Current and future requirements for affordable housing at local and regional levels identified in line with Policies 3.8 and 3.10 and 3.11;

(b) Affordable housing targets adopted in line with Policy 3.11;

(c) Need to encourage rather than restrain residential development (Policy 3.3);

(d) The need to promote mixed and balanced communities (Policy 3.9);

(e) The size and type of affordable housing needed in particular locations;

(f) The specific circumstances of individual sites.

B - Negotiations on sites should take account of their individual circumstances including development viability, the availability of public subsidy, the implications of phased development including provisions for reappraising the viability of schemes prior to implementation ('contingent obligations'), and other scheme requirements.

4.11 In reference to the location of affordable housing, paragraph 3.74 states that 'Affordable housing provision is normally required on-site. In exceptional circumstances it may be provided off-site or through cash in lieu contributions ring fenced, and if appropriate 'pooled', to secure efficient delivery of new affordable housing on identified sites elsewhere'.

4.12 The GLA have recently completed an Examination in Public (EiP) is relation to Revised Early Minor Alterations (REMA) to the London Plan. The purpose of the REMA is to bring the London Plan into alignment with the NPPF. In particular, the REMA introduces a definition of Affordable Rent (that is now contained in the GLA Housing Strategy) into the London Plan. We understand that the Inspector's Report into the EiP will be released shortly.

4.13 However, the REMA continues the general theme of viability and encouraging development. The REMA notes the Mayor's strategic position remains to deliver an average of at least 13,200 affordable dwellings per year with 60% as social rent and 40% as intermediate.

GLA Housing Strategy

4.14 The GLA published their updated Housing Strategy in November 2012. The strategy notes that 'It is essential that an appropriate balance is struck between delivery of affordable housing and overall housing development, especially in current economic circumstances'.

4.15 Part Four of the Housing Strategy provides a definition of affordable housing in accordance with the NPPF. The section also sets out the Mayor's strategic approach to maximising the delivery of affordable housing with an expectation of a 60 / 40 weighting in relation to affordable rented and social tenures, from all sources.

4.16 The Strategy, in relation to Plan Making, in 4.3.20 makes reference to paragraph 173 of the NPPF and encouraging land to come forward for development. Similarly, in regard to individual sites paragraph 173 is similarly referenced at 4.4.10.

Local Planning Policy

4.17 We have had regard to LBS's affordable housing policy, as detailed within their Local Development Framework (LDF). Strategic Policy 6 of LBS's Core Strategy (adopted April 2011) sets out the requirement for as much affordable housing, with a minimum target of 35%, on developments of 10 or more units as is financially viable.

4.18 Further detail is contained within LBS's draft Affordable Housing SPD dated July 2011 which contains the sequential approach to affordable housing delivery being on-site in the first instance, off-site and then payments in lieu. The SPD notes the adoption of the Canada Water Area Action Plan and the policy basis for affordable housing contributions.

4.19 The SPD is in draft format and that LBS are awaiting the Inspector's Report from the Examination in Public for the Minor Revisions to the London Plan with particular regard to the outcome of the Affordable Rent debate.

Canada Water Area Action Plan

4.20 The Canada Water Area Action Plan (CWAAP) was adopted in March 2012 and seeks the maximisation of affordable housing delivery. Policy 22 of the CWAAP states:

'Development in the AAP area will provide a minimum of 875 new affordable homes between 2011-2026. Most of these new homes will be on the proposal sites. In schemes of 10 or more homes, at least 35% of homes must be affordable. Of the affordable homes, 70% should be social rented and 30% should be intermediate'.

4.21 The subtext to the policy states that LBS's Strategic Housing Market Assessment and Housing Requirements Study indicates that LBS should provide as much affordable housing as is viable to meet the needs of local people and those wanting to live in Southwark.

Summary

4.22 In summary, national, regional and local planning policy encourages the delivery of sustainable mixed use development with the maximum reasonable amount of affordable housing and other financial obligations that can be supported based upon robust viability assessments thus encouraging the prospects of delivery.

5 Viability Methodology

<u>Context</u>

5.1 In completing this task, our methodology contained within this FVA has been framed by the following national, regional and local adopted planning policy and non-adopted guidance:

- National Planning Policy Framework, published in March 2012;
- Recent Planning Inspectorate and Secretary of State Decisions on viability matters;
- HCA's 'Investment and Planning Obligations - Responding to the Downturn' publication dated July 2009The GLA & HCA's guidance notes accompanying the Toolkit and EAT/DAT models (development appraisal models specifically published to assist with financial viability negotiations);
- London Plan (July 2011) Policies 3.10 to 3.12 and accompanying text;
- The GLA's Strategic Housing Land Availability Assessment and Housing Capacity Study Viability Assessment (August 2010);
- GLA Housing SPG released November 2012;
- GLA REMA documentation;
- LBS adopted and emerging planning policies including the recently published LBS CIL Draft Charging Schedule;
- Canada Water Area Action Plan (adopted March 2012);
- Royal Institution of Chartered Surveyors Valuation Information Paper 12 (VIP12) 'Valuation of Development Land' (2008);
- Royal Institution of Chartered Surveyors Valuation Standards, 8th Edition (VS) (March 2012);
- Royal Institution of Chartered Surveyors (RICS) 'Financial Viability in Planning' Guidance Note (GN), September 2012; and
- Local Housing Delivery Group (Viability Testing Local Plans) June 2012.

<u>Methodology</u>

5.2 The residual methodology underpinning viability appraisals is a relatively simple concept. The Residual Method of Valuation is the most commonly used method for valuing land which is set out in the RICS's Valuation Information Paper 12 (VIP12), '*Valuation of Development Land*' and RICS Financial Viability in Planning (FVIP) Guidance Note.

5.3 Sales prices of the individual properties to be constructed are estimated at prices current at the valuation date and aggregated, along with any other income, including commercial property, car parking and ground rents to find the total Gross Development Value (GDV). The cost of sales is deducted to arrive at a Net Development Value (NDV).

5.4 From this income, the costs of building the scheme, professional fees, the cost of borrowing and the developer's profit are all deducted. The following table provides a representation of the residual methodology.

Table 4: Residual Value Analysis
Gross Development Value
Residential sales income
Commercial sales income
Any additional income (ground rents, car parking)
Less
Costs
Build costs
Exceptional development costs (where applicable)
Professional fees
Internal overheads
Planning obligations
Marketing costs and disposal fees
Finance costs
Less
Developer's Profit / Site Value
Equals
Residualised Land Value (RLV) / Residual Profit

5.5 In the table above, the level at which the developer's margin or profit is set, is critical to the output. In accordance with policy guidance in the form of the NPPF, and best practice, the profit margin must be set at a level consummate with a range of criteria.

5.6 These criteria include property use type, the scale of development, development risk and location. Banks and other funding institutions will have minimum expectations in terms of profit returns aligned with the risk profile as will developers.

5.7 The residual calculation is estimated at a given point in time (i.e. today's date). If in the future input values change before a development has been completed, the residual outputs may be higher or lower. Any approach that uses inflationary measures carries with it additional risk given the inherent volatility in property markets. We shall come onto the use of outturn modelling on strategic projects such as this in Section 12.

5.8 This market risk is driven by macroeconomics and as clearly illustrated in recent times the Market Value of property can fall as well as rise over time. This risk is solely with the developer and therefore any upside or downside is reflected in the profit margin.

5.9 Through scenario testing it is possible to determine the maximum reasonable level of affordable housing and other obligations that ensure that a scheme remains financially viable and has the highest possible chance of being funded and subsequently delivered.

