DVS Property Specialists for the Public Sector

FINAL REPORT

VIABILITY ASSESSMENT REPORT

Sites C & E Canada Water Development Proposal

On Behalf of:

London Borough of Southwark

Reference: 1417315

Date: June 2013

Version: 1.0

Prepared by:

Andrew Murphy MRICS

Development Consultant &

RICS Registered Valuer

James Purvis MRICS

Development Consultant &

RICS Registered Valuer

1. Introduction & Background

1.1. We have been instructed to consider the applicant's Financial Viability Assessment (FVA) dated January 2013 that was initially provided to DVS on the 25th January 2013. The applicants FVA was augmented with further information subsequently following further discussion with the applicant and the Local Planning Authority (LPA).

<u>Viability</u>

1.2. The RICS published a First edition guidance note "Financial Viability in Planning" in August 2012 which is a best practice guidance note to guide practitioners in the assessment of site wide and site specific viability assessments as part of the Planning process.

1.3. *'Financial viability has become an increasingly important material consideration in the planning system. While the fundamental purpose of good planning extends well beyond financial viability, the capacity to deliver essential development and associated infrastructure is inextricably linked to the delivery of land and viable development.'* – extract from RICS Guidance

<u>National Planning Policy</u>

1.4. The National Planning Policy Framework (NPPF) emphasises scheme deliverability and the provision of competitive returns to willing land owners and developers to enable sustainable development to come forward.

1.5. In respect of affordable housing, paragraph 50 of the NPPF aims to significantly boost the supply of housing and states that where local planning authorities have identified that affordable housing is needed, they should set policies for meeting this need on-site, unless off-site provision or a financial contribution of broadly equivalent value can be robustly justified. Such policies should be sufficiently flexible to take account of changing market conditions over time.

1.6. The NPPF also recognises that development should not be subject to such a scale of obligation and policy that threatens scheme viability. This reinforces the need for viability testing in order to allow willing landowners and developers to receive competitive returns which in turn enable the delivery of development.

1.7. In the context of achieving sustainable development the NPPF refers to ensuring viability and deliverability at sections 173-177. Section 173 in particular states:

> *"…. To ensure viability, the costs of any requirement likely to be applied to development, such as requirements for affordable housing, standards, infrastructure contributions or other requirements should, when taking into 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."*

1.8. The RICS GN addresses "competitive return" as follows:

> *"A "Competitive Return" in the context of property transactions is usually acknowledged as the highest overall offer accepted for land or premises, at that time, and should be constructed in accordance with the definitions of Site Value in this guidance. A "Competitive Return" in the context of a developer bringing forward development should be in accordance with a "market risk adjusted return", as defined in this guidance, to the developer in viably delivering a project."*

1.10 In assessing the applicant's Viability Assessment we have had regard to the national policy background and the RICS Guidance Note First Edition August 2012.

1.11 We set out our comments under the numbered sections of this report below.

2. Property Description and Location

Location

2.1 Canada Water is located on the Rotherhithe Peninsula in south east London and is served by the Jubilee underground line, situated two stops east of London Bridge and one west of Canary Wharf. The two development sites referred to by the applicant as Site C & E are the subject of the development proposals are located within the Rotherhithe Ward and are located immediately east of Canada Water underground station.

Site C

2.2 We are advised by the applicant that Site C extends to 2.31 hectares (5.7 acres) and the site currently provides 224 surface car parking spaces and two large retail units which are currently occupied by Decathlon. Unit 1 overlooks the basin and extends to c. 3,756 Sq m (40,427 Sq ft) and Unit 2 c. 2,432 Sq m (26,174 Sq ft).

2.3 We have not been provided with copies of the leases or rent review memorandums. We are advised by the applicant the retail warehouses are let to Decathlon by way of two leases expiring 2028, with tenant break options in December 2016 and 2022.

2.4 The applicant sets out the leases are subject to fixed annual uplifts in accordance with RPI uplifts. The applicant's valuer Savills sets out they understand the current combined rent to be £812,109 per annum.

2.5 We have not been provided with copies of the leases although we have been provided with extract title reports dated July 2012. We are advised that Decathlon have no intention of exercising the break clauses in the respective leases.

2.6 However, we have been provided with a redacted copy of a conditional Agreement for Lease relating to units 1, 2 & 3 Canada Water Retail Park dated 14 December 2012.

Site E

2.7 We are advised that site E extends to an area of c. 0.78ha (2.11 acres) and is situated east of Surrey quays Road and south of Canada Street which is adjacent to Harmsworth Quay. The site accommodates a single detached retail warehouse unit providing a retailing space with a gross internal area of c. 2,000 sq m (21,528 sq ft).

2.8 We have not been provided with any tenancy information regarding this property other than it is occupied by a discount retailer What Home & Leisure on a short term informal basis.

2.9 We are advised by the applicant's valuer the current gross passing rent is £150,000 per annum but the net rent receivable after payment of business rates and service charge is c. £46,000 per annum.

Ownership

2.10 The applicant's advisor (DS2) sets out the freehold interest of Site C & E (title number TGL215017 & TGL218564 respectively) is currently held by Canada Water (Development) Limited. DS2 set out in the FVA that Canada Water (Development) Limited is a subsidiary of Sellar Design & Management although no documentary evidence has been provided.