RLV vs. Benchmark

5.10 The FVA methodology works on the rationale that if the Residual Output produced by a scheme is lower than the benchmark the scheme is deemed to be unviable and is unlikely to come forward for development without a reduction in planning obligations or the costs of development or improvements in the efficiency or scale of the project.

5.11 If the Residual Output produced by a proposal is higher than the benchmark, then the scheme can, in theory, provide additional affordable housing and/or additional planning obligations.

5.12 Alternatively, the benchmark can be a profit return with a fixed Site Value as a cost. The residual profit calculation is compared to a benchmark profit equating to a reasonable target return commensurate with the risks being taken. If the benchmark is a profit return (which is often more appropriate on larger schemes), the methodology is unchanged.

5.13 The rationale in terms of the use of benchmarks had until recently been led by limited guidance available such as the HCA's Best Practice Guidance 'Investment & Planning Obligations, Responding to the Downturn' published in July 2009 (pre-dating the introduction of the NPPF) and the GLA and HCA guidance notes accompanying their respective financial viability appraisals.

5.14 The RICS Financial Viability in Planning[2] (FVIP) publication post-dates the adoption of the NPPF and in our opinion, carries greater weight than those publications issued prior to new central Government Guidance. We shall come onto the implications of this guidance.

Site Value

5.15 Historically, Site Values for viability purposes have been included, in the main, on the basis of a Current Use or Alternative Use Value. In summary, a number of Affordable Housing Viability Studies underpinning Core Strategy Affordable Housing policies have been constructed upon this approach, including LBSs, with the rationale being that a margin above CUV is an appropriate Site Value for viability purposes.

[2] RICS Financial Viability in Planning, Guidance Note, September 2012

5.16 This rationale has also found its way into a number of current draft CIL charging schedules, most notably in LBS (published in the last quarter of 2012) and we understand a significant number of representations have been received querying the use of the CUV plus approach.

5.17 The proposed margin above CUV has been debated extensively but the Planning Inspectorate and Secretary of State, in the absence of guidance on the matter, has deemed that anywhere between 10% and 40% is a reasonable uplift for viability purpose depending on the site circumstances.

5.18 There is however no adopted policy explicitly stating what the benchmark value should be for viability purposes. As a starting point, historically, the GLA Toolkit guidance notes include a number of benchmarks to which the proposal's Residual Value (RV) can be compared to assess scheme viability. These are:

- Existing Use Value (EUV) - the value of the land to the landowner(s) in its existing planning use;
- Alternative Use Value (AUV) - the value of the land in another use that has a reasonable chance of gaining planning permission or indeed already has planning permission;
- Acquisition cost - the cost of the land to the developer and/or landowner of acquiring the land.

5.19 We note the following commentary in the most recent version of the GLA Toolkit Notes published in October 2012:

'Market Value (MV) is an alternative approach and this approach is being promoted by the recently published RICS guidance. It is possible for the Toolkit to model an approach where the land acquisition cost is used as a driver for the viability calculation. This is an approach which is similar to that being promoted by the RICS. Users will be need to be aware that this approach effectively "turns the model on its head", and determines that policy requirements are the 'residual' in the calculation and open to being 'squeezed' by developers who have not reflected policy in their bid for land.

The Mayor considers that it is for boroughs (and for himself, in cases he determines) and other toolkit users to determine which is the most appropriate in the light of their local circumstances. In instances where there is some uncertainty over which approach to adopt, users are advised to take into account the precedents and established practice set out below rather than simply taking RICS advice that the MV approach should be used. If the user opts for the MV approach, the GLA suggests that they pay full regard to development plan policies and all other material planning considerations and disregards that which is contrary to the development plan. This approach is supported by the RICS Guidance'.

5.20 The note makes no reference to the NPPF and London Plan and the need to encourage rather than restrain development. The Market Value approach, in cases, requires a flexing of the planning obligations in alignment with Government intent on land delivery. However, the use of Market Value is not intended to be incorporated in viability statements to simply protect acquisition cost and market risk to which developers are indemnified through the margin.

5.21 In terms of the options for Site Value, EUV relates to the value of the asset at today's date in the current planning use. A number of practitioners have confused EUV with CUV, and whilst they can be the same thing, the difference is that EUV relates to the value of actual income whereas CUV is based on the site's existing planning use.

5.22 EUV as defined by the RICS's Valuation Standards ('Red Book') should only be used to value property that is owner-occupied by a business, or other entity, for inclusion in financial statements.

5.23 The AUV relates to a residual Site Value for another planning use that has a reasonable chance of obtaining planning permission. AUV should not be confused with Market Value although in some instances they can be the same.

RICS Financial Viability in Planning (FVIP)

5.24 The RICS FVIP was published in September 2012 and provides an update on the CUV plus approach based on the sector's interpretation of Government policy, most notably in the form of the NPPF.

5.25 The RICS's criticism of the CUV based approach in particular is that it is too arbitrary and provides an artificial view on viability ignoring deliverability (i.e. that the market may not deliver land at the Site Values proposed).

5.26 To give an example, where a site in a medium to high value residential location has an existing use of say £1 million for a low grade industrial use, it is not necessarily reasonable to expect the site to be sold for development purposes, where there is a reasonable prospect of planning being achieved, with a 20% uplift.

5.27 The market is unlikely to deliver sites at this level and the NPPF seeks to strike a balance between Site Value and the delivery of proposals that meet the required policy tests. The RICS FVIP presents a shift in direction on viability matters in this regard with the deliverability of projects being a key theme aligned with Government intent.

5.28 The RICS GN proposes the use of a risk adjusted Market Value as an appropriate Site Value in planning negotiations, being in accordance with paragraph 173 of the NPPF and the requirement for a reasonable return to the site owner in order for landowners to be encouraged to bring sites forward for development.

5.29 Section 2.3.1 of FVIP states that Site Value as an input into an appraisal or as a benchmark value should be defined as follows:

'Site Value should equate to the Market Value subject to the following assumption: that the value has regard to development plan policies and all other material planning considerations and disregards that which is contrary to the development plan'.

5.30 To take the example above in 5.25, using the Market Value approach, an uplift of 20% is no longer added to the CUV but a practitioner should look at the local market and assess what constitutes a reasonable Site Value. The Site Value should represent a balance with a requirement for a proposal to meet its planning obligations in accordance with the Development Plan and thus for the proposal to be deemed acceptable in planning terms.

5.31 One might conclude that the CUV plus approach is a 'bottom up' methodology whereas the RICS FVIP takes a 'top-down' approach. The RICS view is in our opinion aligned with the NPPF and the need to encourage landowners to deliver sites.

5.32 The use of Market Value and reference to the RICS FVIP by the Planning Inspectorate and Secretary of State is as yet relatively limited given the timeline. However, there is a general acceptance by most practitioners that the approach is aligned with the NPPF and the St Edmunds Terrace Appeal decision (reference APP/X5210/A/12/2173598) is of interest in this regard.

5.33 A copy of this Decision is included as Appendix Seven and paragraphs 7 to 11 of the Decision relate to the Inspector's interpretation of Site Value and the use of Market Value with reference to the RICS FVIP.

5.34 We are of the opinion that the decision reflects the direction of travel on viability matters, and one we expect to be repeated in other decisions going forward reflecting central Government intent on such matters.

<u>Local Housing Delivery Group Viability Testing in Local Plans</u>

5.35 The LHDG[3] report was published for the attention of planning practitioners in July 2012. The report as the name suggests is compiled in the context of viability testing for Local Plan Policy making however the report notes that the principles are relevant to development management (i.e. individual sites).