3. Development Planning Proposal

3.1 The planning application submitted by the applicant is a hybrid application being part detailed/outline and proposes to provide 5 separate buildings and are referred to as C1, C2, C3, C4, and E1.

3.2 The application seeks outline permission for the demolition of all buildings and the erection of 5 buildings (C1 – C4 and E1) ranging from 5 to 40 storeys (150.86m AOD) and comprising a maximum overall floor space of up to 137,614 Sq m GEA.

3.3 This includes a maximum of up to 97,5741 Sq m of residential accommodation (Class C3) (equating to up to 1,046 residential units), 12,308.9 Sq m Class A1 retail store (including 10,178 Sq m (net) sales area, 745 Sq m ancillary office accommodation and 308 Sq m (ancillary café); 4,335 Sq m of other Class A1/A2/A3/A4 floorspace); 2,800 Sq m office floor space (Class B1) up to 658 Sq m health centre floorspace (Class D1) and up to 698.2 Sq m of cinema floorspace (D2); 19,271.8 Sq m ancillary parking, plant, and storage accommodation, including the provision of basements to provide vehicle and pedestrian access and new public amenity space and landscaping including new public square.

Proposed Phasing of Development

3.4 Phase 1 (Building C1) – A mixed use building ranging in height from 5 to 17 storeys, providing a new decathlon store of 12,103 Sq m GIA, 235 residential dwellings, 173 Sq m GIA of mixed retail space, basement car parking, storage and plant areas and landscaping.

3.5 Phase 2 (Buildings C2 & C3) - Two mixed use buildings. C2 is an 8 storey building providing 112 residential dwellings and 1,892 Sq m of mixed ground floor retail space. C3 is a 16 storey building providing 190 residential units, mixed retail 753 Sq m GIA and a cinema of 640 Sq m GIA and at basement level phases 2 & 3 are connected.

3.6 Phase 3 – C4 is a mixed use 40 - storey tower providing 273 residential dwellings and 709 Sq m GIA mixed retail to be linked at basement to Phase 2.

3.7 Phase 4 – A mixed use building providing 21,999 Sq m GIA of residential accommodation of up to 236 dwellings and up to 507 Sq m GIA of mixed retail and up to 2,460 Sq m GIA mixed commercial a health centre of up to 573 Sq m GIA together with basement car parking, storage, plant and associated car parking.

In summary:

- Phase 1 is submitted in full detail and no reserved matters,
- Phase 2 & 3 are submitted in outline and the floor layouts of the buildings and disposition of uses between floors and landscaping will be subject to a separate reserved matters application.
- Phase 4 is submitted in outline with layout, scale access, appearance and landscaping all subject to reserved matters application.

3.8 The design and disposition of uses and layout of phases 2 – 4 will be capable of amendment in the future which will impact upon the revenue and cost variables of the development scheme we are being asked to consider. Consequently, it follows that any scheme amendments will vary the scheme metrics and with that viability.

Floor space by Building

Building	Maximum GIA (Sq m)	Maximum GEA (Sq m)
C1	42,263 (fixed)	46,483.1
C2	14,410	14,648.2
C3	18,411	19,141
C4	26,371	27,431
E1	27,769	29,907
Total	**128,924**	**137,612**

Floor Space by Use

	Land Use	GIA Sq m	GEA Sq m
Residential	C3	90,337	97,541
Office	B1	2,460	2,800
Decathlon Retail Store	A1 – A4	12,103	12,308
Other retail	D2	4,035	4,334
Cinema	D1	640	698
Health Centre	D1	573	658
Parking, Plant & Storage	Ancillary	18,775	19,271
Total		**128,924**	**137,612**

4. Information Relied Upon

4.1 In preparing this report we have had regard to a comprehensive amount of information and correspondence. The key documents relied upon are:

- Financial Viability Assessment (FVA) prepared by DS2 dated January 2013.
- CD containing a copy of FVA together with scheme plans;
- A copy of Savills Residential Property Focus Q4 2012;
- An analysis of Residential Forecasts for London (Non prime) drawn from Savills Residential Property Focus Q2 2012, Knight Frank UK Housing Market Forecast Q4 2011;Jones Lang LaSalle UK Residential market Forecast Nov 2011;
- ProVal Appraisals for scheme proposal that include New Build Home Buy and Affordable Rent Tenure mixes dated August 2011;
- Use of IRR in Financial Viability Assessments Commentary prepared by DS2 dated September 2012;
- Cost inflation Forecasts – Davis Langdon Summary letter addressed to R Goodlet dated 1 November 2012, Gleeds Economic and Regional inflation report dated Q4 2012, G& T Tender Price Indicator Q1 2013.
- A redacted extract from a Conditional Agreement For Lease between Canada Water (Developments) limited and Sportstock Limited and Decathlon Limited and Decathlon SA and Sellar Design & Development Limited relating to Units 1, 2 and 3 Canada Water Retail Park – NB. The agreement refers to annexures 1 – 15 and these have not been provided.
- Revised Argus Electronic models which capture JLL Residential Values
- Email correspondence dated 20 February timed at 19:47 setting out information would be provided to support:
    - Justification of 4% marketing and sales fees
    - Details from Savills to support the Market Value they have assessed Sites C & E to support the benchmark land value relied upon at £25m
- Copy correspondence from JLL dated 21 February 2013 addressed to R Goodlet re: Pricing Rationale
- Letter prepared by DS2 dated 26th April 2013