5.36 The report states that the benchmark or Threshold Land Value should be based on a premium over current use values and credible alternative use values. This approach reflects the 'bottom up' methodology discussed above (i.e. CUV plus). The LHDG publication provides a definition of viability, being:

"An individual development can be said to be viable if, after taking account of all costs, including central and local government policy and regulatory costs and the cost and availability of development finance, the scheme provides a competitive return to the developer to ensure that development takes place and generates a land value sufficient to persuade the land owner to sell the land for the development proposed. If these conditions are not met, a scheme will not be delivered."

5.37 The report notes that reference to Market Value can provide a useful 'sense check' in relation to the threshold values that are being used in the model. This is an important meaning in our opinion that the uplift from CUV should make reference to the local market thus enhancing the probability that sites will come forward.

5.38 In our opinion, this reference to Market Value is aligned with the NPPF and implies that the premium to be added to the CUV should not be an arbitrary figure but should be based on a level at which, on a risk-adjusted basis (i.e. taking into account planning risk), a landowner would likely release land for development.

[3] Local Housing Delivery Group, Viability Testing local Plans, Advice for Practitioners, July 2012

Outturn Modelling

5.39 As a starting point, we have assessed the commercial viability of the project on a Present Day basis in accordance with best practice on viability matters. However, we have also included outturn modelling that incorporates property growth and cost inflationary measures on the major development appraisal inputs.

5.40 The use of growth and inflationary measures has historically been resisted in FVAs and there have been Planning Appeal cases where the Planning Inspectorate has concluded that viability should be conducted on a Present Day basis.

5.41 However, in the current economic environment and particularly with regard strategic development with significant enabling costs, this invariably results in appraisals that are unable to support a 'reasonable' level of planning obligations on a present day basis.

5.42 In cases where outturn modelling is used to the benefit of the appraisal we are opposed to the use of the review mechanisms as a further way in which to potentially secure uplift. The use of reviews negates the inclusion of outturn modelling and as such, the ability of an Applicant to make an improved 'day one' offer as is the case here.

5.43 Outturn modelling is now being encouraged as best practice on large scale capital intensive regeneration projects where a higher level of planning obligations can potentially be yielded using this approach. The inclusion of outturn modelling has recently found its way into a number of publications including the RICS GN and the Local Housing Delivery Group publications and is supported by the GLA. This however carries with it a higher level of risk for the Applicant.

6 Site Value for Plots C & E

Subject Site

6.1 The site benefits from an extant consent for residential led mixed use development. The consent (reference: 09/AP/1783) was granted in 2010. The application was submitted by the Conrad Phoenix Group in partnership with Investec Bank. Sellar have since replaced the Conrad Phoenix Group as the joint venture organisation.

6.2 The consent comprised 430 residential units, including 100 affordable dwellings and a range of commercial uses. As part of our initial work, this consent was valued however the land value was negative.

6.3 We understand that no contractual arrangement was ever reached with Decathlon and as such, whilst the consent could have been technically implementable, the scheme could not be delivered.

6.4 Appendix Eight is a Red Book valuation letter provided by Investec's valuers illustrating their opinion of the value of the two assets on a Current Use and Market Value basis. The letter reports that the EUV of Site C is £12.5 million however the Site has a Market Value of £18 million. The reported EUV of Site E is £2 million with a Market Value of £7 million.

6.5 Therefore the EUV is £14.5 million but with a Market Value, in accordance with the RICS Valuation Standards, of £25 million. In incorporating this figure as a robust Site Value in our appraisals we have assessed the Market Value on the basis of the proposed development quantum and at significantly less than £50 psf on both the gross and net areas, concluded that this is a reasonable assumption.

7 Development & Sales Timings

7.1 The development programme is estimated at today's date. The accuracy of the programme will depend on a number of factors including the Applicant's ability to fund the scheme and the performance of the relative commercial and residential property markets over a considerable period of time.

<u>Development Timings</u>

7.2 Table Five sets out the key milestones in the 15% on-site affordable scenario:

Table 5: Canada Water Sites C & E, Development Timings, January 2013

Phase	Building	Units	Pre-construction		Construction		Post Completion	
			Start	End	Start	End	Start	End
1	C1	235	August 12	July 13	August 2013	January 2016	February 2016	July 2016
2	C2, C3	302			February 2016	July 2018	August 2018	April 2019
3	C4	273			August 2018	July 2020	August 2020	July 2021
4	E1	236			August 2020	January 2023	February 2023	July 2023

7.3 The overall construction programme is 10 years. In reality the programme, with associated costs, is longer as our cash flow includes an August 2012 starting point whereas the Applicant have been involved in site assembly and the subsequent planning and design process for a considerable period of time.

7.4 The 12 month pre-commencement period includes time for the following:

- Obtaining a satisfactory planning consent;
- Signing of the legal agreements;
- Expiration of the Judicial Review period following the granting of planning;
- Securing Vacant Possession;
- Securing necessary development funding; and
- Preparation of a sales and marketing campaign.

Delivery of Affordable Housing

7.5 In terms of on-site affordable housing delivery there are two scenarios. Firstly 15% affordable housing delivered as part of Site E (phase four) with an anticipated start on site in August 2020. Secondly, Phase Four being brought forward and aligned with Phase Two, with an anticipated February 2016 start on site.

Residential Sales Timings

7.6 In terms of our sales timings, we have assumed that 20% of the sales for each phase will be secured prior to the construction start in order to partially de-risk the project and provide security for the Applicant and their funders.

7.7 Upon construction sales will be secured at 10 per month with a 10% deposit secured in the cash flow, and the balance payable on practical completion. The only phase with any post completion sales in Phase Four, Site E1. This is an aggressive sales profile given the volume of private accommodation and price point anticipated.

8 Development Value

Appraisal Inputs

8.1 All the following inputs are based on research and information available at today's date and are included on a present day basis. We shall come onto growth and inflationary measures and the resulting impact on residual outputs in Section 12 of this report.

Residential Values

8.2 The residential apartments have been designed to meet 'Lifetime Homes' requirements and also are in accordance with the Mayor of London's Housing SPG Standards and LBS's Residential Design Standards. In many cases, the standards are exceeded. The average present day £ per sq ft rates for each block are illustrated below:

- Block C1 - £540 per sq ft
- Block C2 - £580 per sq ft
- Block C3 - £600 per sq ft
- Block C4 - £800 per sq ft
- Block E - £560 per sq ft

8.3 The residential accommodation will be delivered to a specification commensurate with the location, target market and values likely to be achieved. An indicative specification is included as Appendix Nine.

Comparable Residential Evidence

8.4 In terms of evidence, Barratt's Maple Quays scheme to the immediate north-west is the most obvious comparable.

8.5 Molior London monitors pricing across all of London's boroughs and notes that Barratt's are currently marketing and selling dwellings at Phase 3 of their Maple Quays development (which is previously referred to as Canada Water Site A, and is immediately North West of the subject site, Site C).

8.6 In terms of historic sales on the site, phase one (Toronto House) comprising 41 private dwellings sold at an average of £449 per sq ft (achieved pricing from Land Registry) in the summer of 2008 and early 2009.

8.7 Phase one consisted of an eight storey building with a commercial ground floor. The highest capital value that Molior has relates to a 6th floor, 2 bed 794 sq ft apartment that sold for £347,000 equating to £437 per sq ft. The average selling price across the scheme, from the data available was under £300,000.

8.8 Phase Two (Montreal House) consisted of a part seven, part eight storey building with 124 private dwellings. The scheme was marketed at the start of 2009 and sold out by the end of the third quarter of 2010. The sales averaged £529 per sq ft and the highest value apartment we can find is an eighth floor 2 bed 814 sq ft apartment that sold for £480,000 equating to £589 per sq ft. The average selling price across the scheme, form the data available was just under £334,000.