- E-mail prepared by DS2 containing Maple Quays pricing
- E-mail prepared by DS2 dated 23rd May 2013 regarding residential pricing and Internal Rate of Return
- E-mail prepared by DS2 dated 17th May 2013 regarding residential pricing and internal rate of return
- E-mail dated 30th April 2013 containing revised Argus Electronic models
- E-mail dated 8th May 2013 containing revised Argus Electronic models

5. Methodology

5.1 The viability methodology adopted by DS2 reflects the nature of the proposed development and they have considered viability on a present day basis and on an out-turn basis as the project period envisages a phased programme over 11 years, therefore a growth model approach (revenue growth and cost inflation) having regard to an Internal Rate of Return (IRR) as a measurement of risk reward has been adopted.

5.2 The out-turn approach is not a common method of considering viability assessments but it is an appropriate measurement of return for a multi-phased schemes of this scale over the anticipated project programme of c. 11 years.

5.3 The applicant has contended the scheme is not viable on a present day cost and revenue basis and it is therefore necessary to consider on an outturn approach which adopts revenue growth and cost inflation over the duration of the assumed project programme.

5.4 The merit of using an out-turn approach is that it can secure a known amount of affordable housing and S106 planning obligations when the scheme on a current cost and revenue approach is not viable.

5.5 The downside, however, is that growth and cost inflation is difficult to predict and the amount of affordable housing and S106 contributions secured could look insufficient if the market grows at a faster rate and the scheme outperforms current forecast revenue and cost inflation projections.

5.6 Conversely, if the market declines relative to the forecast growth and cost inflation assumptions contained in the financial model(s) the amount of the affordable housing and S106 planning obligations will be overstated.

<u>Financial Model</u>

5.7 DS2 have used industry standard development appraisal software to appraise the applicant's project viability. The software calculates the development revenue and costs subject to variables that are input to the model and the project programme assumptions that inform the project cashflow.

Appraisal Land Use Area Assumptions

5.8 Details of the proposed floor space for each land use that inform the financial model(s) are set out above (Para 3.8) and this input field is informed by the architects area schedules for the various phases for the land uses which are envisaged as part of the planning application.

5.9 Apart from the first phase the residential unit numbers are based upon average unit sizes and are calculated having regard to the applicant's proposed mix of units within each building envelope.

Efficiency

5.10 We have considered the gross to net floor areas assumptions that inform the financial model and these appear to fall within an acceptable range, given the stage of design of the scheme.

5.11 However, as the scheme evolves this should be reviewed as changes to the scheme design and layout may serve to increase/decrease gross to net sale areas. Clearly any change in floor layouts will serve to impact upon construction costs and revenue that may currently be anticipated and it follows the viability of the applicant's proposals.

5.12 Phase 1 of the applicant's proposals is the only phase to have been designed together with layouts on the individual apartments. The remaining phases 2 – 4 are outline and therefore may be subject to change.

Internal Rate of Return

5.13 The IRR is calculated using a discounted cashflow appraisal at a discount rate which equates the total costs and total revenue over the cashflow programme period. An IRR measurement takes full account of the time value of money and is used as the measure of profitability having regard to the time the project takes to complete.

5.14 An IRR has been applied to the growth models where as an annualised percentage this provides a measure of the rate at which the scheme generates a return.

5.15 The applicant's advisor DS2 refers to IRR returns at Battersea Power Station, Goodman Fields, New Covent Garden Market and Olympic Legacy Project which they set out range between 17.5 – 18.0%.

5.16 More recently DS2 set out in an email dated 23rd May that an application in respect of Shell Centre (in the London Borough of Lambeth) made reference to a IRR hurdle rate in respect of the application in order to support their assertion the threshold ungeared IRR for that project should be 20%.

5.17 DS2 set out in the email note this was anecdotal and they would seek to obtain more detailed information, but to date no further information has been provided.

5.18 We have considered the unqualified information at face value, and without a more detailed understanding of the project (More particularly the risks presented by the project given the location and the listed nature of the building) it is difficult to comment any further.

5.19 In adopting the IRR for Canada Water the applicant has adopted a 2.5% margin above a base IRR at 17.5% to reflect the scale and speculative nature of the Canada Water proposals. However, we would comment development activity by its very nature is speculative and this risk is implicit in the base IRR at 17.5% and we can see no reason why the applicant is seeking to hedge by adopting an additional margin at 2.5%.

5.20 In considering the IRR threshold return which the applicant is seeking to reserve it would be helpful understand the scale of the projects which they are seeking to rely upon (Battersea Power Station, Goodman Fields, New Covent Garden Market and Olympic Legacy Project) as these projects will have different site specific characteristics, project durations and will therefore be subject to different patterns of revenue and costs to inform the relative risk threshold returns.

5.21 In response to our request for more information to inform the applicant's base IRR threshold we received the following response.

'We are not in a position to provide additional detailed information on the projects they we have previously referred to. The references to these schemes were previously made in regard to relatively large central London strategic developments to give a general indication in terms of the market and funding requirement for such development. They should not be assessed on the same basis as 'standard' development with reference to the quantum of development, the extensive timescales envisaged and the riskier nature of the modelling with growth/inflationary measures used to form a view on the level of viable planning obligations that can be delivered.'

5.22 DVS have been involved in a number of strategic development proposals that have been informed by revenue and cost inflation forecasts and key to determining an appropriate IRR hurdle rate has been an understanding of the pattern of construction cost expenditure relative to revenue receipts and positive cashflows.

5.23 In considering this proposal alongside other recent schemes that we have provided advice. These schemes have involved considerable upfront infrastructure investment far in excess of £140m and over a longer time period.

5.24 Therefore those schemes carry with them more risk than the proposal that we are being asked to consider which is why we do not consider an IRR hurdle rate at 20% is appropriate for this scheme.

5.25 More recently the applicant provided a letter dated 16 April 2013 from Investec in their capacity as a property lender. The letter sets out the following

' I have reviewed and assessed the fundability of the scheme being proposed by Canada water (Developments) Limited and would highlight 2 key factors/issues.

Firstly, it should be pointed out that Investec would expect a development project to show an ungeared IRR of between 20% and 25% as this is what we (and we believe the lending market) deem to be an appropriate return for development risk.

As a lender we come across a number of potential development deals and the majority of these show an ungeared IRR of around 25%. Therefore, when we are presented with a project with an IRR of less than 20%, we would turn this away on the basis (i) there are more profitable deals in the market which need funding and (ii) for the IRR to be so low, it is likely the developer is overpaying for the land, or insufficient revenue will be generated from the scheme relative to the build costs.

Secondly, and with respect to the nuances of the scheme itself, it is apparent that a lender would not start receiving any meaningful capital repayments until a large number of sales have been achieved from phase 2. This is due to the high costs of delivering phase 1, particularly the Decathlon store. This would make a lender uncomfortable as it could take 4 – 5 years to reach this stage – a lengthy period of time which would leave the bank vulnerable to construction risk as well as unforeseen market events which could adversely impact the GDV.'[1]

5.26 Whilst the applicant's revised May dated appraisals IRR range between 15.29% - 16.10%, they clearly fall short of the Investec funding criteria. In considering the comments set out above we are unsure of the relationship of the bank with this development proposal despite their strict funding criteria which they refer.

5.27 However, in considering the applicant's proposal only phase 1 is designed in detail and phase 2 is at outline. But it is reasonable for a developer at the next stage of development design to optimise the scheme to improve the efficiency and layout, and as part of this process they will value engineer.

5.28 It is at this point when the scheme has been worked up in more detail (i.e. cost certainty and revenue sales research) will they really be in a position to firm up the construction costs before re-casting their financial appraisals to determine an IRR before engaging in detailed funding discussions.

[1] Correspondence from Investec from Kyri Hadjisoteris dated 16th April 2013 addressed to LPA

5.29 DS2 have also highlighted the Borough's current CIL guidance and are seeking to benchmark the scheme IRR hurdle rate to this and they highlight the following:

In relation to current CIL guidance in the borough, Page 14 of the BNPP Viability Study (January 2013) to support the CIL Charging Schedule states:

> *'While Developer's Profit has to be assumed in any appraisal, its level is closely correlated with risk. The greater the risk, the higher the profit level required by lenders. While profit levels were typically up to around 15% of completed development value at the peak of the market in 2007, banks now require schemes to show a higher profit to reflect the current risk. Typically developers and banks are targeting 20-25% Internal Rate of Return on a development scheme. IRR is used as a key hurdle rate in determining viability, since it accounts for the length of time a development takes, with a higher IRR reflecting a shorter period to realise a return on an investment. Although IRR is readily comparable with other investment opportunities, other measures of profitability can include profit on cost or profit on Gross Development Value (GDV). Our appraisal summaries provide reference to all three measures, although IRR is targeted at 20%.'*

5.30 Whilst these assumptions made by BNP have informed the Borough's CIL studies, this was a Borough wide study. This is distinct from what we are being asked to consider, which is a site specific proposal having regard to a planning application supported with architects plans, and detailed construction cost plans, sales prices and assumptions drawn from a detailed proposal.

5.31 Whereas CIL studies do not consider this level of detail hence why they may hedge their financial performance thresholds. Whilst this application is a hybrid application in part the applicant and indeed DVS have considered this proposal in far greater detail than the CIL study which was quite probably prepared adopting wide ranging assumptions.

5.32 In taking into consideration all the comments above (Para 5.13 – 5.31) we have adopted an ungeared IRR at 17.5% for this project on an outturn (growth model) model. This opinion is informed through our involvement in a number of strategic development proposals that were informed by cost inflation and revenue growth forecasts; and key to determining an appropriate IRR hurdle rate has been the pattern of construction cost expenditure relative to revenue receipts and positive cashflows.

5.33 In considering this proposal alongside other recent schemes that we have provided advice. These schemes have involved considerable upfront infrastructure investment far in excess of £170m and over a longer time period and reserved an IRR in excess 17.5%.