8.9 Phase Three is by far the largest phase, with as we understand it, 498 private dwellings in a number of blocks, namely, Faremont, Vancouver, Ottawa, Ontario, Brampton House, Victoria House and Canada Point. The tallest building on the site comprises a 26 storey residential tower called Ontario Tower. The third phase launched in the summer of 2010.

Table 6, Maple Quays Sales Data, January 2013

Plot No	Floor	Beds	Sq Ft	Prices	£ psf	Sales date
B37	1	2	693	£391,000	£564	Mar-12
B43	2	2	699	£394,000	£564	Mar-12
B46	2	1	578	£311,000	£538	Mar-12
B48	3	1	538	£299,000	£556	Mar-12
B57	3	1	554	£306,000	£552	Mar-12
B59	4	1	525	£299,000	£570	Mar-12
B61	4	1	578	£327,000	£566	Mar-12
V093		Studio	375	£267,000	£712	Mar-12
V167		Studio	375	£273,000	£728	Mar-12

B29	G	Studio	406	£265,500	£654	Jun-12
B33	1	2	790	£423,500	£536	Jun-12
B36	1	Studio	407	£270,500	£665	Jun-12
B44	2	1	525	£299,000	£570	Jun-12
B56	4	1	534	£323,000	£605	Jun-12
B64	5	1	525	£328,500	£626	Jun-12
OP06	1	2	770	£418,500	£544	Jun-12
OP08	2	2	747	£437,000	£585	Jun-12
OP24	4	2	770	£427,500	£555	Jun-12
OP30	5	2	770	£430,500	£559	Jun-12
OP54	9	2	770	£451,000	£586	Jun-12
B62	5	Studio	376	£310,000	£824	Sep-12
OP07	2	1	548	£325,000	£593	Sep-12

8.10 Brampton House is in the final stages of being marketed. There are three units available on the developer's website, all one bed fourth floor apartments ranging from £299,000 to £327,000 equating £552 to £565 per sq ft. In forming our opinion of value we have also had regard to local agents and a range of recently built apartments that are currently on the market.

8.11 There is limited information available and we note that only the lower floors are currently available (up to the ninth) however to give examples of the highest priced units available, there is a fifth floor two bed en-suite 768 sq ft apartment priced at £422,000 equating to £549 per sq ft and a one bed third floor 548 sq ft apartment at £321,000 equating to £585 per sq ft. Discounts and incentives will need to be considered on what are headline prices.

8.12 The average selling price on the scheme is £350,000 and the phase is averaging £560 per sq ft according to Molior. Similarly, Estates Gazette is stating that the average selling price across the third phase is £557 per sq ft with an average selling price of £354,000 (see Table 7 below for listed 2012 sales).

8.13 We note that Barratts have started to market Ontario Point, the 26 storey tower. Their website is currently marketing a number of dwellings. These are:

Table 7, Ontario Tower, Current Availability, January 2013

Plot No	Floor	Beds	Sq Ft	Prices	£ psf
94	16	1	548	£430,000	£784
93	16	1	541	£435,000	£804
112	19	1	548	£439,000	£801
111	19	1	541	£444,000	£820
117	20	1	541	£500,000	£924
115	20	1	548	£560,000	£1,021
120	20	2	768	£700,000	£911

8.14 There is a significant height for premium, albeit these are asking prices and not achieved. The sales data available would suggest that only a handful on units have been sold over the tenth floor. That said our valuation of the subject site takes into consideration this premium for height albeit it appears to be relatively untested in this location.

Residential Agent's View

8.15 We have sought advice from Jones Lang LaSalle who are one of the UK's lead agents for new homes sales and have most recently been the leading agent on the first phase of the Battersea Power Station residential sales and marketing campaign. Their formal advice is included as Appendix Ten.

Commercial Property Values

8.16 The CBRE advice and comparable evidence for the commercial property element is included as Appendix 11. In summary the CBRE view is that commercial rents for retail and office space in this location will be between £20 and £25 psf with significant voids and rent free periods.

8.17 CBRE note that there may be some upside, as well as downside, from these rental levels depending on the lease however they note the importance of ‘building’ value in such a location as Canada Water where the delivery of new commercial uses is relatively untested.

8.18 This would imply that there is significant downside on rental levels for a period of time until the location matures. In summary, the CBRE letter states:

- General value of £20 to £25 per sq ft for the retail elements as A1 or A3 (restaurant);
- Local uses such as dry cleaners/pharmacies likely to be in the region of £18 - £20 per sq ft;
- Gymnasium space which we have included in Phase 3, we would look to put a rental figure of £8- £12per sq ft dependant on whether it is a wet or dry gym; and
- Cinemas value at £6 - £8 per sq ft.

8.19 CBRE advocate the use of strong void periods on the retail, as the phased elements do effect the position on letting and retailers view of critical mass. A period of 12 months should be allowed from completion and an amount for capital contributions on the site.

8.20 CBRE suggest at least 12 months equivalent as the units are relatively small overall. You will note that in the majority of cases we have included only a 6 month void for the office and retail elements, with the cinema let on completion.

Affordable Housing Valuation

8.21 In valuing the affordable housing we have had regard to LBS's emerging policy and in particular our recent experience of valuing Affordable Rent in the borough. We have used ProVal which is specialist discounted cash flow software used by the Housing Association sector. We have experience in valuing affordable housing for banks and Registered Providers and have advised the RICS on valuation matters.

8.22 The affordable accommodation is included at a blended average of £200 psf which includes the provision of 70% affordable rent and 30% intermediate tenures.

8.23 The affordable payments are cash flowed through the construction period in quarterly payments, assumed to be on certification by the Employer's Agent. There would be a relatively small, say 2%, retention held back for 12 months to cover defects albeit this is not included in our appraisals.

Affordable Rent

8.24 As of April 2011, Registered Providers, Local Authorities and other providers of affordable housing were able to offer new tenancies in accordance with the definition previously contained in PPS3 and now in Annex 3 of the NPPF.

8.25 The Affordable Rent model did not require new legislation. Affordable Rent falls within the definition of social housing in Section 68 of the Housing and Regeneration Act 2008 (and, in particular, the definition of low cost rental accommodation in section 69 of that Act). Affordable Rent was worked up alongside the Localism Act 2011 that contained provisions to enable social landlords to offer 'flexible' tenancies with a minimum fixed-term of two years for new tenants of social housing.

8.26 Local Authorities have interpreted Affordable Rent in different ways, often based on research of affordability and housing need at a local level. In some areas (predominantly outside London) 80% of Market Rent may be very similar to target rents and as such the change is not substantial.

8.27 In areas with high Market Rents, Local Authorities and Registered Providers have had regard to affordability with in many cases particular reference to Local Housing Allowance caps (these are broadly double previous target rents) and with an eye on current Government initiatives around welfare reform.

8.28 For the purposes of the subject site and the valuation of the Affordable Rented element we have had regard to LBS's current position which is, in summary, concerns regarding the affordability and as such LBS's position is some way below 80% Market Rents in perpetuity.

8.29 LBS's current position on Affordable Rent will be influenced by the Inspector's Report from the recent Examination in Public for the Minor Alterations and any update to their draft Affordable Housing SPD may have an impact on our affordable housing valuation and as such the viability of the current proposed provision.

Intermediate Provision

8.30 In terms of the valuation of the intermediate accommodation we have had regard to LBS's affordability criteria set out on page 17 to 18 of their Affordable Housing draft SPD. The policy refers to London Plan affordability caps which we note have recently been updated in the Mayor's Annual Monitoring Report (AMR) as required.