5.34 In assessing on a present day model we would anticipate a reduced IRR threshold below 20% as a risk reward threshold. The applicant has not reduced their IRR hurdle rate.

5.35 We would expect a reduction to reflect the fact the metrics are not reliant upon any revenue growth or cost inflation forecasts. We would expect a present day model IRR to be c. 14.5 - 15%.

6. Assessment of Benchmark Land Value

Decathlon Store

6.1 In October 2010 a planning consent was secured in respect of site C by way of a detailed planning consent for the redevelopment of the site.

6.2 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 9,104 Sq m, 1,287 Sq m of other Class A1/A3/A4/A5 space, 644 Sq m of office space, 528 Sq m of community space, access, basement car parking for 340 cars, public realm, landscaping and communal space.

6.3 We are informed that it was not possible to implement this proposal as the retail accommodation proposed as part of the scheme is not acceptable to Decathlon. Therefore in the absence of either their agreement or statutory powers to assemble the site the scheme is frustrated until expiry of the lease.

Conditional Agreement for Lease

6.4 The applicant has entered into a conditional agreement for lease relating to Units 1, 2 and 3 Canada Water Retail Park dated 14th December 2012. We have been provided with a redacted extract of the agreement albeit we have not been provided with a complete copy together with the annexures that form part of the agreement between the parties.

6.5 The recitals of the document set out:

'The Landlord (Canada Water (Developments) Limited plans to redevelop Canada Water retail Park'…'and intend to apply for the necessary planning permission for such development to take place;

Once planning permission has been secured in terms of satisfactory to the Landlord it will be necessary for the two existing units on the site that are presently occupied by Decathlon to be demolished in order that a mixed use development can be constructed on the site of the northernmost unit currently occupied by Decathlon by way of a lease;

Decathlon has agreed to vacate and surrender its interests in the two existing units on the site it currently occupies and to take a lease of the retail part of the said mixed use development;

The tenant has agreed to take long leasehold interest in the retail unit forming part of the said mixed use development subject to and with the benefit of the Decathlon Lease (as hereinafter defined);

The parties have agreed a temporary trading solution which will enable Decathlon to continue trading from the southernmost unit that it presently occupies (after enabling works have been undertaken by the Landlord, part of the cost of which will be reimbursed to the Landlord by Decathlon) whilst construction of the mixed use development take place, including the grant to Decathlon of a temporary licence to occupy other premises within the site in order immediately to provide a temporary Head Office facility for Decathlon;

The Landlord has appointed Sellar as development manager for the development to be undertaken at the site in order to drive the development through from application for planning permission to completion of the leases to Decathlon and Sportstock respectively and the Agreed Programme identifies the key milestones for the development; and

The parties have agreed to enter into this Agreement for Lease to govern their respective rights and obligations in connection with the intended transaction.'

6.6 As part of the agreement Decathlon will pay a [redacted] premium to the Landlord for the lease on completion of their new store to be located in building C1. It is unclear how the premium has been determined and the terms of the new lease.

<u>Benchmark Land Value</u>

6.7 As set out in our March 2013 report (as attached to this report) the applicant initially adopted a site value of £25m without an evidence base to inform how Savills arrived at their opinion of value.

6.8 Since our draft report DS2 provided a number of retail warehouse investment sales transactions and we make the following observations:

- The evidence is drawn from standing investments located in established edge of town locations with term certain income.
- It is difficult to draw comparison on the NIY evidence provided as it is not clear whether the income is reversionary or not?
- The yield evidence ranges from 5.70% to 6.89% reflecting lot sizes of between £3.2m - £24.4m
- Site C has 3 yrs term certain income (tenant break options Dec 2016 & 2022).
- Analysis of applicant's opinion indicates an income multiplier reflects a NIY yield of 6.5%.
- It is unclear whether the property is rack rented as the annual rent is subject to annual RPI uplifts.
- We have visited Site C which is currently occupied by Decathlon and operates as an outdoor sports retailer but we have not inspected the property in any detail.

6.9 We have considered the investment evidence and in discussion with our retail warehouse valuers the most comparable transaction (subject to our comments above) would appear to be a property located in Leytonstone which analyses to a passing rent of £13.50 psf and transacted Feb 2013 at £7m. This reflects a net initial yield of 6.89% for 14yrs unexpired income (and is reflective of its location on Leytonstone High Road adjoining secondary retailers in an established retail pitch).

6.10 We have adopted this as our base yield and have adjusted to 7.5% to reflect the uncertainties of a 3 year term certain income resulting in a value of c. £10.23m but say £10.25m.

6.11 We accept the Site E value at £2m.

6.12 We have not made any allowance for hope value for either Site C or E as the applicant asserts the extant planning application is not viable. Clearly, if there is any further information to support the values indicated by Savills we would be happy to consider and review our opinion of value.

6.13 Based upon information provided DVS have assessed the existing use value of the site at £12.25m. The applicant has since been revised their opinion of the benchmark land value from £25m to £14.5m.

7. Residential Revenue

Market Housing

<u>Residential Revenue</u>

7.1 Since issuing our draft report dated March 2013, we have met with the applicant and discussed sales values in greater detail.

7.2 Subsequently, the applicant has provided further information in respect of sales at the last phase of the adjacent Barrett's Maple Quays scheme which is the 24 storey tower "Ontario Point".

7.3 To re-iterate a comment we made in our March report, we understand Block C1 has been designed in detail whilst C2, C4 and C4 are currently at an outline stage of design whilst Block E has yet to be designed in any detail.

7.4 Consequently, if any changes are made to buildings C2, C3, C4 and E (i.e. in terms of layout, configuration, specification etc), it would follow that the sales values could also change.

7.5 The applicant has also provided a schedule of sales for all apartments within Ontario Point with sales dates ranging from March 2012 to April 2013.

7.6 The schedule provided states "net prices" in respect of each of the apartment sales and upon discussing this with the applicant we were advised that these prices relate to the actual price agreed between the developer and purchaser and did not reflect incentives.

7.7 However, we have undertaken research within our “in-house” property database and sales from Ontario Point have started to transact. At the time of writing this report, we have cross checked c. 20% of the 144 sales in Ontario Point and the actual transaction price is not the same as the “Net Price” in the sales schedule provided by the applicant.

7.8 Therefore, the evidence relied upon by the applicant is not the actual price agreed between the developer of Ontario Point and the purchaser.

7.9 In considering these sales, the difference from the Net Price to the actual transaction price ranges from values up to 14.61% higher than the net price with the average uplift at present being c. 3%.

7.10 However, it should be noted that this only reflects a small number of transactions and at present we are unable to cross check all sales and as a result there may well be a larger/smaller average uplift from net to gross sales price.

7.11 The applicant has provided a schedule entitled “Ontario Tower Comparison May 2013” in which the “net sales prices” at Ontario Point have been compared to Buildings C4 and C1.

7.12 In terms of considering the pricing undertaken by the applicant, over the first 24 floors overall building C4 shows values c. 16% higher than that at Ontario Point and Building C1 overall shows values c. 10% lower than Ontario Point.

7.13 Whilst the applicants schedule shows the tower values are 16% higher than Ontario Point, this is a misleading indicator as the Ontario Point prices are “net prices” and do no reflect the actual transaction prices as referred to in paragraph 7.8 above.

7.14 We would expect the proposed scheme to provide a product which is superior to that provided at Maple Quays. Whilst the applicants C4 values on a unit by unit basis appear to be higher overall than Ontario Point there is no evidence available to suggest that their values should be 16% higher on an overall blended value per sq ft rather than on a unit by unit basis.

7.15 We highlight that we are not aware of any evidence to suggest whether the proposed scheme values should be 10%, 15% or 30% higher than that at Ontario Point on an overall blended rate per sq ft.

7.16 In addition, there is no justification to suggest why the pricing in building C1 should be 10% lower than Ontario Point.

7.17 The sales from Ontario Point are largely historic with sales occurring from between March 2012 to April 2013. Consequently, these sales values will be fall behind the current market in terms of revenue growth.

7.18 As a result, we have considered re-sale evidence from the adjacent Maple Quays scheme in addition to data contained in the Land Registry House Price index for this period.

7.19 There are a handful of re-sales that have taken place within the Maple Quays scheme however; the most pertinent evidence shows an increase in value from initial off plan sales to re-sale of 11.5% over a 9 month and 18 month period covering 2012 and a 16% uplift from June 2011 to May 2013.

7.20 In addition, a sale has recently taken place in May 2013 which shows an uplift in value from March 2012 of 7.5%.

7.21 As at the date of this report, there is an apartment currently on the market with an asking price of £0.425m. The sales schedule provided by the applicant states the net price of this apartment as being £0.299m in September 2012.

7.22 Whilst we appreciate this is only an asking price, this provides a contextual background insofar that sales values show the possibility of increasing considerably from the date of the initial off-plan sale.

7.23 At face value, a 30% uplift in value for the unit currently on the market appears optimistic. However, the re-sale evidence currently available indicates that an uplift in value from the initial sale in September 2012 to the present day is not unreasonable.

7.24 In addition, we have considered the sales from Ontario Point using the Land Registry House price index and uplifted our updated sale prices (reflecting what the units transacted at and not net prices) on a month by month basis in line with the index.

7.25 In terms of assessing the applicant's sales values, we have uplifted the blended rates per sq ft adopted by the applicant within their appraisal model by 6%.

7.26 This uplift takes into consideration that at present the applicant's net prices for the sales at Ontario Point are on average understated by c. 3% when compared to the actual transaction prices.

7.27 Consequently, as Jones Lang La Salle have priced the proposed scheme on the basis of net prices that are on average 3% understated we have followed the logic that the pricing for the proposed scheme is understated by c. 3%. In addition, the blended average revenue growth when applied across Ontario Points equates to c. 3% which overall equates to a 6% uplift.

<u>Car Parking</u>

7.28 The applicant has valued all residential car parking spaces across the scheme at £0.025m and for the purpose of this assessment we find this rate to be acceptable.