8.31 Intermediate provision is sub-market housing, where costs, including service charges, are above target rents for social rented housing, but where costs, including service charges, are affordable to households with a household income cap. The latest Mayoral AMR states that the cap is £64,300 and this is applicable for one and two bed properties.

8.32 In the Mayor's 2011 replacement London Plan, the Mayor sets out a higher intermediate housing income threshold of £74,000 for households with dependents, in order to reflect the higher cost of both developing and buying family-sized homes in London. This figure has since been updated to £77,200 for family accommodation (three bed plus dwellings).

Affordable Housing Provider

8.33 It is assumed that the Applicant will enter into a contract with an affordable housing provider and the accommodation would be transferred upon completion to a pre-defined specification.

8.34 The accommodation would be 'tenure-blind' and meet the same high standards that are being proposed for the private space. The affordable housing provider is likely to be on LBS's preferred Registered Provider list albeit there are a number of additional associations that may also be considered.

Additional Income

8.35 We have assumed that the ground rent income will be capitalised and sold as an investment. The average ground rent is estimated to be £350 per dwelling, and this income capitalised at 6%. Information related to service charges and ground rents at neighbouring Maple Quays is included as Appendix 12.

8.36 The capitalised ground rent per unit is £5,500 once purchaser's costs are deducted. The income is cash flowed upon the sale of the last residential dwelling. No ground rent income is included for the affordable element.

8.37 Car parking has been included for the residential element at an additional £25,000 per space which is consistent with asking prices from Maple Quays. There are 220 residential car parking spaces that derive an income and these will be located in the basement area below buildings C2, C3, C4 and E1. There will be no residential parking for Phase One and building C1.

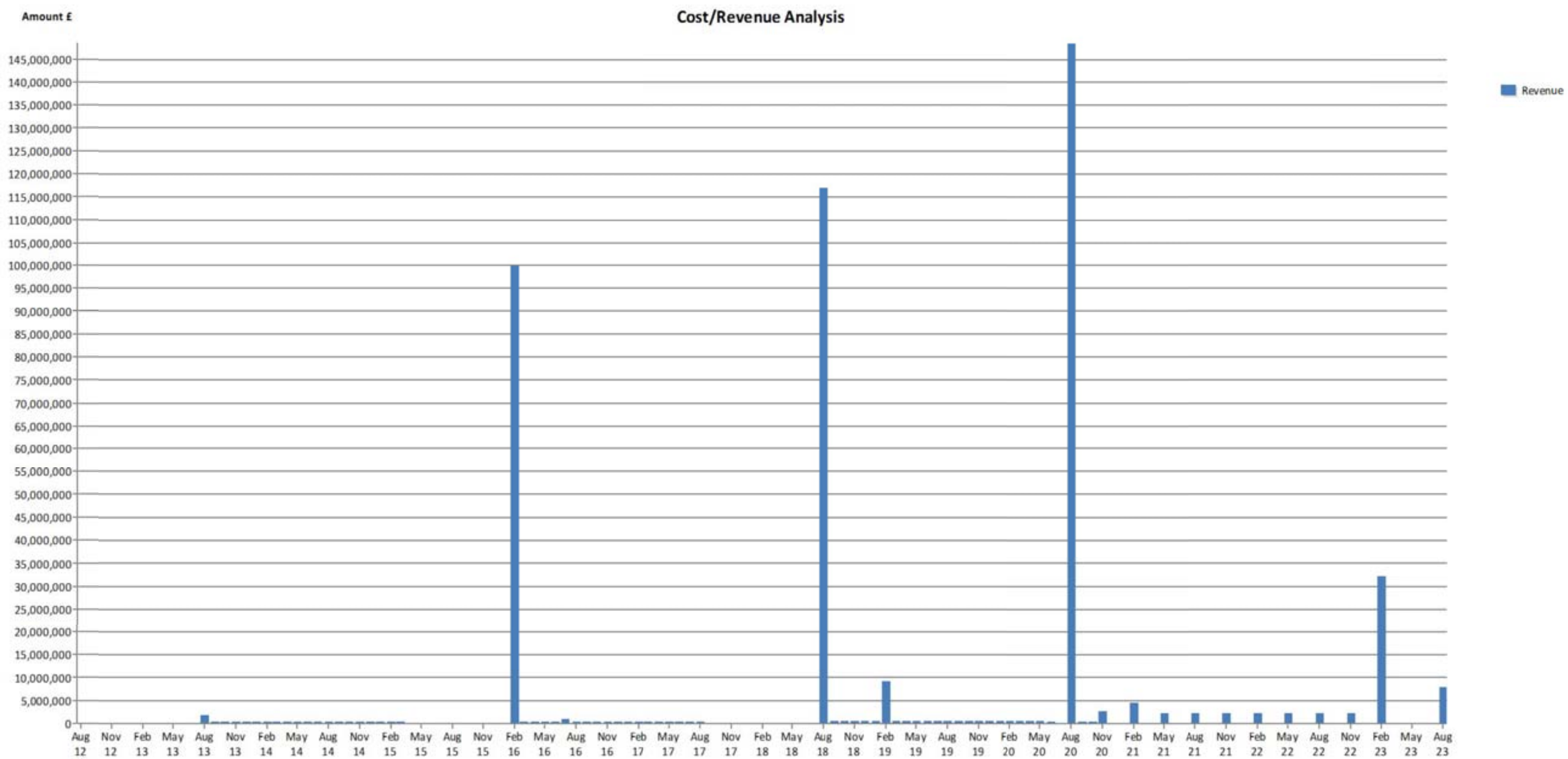
Revenue Profile

8.38 The graph (over page) illustrates on a present day basis that there are a number of spikes, reflecting the completion of individual phases, where the majority of income is received from the residential sales.

8.39 There is a significant capital commitment until the first tranche of income in 2016. The peak cumulative debt, inclusive of the land cost, is forecast in January 2018 at £96 million. This will be funded through a combination of senior and mezzanine debt and other equity sources.

8.40 The cash flow is forecast to become positive in August 2018, some five years after the commencement of development. The profile is based upon the 15% on-site affordable housing scheme. The 100% private scheme with £20 million in affordable housing contributions has a greater aggregated deficit and a longer period until the cash flow becomes positive.

Chart One: Canada Water Sites C & E Revenue Analysis (15% affordable scheme)



9 Development Costs

9.1 This section provides a summary of the development costs on a Present Day basis These comprise:

- Build costs;
- Exceptional costs;
- Professional fees (incl. of planning, building regulations & Rights of Light payment);
- Sales, letting & marketing costs;
- Financing costs;
- Profit expectations;
- Planning obligations including Mayoral CIL; and
- Additional development Costs.

Build Costs

9.2 We have provided with two cost plans by Davis Langdon and these are included as Appendix 13. In summary, one for phase one (building C1) and one for the remaining site (buildings C2, C3, C4 and E1). The main components of the build costs are as follows:

Table 8: Canada Water Site C1, New Build Costs, January 2013

Component	**C1**
Demolition / Enabling Works / Site Prep	£2,600,000
Basement works	£9,980,000
Retail store (above ground)	£13,030,000
Podium Residential (above ground)	£9,440,000
Residential (above retail)	£41,080,000
Public realm / external works / utilities	£4,020,000
	£80,150,000

9.3 Site C1 has a total build cost of £80,150,000 on a present day basis. This equates to £195 psf on the GIA and £333 on the NIA. The figure includes main contractor's preliminaries, overheads and profit. Table 9 includes the core build costs for buildings C2, C3, C4 and E1.