8. Commercial Uses

8.1 The application scheme comprises a mix of commercial uses including offices, retail, leisure, and other community uses. The proposal includes the following approximate floor areas for each of these uses:

	Land Use	GIA Sq m	GEA Sq m
Office	B1	2,460	2,800
Decathlon Retail Store	A1 – A4	12,103	12,308
Other retail	D2	4,035	4,334
Cinema	D1	640	698
Health Centre	D1	573	658
Parking, Plant & Storage	Ancillary	18,775	19,271

8.2 The conditional agreement to lease refers to replacement Decathlon retail store having a net internal area of not less than 5,000 Sq m and a gross internal area of not less than 5,700 Sq m at ground floor and an office unit having a gross internal area of not less than 600 Sq m at the ground floor mezzanine level.

8.3 The agreement to lease refers to a premium which Decathlon will pay to the Landlord. In addition it is not clear how long the lease term or indeed the lease terms to include any rent or management or service charges that may be payable over the term.

Retail Revenue

<u>Overview</u>

8.4 We are informed that a detailed design for the retail units does not exist for the scheme and whilst DVS requested details and values for proposed individual units this has not been provided. In addition we are informed that proposed breakdowns for the different classes (A1 – A5) within the retail is not available.

8.5 Both of these factors are value significant; smaller units tend to attract higher rental values per sq ft than larger units as do corner units and those with more prominence and return frontage. Use classes A3 – A5 tend to attract higher rental values than A1 – A2. Accordingly we would normally expect a more detailed valuation breakdown for the retail units.

8.6 The applicant has adopted the following valuation assumptions in respect of the retail units :

- Retail A1-A3 £20-£25 psf
- Local uses (i.e. dry cleaners/pharmarcies) £18 - £20 psf
- Gym £8 - £12 psf
- Cinema £6 - £8 psf

Retail Rents

8.7 In support of the proposed rental values the applicant's advisor refers to quoting rents.

Retail Yields

8.8 Based on the applicant's current retail vision and strategy, the initial yields at 6.5% do not seem unreasonable. However, as a more detailed design and strategy evolves there will be a greater level of certainty. Furthermore a change in strategy to secure anchor tenants with stronger covenant strengths would see a reduction in yield for some of the units and thus a rise in value.

Rent Free & Void Periods

8.9 A rent free and void period of 12 months has been assumed in the applicant's models which we accept.

9. Growth Assumptions

9.1 The merit of using an outturn approach is that it can secure a known amount of affordable housing when the scheme on a current cost approach is not viable. The downside, however, is that growth is difficult to predict and the amount of affordable housing and S106 contributions secured could look insufficient if the market grows at a faster rate and vice versa.

9.2 The applicant has provided residential forecasts for Non-Prime London from Savills, Knight Frank and Jones Lang LaSalle. The forecasts are historic insofar that the Knight Frank & JLL report dates to November 2011 whilst the Savills forecast is dated Q2 2012. In addition we have also been provided with JLL residential research document dated November 2012.

9.3 For the purpose of this assessment we have adopted JLL growth forecast assumptions dated November 2012 which we set out below:

London Residential House Price Forecast						
JLL	2013	2014	2015	2016	2017	2018 - 2022
	2.0%	3.5%	6.0%	7.5%	7.5%	5.3%

Source: JLL Residential Eye November 2012

9.4 It should be noted that the forecast relied upon by the applicant refers to Non-Prime London and would cover a large geographic area. The forecast therefore is not location specific and would not take into consideration the impact of future changes to a specific location.

9.5 For example, the impact of the introduction of Crossrail at Canary Wharf in c. 2018 could see a considerable impact on revenue growth at Canada Water as it is located one stop from Canary Wharf on the Jubilee Line.

9.6 This could potentially widen the appeal of the proposed scheme to international investors due to improved transport links to key business centre locations in London in addition to enhanced transport links to Heathrow Airport.

<u>Construction Cost Inflation</u>

9.4 In preparing the FVA the applicant adopted BCIS Tender Price Indices for Greater London in the outturn modelling this forecast the following – 1.4% until end of 2012, 1.8% in 2013, 3.2% in 2014, 3.5% in 2015, 4.2% in 2016 and 4.9% in 2017.

9.5 The applicant has also provided Tender Price Forecast prepared by Davis Langdon dated November 2012 together with a number of other forecasts prepared by Gleeds and G & T. Having considered these we have adopted the following blended average tender price growth:

	G & T	DL London (4Q 12)	ECH London (4Q 12)	Sweett London (4Q 12)	Blended Average
2013	0.5	0.75	0.3	2.0	**0.89**
2014	2.0	2.5	4.1	3.5	**3.03**
2015	3.0	4.0	4.0	4.0	**3.75**
2016	3.5	5.0	4.0	4.0	**4.13**
2017+					3.0

Commercial Value Growth

9.6 The applicant has not included rental growth on any of the rents that have been adopted in the FVA as they set out that they have adopted the higher order end of rents and lower voids.

9.7 However, after careful consideration we are of the opinion the outturn model should track inflation as a minimum and we have adopted 2% per annum growth over the project term as opposed to the straight line inflation forecast at Para 12.8 which reflects a straight line annualised RPI inflation for the period 2012 – 2017 at 3.2% per annum.

10. Construction Costs

10.1 We have been provided with Draft Feasibility Estimates for the scheme proposals prepared by the applicant's cost consultant which indicate the construction costs are c. £300.5m.