Table 9: Canada Water Site C1, New Build Costs, January 2013

Component	**C2-C4 & E1**
Demolition / Enabling Works / Site Prep	£2,100,000
Basement works	£21,440,000
Building C2	£24,590,000
Building C3	£36,490,000
Building C4	£67,160,000
Building E1	£60,040,000
Public realm / external works / utilities	£8,560,000
	£220,380,000

9.4 Sites C2, C3, C4 and C5 have total build costs of £220,380,000 on a present day basis. This equates to £248 psf on the GIA and £385 on the NIA.

9.5 In both cost plans Davis Langdon have allowed for 3.5% overheads and profit, 14% for preliminaries and 7.5% for design reserve and contingency.

9.6 A full list of exclusions is contained within the Davis Langdon cost reports along with an elemental back up based on the planning application drawings.

Professional Fees

9.7 Professional fees are included at 14% of the build costs. The costs are reflective of a large scale regeneration project and include the following general inputs:

- Architect 4 to 6%
- Engineer (MEP) 1.5 to 2%
- Engineer (Structures) 1.5 to 2%
- Quantity Surveyor 1 to 1.5%
- Landscape Architect 0.75 to 1%
- Planning Supervisor / CDM Coordinator 0.5%
- Project Manager 1 to 1.5%
- Sundries 1%

9.8 The total equates to a range of 11.25% to 15.5%

Sales, Marketing & Disposal Costs

9.9 Residential marketing is included at 2% of the overall private value with an additional 2% agency fee (includes the costs of on-site marketing suites and a regional, national and overseas sales campaign). The residential costs also include a £1,000 per dwelling legal fee.

9.10 This is as advised by Jones Lang La Salle who state that a 2% sole agency fee for international and local sales. Advertising and marketing budget, including brochures, models, print advertising, on line advertising, overseas marketing campaign and the construction of an on-site marketing suite with 2 to 3 full time members of staff would equate to circa 2 to 3% of the GDV.

9.11 CBRE advise that the commercial costs would be a 15% (of first year ERV) letting fee, and a 5% legal fee of the capitalised rent. Commercial marketing is included at £2 psf on the NIA.

Finance

9.12 We have included a pre-finance IRR as the profit measure given the nature of the project and the anticipated timings of the proposal. Therefore we have not included funding costs in this appraisal. However this is a significant development cost that impacts upon the level at which the IRR will be set.

9.13 In the current lending environment, and that for the foreseeable future, we would anticipate that a bank will require a significant level of equity to be provided. This may be thorough the use of the Applicant's cash or other forms of private equity.

9.14 The latter can be expensive as the returns required currently for private equity are high, typically 15% and above return required. Mezzanine and junior debt will also be expensive and at a significant premium to senior debt.

9.15 We would also anticipate arrangement fees. This could be significant, and at say 1.5% of the peak cumulative debt. There may also be a monitoring fee attached to the bank's senior debt.

Profit Expectation

9.16 The cash flow, less profit allowances or finance, is discounted at an appropriate rate in order for the cash flows to achieve a net present value of zero. The approach is not uncommon on major developments spanning a significant period of time and is a more accurate way of assessing a project's commercial strength, when compared to other investments, than a more traditional profit on cost or value approach.

9.17 A more traditional profit on cost measure for example is not appropriate in this type of model as it represents a return over the entire development period and therefore fails to take account of the length of time that money is committed to the project.

9.18 The RICS GN advocates the use of a pre-finance IRR particularly for use on long term projects in excess of five years. The IRR is undertaken on a pre-finance basis in order to assess the commercial status of a project without the costs of finance attached and then a separate calculation will be undertaken to assess the impact of the cost of debt and other sources of capital.

9.19 Southwark's Viability Report written in July 2012 supporting the draft CiL Charging Schedule states that a 20% IRR is a reasonable target rate for London development.

9.20 We are therefore of the opinion that a 20% IRR on the subject site is a reasonable target return for the subject site given the scale, location and speculative nature of the development.

Internal Overheads (Development Management Fee)

9.21 We have included a 2% development management fee that reflects the Applicant's cost of running the project. This cost is a real and legitimate development input and one that is included at 6% of the build costs in the GLA's model.

Financial Obligations

9.22 We have included the following additional financial obligations as advised by Tibbalds the project planning consultants with reference to LBS's Planning Obligation SPD:

- CIL: £4,154,850
- Education: £1,131,079
- Employment in the Development: £247,207
- Employment during construction: £1,073,018
- Employment during construction (management fee): £84,092
- Public open space, children's plays equipment and sport development.
  - Open space: £495,387
  - Children's play equipment: £132,359
  - Sports Development: £1,208,112

➢	Transport strategic:	£754,043
➢	Transport site specific:	£801,970
➢	Public realm:	£1,063,470
➢	Archaeology:	£16,135
➢	Health:	£1,180,824
➢	Community facilities:	£177,494

9.23 This equates to a total of £12,547,040 and excludes an administrative charge of £113,922 equating to 2% of the first £3 million of monetary contributions to be provided thereunder and 1% of monetary contributions to be provided thereafter.

9.24 In terms of cash flow we have pro-rated the Section 106 costs across all four phases of the development albeit the payment is subject to an agreement in respect of the amount and the timing between LBS and the Applicant. The Mayoral CIL costs are payable on implementation on the first phase.

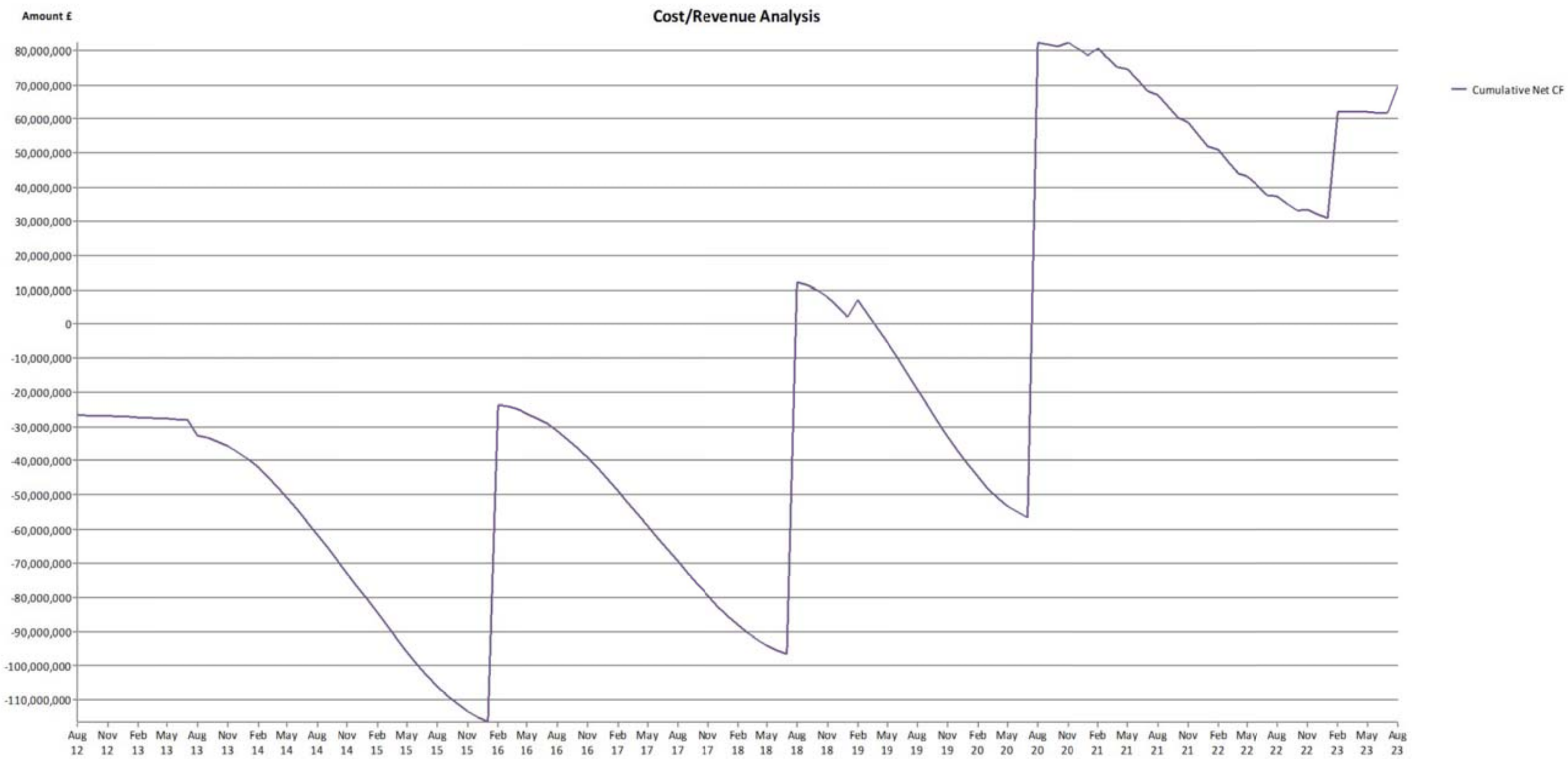
Community Infrastructure Levy

9.25 We note that LBS have recently published their draft Charging CIL Schedule as required by the 2010 CIL Regulations (as amended).

9.26 The draft Charging Schedule is not yet adopted and this application will therefore not be liable for LBS CIL. It is perhaps worth noting however, the implications of the new draft CIL rates on the site, against the current S106 liability, based upon the proposed rates and the scale of Chargeable Development proposed at the subject site.

9.27 The Chart (over page) reflects the cumulative cash flow position for the 15% affordable housing scheme taking into account total revenues and costs.

Chart Two: Canada Water Sites C & E Cumulative Cost / Revenue Analysis (15% affordable housing scenario)



10 Present Day Appraisals

10.1 Our Present Day development appraisals are as follows:

- 15% mixed tenure affordable housing in Site E delivered in 2019/20 with £8,392,190 in financial obligations and £4,154,850 in Mayoral CIL (Appendix 14);
- 10% mixed tenure affordable housing in Site E delivered in 2016 with £8,392,190 in financial obligations and £4,154,850 in Mayoral CIL (Appendix 15); and
- 100% private scheme with a £20 million commuted payment payable in four separate payments to be ring-fenced for affordable housing elsewhere in the borough plus £8,392,190 in financial obligations and £4,154,850 in Mayoral CIL (Appendix 16).

10.2 The present day appraisals produce the following results:

Table 10: Canada Water Sites C & E, Present Day Appraisal Outputs, January 2013

Scenario	Affordable Output	IRR (%)
15% affordable	156 mixed tenure dwellings	11.29%
10% affordable	105 mixed tenure dwellings	11.96%
Commuted sum	£20,000,000	10.07%

10.3 All three outputs deliver a profit return that is below the benchmark expectation namely a 20% pre-finance IRR. We have therefore considered the likely impact of market movements and cost inflation / deflation on the residual outputs. The results of this analysis are illustrated by way of the sensitivity analysis in Section 11 and the outturn modelling in Section 12.

10.4 Based on present day analysis, the affordable housing outputs are not viable and there is a considerable gap between the residual profit returns and the benchmark requirements.

11 Present Day Sensitivity Analysis (15% AH model)

11.1 This section provides analysis in relation to the major cost and value inputs into our appraisals. The sensitivities have been run on the present day 15% on-site affordable housing model only. The outturn modelling is inherently based on additional sensitivities contained within the appraisal (i.e. construction cost and property growth forecasts over a significant period of time).

11.2 Table 11 illustrates 5% incremental changes in the core construction costs and residential sales values.

Table 11: Construction Cost & Sales Value Sensitivities, Canada Water, January 2013

		Sales Rate - psf				
		-10%	-5%	0%	+5%	+10%
Construction - Rate psf	-10%	£411,846,922	£432,354,802	£452,862,682	£473,370,562	£493,878,442
		9.6078%	12.5671%	15.3493%	17.9811%	20.48%
	-5%	£411,846,922	£432,354,802	£452,862,682	£473,370,562	£493,878,442
		7.4511%	10.4780%	13.3169%	15.9968%	18.54%
	0%	£411,846,922	£432,354,802	£452,862,682	£473,370,562	£493,878,442
		5.2969%	8.3943%	11.2921%	14.0220%	16.61%
	+5%	£411,846,922	£432,354,802	£452,862,682	£473,370,562	£493,878,442
		3.1447%	6.3154%	9.2747%	12.0564%	14.69%
	+10%	£411,846,922	£432,354,802	£452,862,682	£473,370,562	£493,878,442
		0.9941%	4.2410%	7.2640%	10.0995%	12.7759

11.3 The blue cell represents the present day output being a 11.29% return and a net development value of £452,862,682. The green shaded cells represent where there is a better outcome in terms of the IRR.

12 Outturn Appraisals

12.1 Our Outturn development appraisals are as follows:

- 15% mixed tenure affordable housing in Site E delivered in 2019/20 with £8,392,190 in financial obligations and £4,154,850 in Mayoral CIL (Appendix 17);
- 10% mixed tenure affordable housing in Site E delivered in 2016 with £8,392,190 in financial obligations and £4,154,850 in Mayoral CIL (Appendix 18); and
- 100% private scheme with a £20 million commuted payment payable in four separate payments to be ring-fenced for affordable housing elsewhere in the borough plus £8,392,190 in financial obligations and £4,154,850 in Mayoral CIL (Appendix 19).

Residential Value Growth

12.2 We have included residential growth forecasts as provided by Jones Lang LaSalle. A copy of their November 2012 Forecast is included as Appendix 20.

12.3 The Jones Lang LaSalle forecasts appear ‘full’ given the current economic uncertainty albeit they are forecasts from a residential agent and not an independent economic forecast so will be inherently bullish.

12.4 Jones Lang LaSalle forecast growth of 2% in 2013, 3.5% in 2014, 6% in 2015 and 7.5% thereafter (whilst their forecast ends in 2017 we have continued the trend until the end of the development cash flow).

Commercial Value Growth

12.5 As advised by CBRE, we have not included rental growth on any of the figures. We note that we have incorporated the higher end of the range in terms of rents and lower void periods as advised by the commercial agent and this comes with its own risks.

12.6 There is a significant risk in the current environment that rental values will not be achieved and the incentives required to secure tenants will not fully reflect the costs incorporated in our appraisals.

<u>Construction Cost Inflation</u>

12.7 The Chancellor's Autumn Statement in 2012 predicted that the economy was to remain weak going through into 2013, with a 0.1% fall in 2012 and 1.2% growth in 2013. Stronger growth of 2.0% is forecast for 2014, growth gaining strength through to 2017, with growth of 2.8%.

12.8 The following information is provided on the Building Cost Information Survey (BCIS) website and relates to recent central Government economic indicators that forecast a gradual reduction in net borrowing.

Table 12: Key Economic Indicators (Autumn 2012)

Indicator/Year	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Growth (GDP) %	-0.1	1.2	2	2.3	2.7	2.8
Inflation (CPI) %	2.8	2.5	2.2	2	2	2
Inflation (RPI) %	3.2	3	2.6	3.1	3.4	3.7
Budget Deficit/Surplus*	-£89bn	-£74bn	-£62bn	-£51bn	-£26bn	-£8bn
Net Borrowing*	£80bn	£99bn	£88bn	£73bn	£49bn	£31bn

12.9 We have incorporated the BCIS Regional Tender Price Index for Greater London in our outturn modelling. The forecast incorporates the following rates - -1.4% until the end of 2012, 1.8% in 2013, 3.2% in 2014, 3.5% in 2015, 4.2% in 2016 and 4.9% in 2017. As with the residential forecast we have included the final year's available figure until the end of the programme.

Outturn Results

12.10 The outturn appraisals produce the following results:

Table 13: Canada Water Sites C & E, Outturn Appraisal Outputs, January 2013		
Scenario	**Affordable Output**	**IRR (%)**
15% affordable	156 mixed tenure dwellings	18.78%
10% affordable	105 mixed tenure dwellings	15.84%
Commuted sum	£20,000,000	15.83%

12.11 All three outputs deliver a profit return that is below the benchmark expectation namely a 20% pre-finance IRR albeit the outturn modelling provides an improved return based on bullish residential forecasts.

12.12 There is significant risk attached to the residential forecasts and whilst they are included here for the purposes of risk analysis the Applicant is hesitant about any future proposed increase in planning obligations based on these forecasts.

12.13 However, the forecasts alongside the sensitivity analysis give the Applicant a view on where the market may move throughout the course of the development programme and as such have informed the scheme's affordable housing content.

13 Affordable Housing Outputs

13.1 The scenarios included in this FVA include two options with on-site affordable housing namely 15% delivered in the final phase or 10% delivered in alignment with phase two. The third scenario is a £20 million commuted sum payment made to Southwark's affordable housing fund.

On-Site Affordable

13.2 According to various sources, Rotherhithe Ward has a high proportion of affordable homes predominantly in the form of social rented accommodation. The CWAAP notes the high propensity of affordable accommodation in the Ward area. However, the CWAAP is clear that additional affordable housing is required in the AAP with a target of 875 new affordable homes over the period until 2016 subject to viability.

13.3 As noted in Section 8 of this report, any on-site affordable housing would be 'tenure blind' that is externally undistinguishable when compared to the private accommodation.

13.4 The accommodation would meet and exceed in many cases the LBS and GLA design and space standards and be delivered to an affordable housing provider in accordance with all recognised affordable housing standards and affordability criteria.

13.5 However the viability analysis has clearly demonstrated that the affordable housing quantum is maximised by late delivery in the programme. This is because of the medium priced location (by central London comparisons), the costs of development and the cost of the Decathlon contractual arrangements.

13.6 In regard the latter, because of the confidential nature of the agreement between the Applicant and the leaseholder we would not expect the other appraisals referred to in the AAP (most notably the Affordable Housing Viability Study) to make any reference to this considerable cost and loss of investment value.

13.7 We have considered how a commuted sum might be used to maximise the provision of affordable housing elsewhere, as is allowed in regional and local planning policy.

Off-Site Affordable Solutions

13.8 The options available to LBS for the commuted sum include:

- Financial payment to Southwark's affordable housing fund – LBS announced in May 2012 that they are planning to build up to 1,000 new affordable homes by 2020. Given LBS's aspirations (LBS are a major landowner with sites that could be used for residential) a payment could be used to directly fund the construction of affordable housing with a number of relatively 'quick-wins' in the current programme;
- LBS owner land – for example Native Land acquired a number of sites from LBS on a subject to planning basis, paying LBS a Market Value, and will deliver circa 50% of their affordable housing requirement to Affinity Sutton and Family Mosaic, on previously LBS owned sites;
- 'Gap funding' sites – in this instance, the housing association may increase the percentage of private accommodation, introducing unwanted risk or change the affordable tenures in order to assist with the viability;
- Gap funding can be used, in the absence of traditional Government grant, to part fund a scheme and deliver, in many cases, higher percentages of affordable than would otherwise be delivered. Our discussions with housing associations have included sites that they are considering purchasing but where funding from the current 2011-15 programme would not be available;
- Street Acquisition Programme – A number of associations have delivered refurbished accommodation elsewhere in London whereby existing family properties are purchased on the open market and then re-let as affordable family accommodation, with the funding plugging the gap between the value of the future income stream and the Market Value. Ideal properties are three bed plus family dwellings;

- Purchase & Repair Programme – this is very similar to the above, however includes properties that are, for example, owned privately but are vacant and need updating / refurbishing. Similarly, the ideal properties would be three-bed plus family accommodation to be let on social rents;
- Estate Regeneration – capital funding used to assist with the Council's extensive estate regeneration programme and assist with the delivery of new affordable homes (potentially provide additional affordable housing or assist in ensuring that new and refurbished homes are let on target rents as opposed to the Affordable Rent); and
- LBS affordable housing programme – (covered partially in the first bullet point) there has been a significant amount of recent coverage regarding LBS's aspiration to deliver affordable housing, with a target of 100 homes per annum. Funding could be used to directly assist with the delivery of affordable housing on LBS owned sites.

13.9 This list is not exhaustive but provides an overview of our understanding of how a commuted sum could be spent to provide a better overall housing outcome and maximise the overall delivery of private and affordable accommodation in the borough.

13.10 We would also note that the Applicant are willing to work with LBS in identifying off-site opportunities for actual delivery in the current programme, if LBS deem this appropriate.

14 Concluding Statement

14.1 DS2 has been appointed by the Applicant to collate an FVA assessing the commercial viability of the subject site.

14.2 The Present Day modelling illustrates that the project is someway from achieving an acceptable commercial return on all three scenarios.

14.3 We have therefore incorporated sensitivity analysis and outturn modelling to best demonstrate how a control in costs and improvement in market conditions can improve the project return. Subsequently, subject to the necessary planning approvals, this would result in a construction start incorporating tangible regenerative benefits with a considerable package of planning obligations.

14.4 The outturn modelling is included at the Applicant's considerable risk. We note that the proposed residential values, which account for circa 95% of the project value, are mid-priced for a central London location.

14.5 The costs of development coupled with a reasonable Site Value result in a proposal that cannot viably support 35% affordable housing. However, the appraisals propose three affordable housing scenarios with additional financial obligations of in excess of £12 million.

14.6 In reaching our conclusions, we would draw your attention to the sizeable cost attached to the contractual arrangements required for Decathlon's involvement. Decathlon has a lease for the existing premises which runs until 2028 and has no intention to exercise break clauses as we understand it. As with the previous consent for the site, no development takes place without the leaseholders' contractual agreement with the Applicant now has.

14.7 The affordable housing ‘scenarios’ propose two on-site options and one with a large commuted payment. The on-site scenarios would need to be fully defined but both propose in excess of 100 affordable homes. The commuted sum option proposes significant payments within the current 2011 to 2015 affordable housing programme.

14.8 The overall proposal will, subject to the necessary approval, deliver a mixed-use sustainable development of a high design quality that will contribute significantly to the aspirations of the CWAAP and wider LBS objectives. The subject site as an integral component of the AAP strategy and its delivery will provided considerable momentum.

14.9 The proposal includes a significant quantum of affordable housing in various forms and additional financial contributions and is in our opinion, as robustly evidenced, the maximum reasonable amount of contributions that can be secured without jeopardising the prospects of delivery. This reflects a key theme of central Government planning policy.

14.10 We look forward to working with LBS and their advisors in exploring scenarios that maximise the on-site affordable housing coupled with potential commuted sums.

for and on behalf of DS2 LLP

Pascal Levine MRICS

Partner, DS2 LLP

Date: January 2013

Signed: ______________________________________