10.2 As part of our pre-application dialogue with the applicant in the summer and autumn 2012 we highlighted that at the next stage assessment we would require a full detailed cost plan. A detailed cost plan was circulated to us 25 March 2013.

10.3 The Davis Langdon (DL) cost plan has evolved from where we initially reviewed in autumn 2012. The build cost proposed by DL is c. £318.12m split into two phases:

a. Phase 1 - £88.19m (Building C1)

b. Phase 2 - £229.93m (Buildings C2, C3, C4 and E1)

10.4 Prior to receiving the detailed cost breakdowns, our assessment was based purely on cost and value benchmarking drawn from recent viability exercises we have undertaken. In reviewing the detailed cost plan we met with DL on 27th March to discuss and work through their cost plan.

10.5 Additional supporting information was subsequently by way of a CD received 9 April 2013 together with various email correspondence in clarifying questions that were raised.

10.6 It is assumed the areas proposed represent the scope of the scheme and any changes to the areas may materially affect the cost at the next stage of design. We set out comments below:

- Generally, the rates appear reasonable and DL confirmed that these came from recent tenders received.

- DL provided a summary of cost drivers which made the estimate higher in relation to other schemes which we had considered and this supports the difference between our initial benchmark assessment approach and the earlier DL cost plan.

- There is little information received with regards to the Mechanical and Electrical package. At this stage, benchmarking information were utilised which appears reasonable.

- It is not clear at this stage whether the design of foundations would 'cater' for the loadings above. At this stage, a separate allowance has been made in the cost plan for a contribution to foundations reflective of individual buildings. It is assumed that these will be firmed up at the next stage of design development.

- DL assume a similar level of fit out costs on Phase 2 based on Phase 1 information. It is expected that on the next phase of development, a separate estimate will be prepared to be reflective of individual mix of each buildings.

- Preliminaries, overheads and profit appear reasonable in relation to other schemes looked at.

- With regards to contingency, this is very subjective and I can understand DL putting a higher contingency at 7.5% as Phase 2, M&E, are not yet fully designed. This level of contingency should not apply to both phases 1 & 2 as phase 1 quite detailed relative to phase 2. With this in mind phase should have a contingency at 5% and it is reasonable to assume that contingency sums will reduce in line with design development.

- At this stage of design, no value engineering exercise has been carried out.

- Building E1 has little information to rely upon, it is very subjective which benchmark to use relative to values and no benchmarking exercise was put forward by DL at this stage.

10.7 In summary our assessment ranges from £306.53m to £312.71m a difference of c. -4% to -2% from the DL cost plan based on 5% to 7.5% contingency. The range of difference is not unreasonable at the stage of design development. However, it is expected that at the next stage of design, risk will be reduced and cost certainty can be achieved.

11. Additional Cost Headings

Professional Fees

11.1 The applicant has adopted professional fees at 14%. We would expect these costs to fall within a range of 10 – 12%. However, for the purpose of this assessment we have adopted 12% and this sits within the applicant’s range of between 11.25 – 15.5% for professional fees as outlined in their FVA.

11.2 However, any developer taking forward this scheme would probably agree fixed fees at a rate lower than the above percentage sum allowances.

Development Management Fee

11.3 The applicant is seeking to reserve a 2% development management fee to reflect their costs of running the project. We do not accept the reservation of a development management fee as the costs of running a project for a market developer would be a business overhead and not an additional development cost.

Sales & Marketing Fees

11.4 The applicant has adopted a sales fee of 2% and marketing fee of 2%. For the purpose of this review, our assessment adopts a sales fee of 1.5% and marketing fee of 1.5%.

Finance

11.5 The applicant has adopted a finance rate of 7%. This rate falls at the upper end of an acceptable range and we have adopted this for the purposes of our assessment.

11.6 The model assumes 100% debt funding which does not necessarily reflect a true market approach that would require equity participation. However, given that we are assessing this scheme by way of an ungeared IRR performance the finance rate is excluded.

Project Programme

11.7 We have adopted the application scheme's project programme, however, should the council wish to have this verified we will need to refer to a specialist construction planner to test and determine whether the applicant's proposed timelines contained within the programme for the site preparation, construction and fit-out works are reasonable.

11.8 Clearly any change in the programme i.e. extension or shortening of the programme will impact upon the metrics of the scheme proposal.

12. Planning Obligations

12.1 The applicant's FVA sets out a provision for total £12.547m and confirmation from the LPA is required to confirm this is correct.

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, Childrens Play Equipment & 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

Affordable Housing

12.2 In addition to the provision for planning obligations the applicant has taken into consideration a premium of £20m to reflect a commuted sum in lieu of providing affordable housing on site as part of their proposal.

12.3 The applicant has also prepared another FVA model which considers the provision of 10% and 15% on-site affordable housing. In determining the affordable housing content the applicant has adopted a blended capital value at £200 per sq ft which includes the provision of 70% affordable rent and 30% intermediate tenures.

12.4 The accommodation will be tenure blind and will meet the same high standards that are being proposed for the market housing.

13. Developer Return

Present Day Model

13.1 The applicant's present day financial models based upon the applicant's assumptions indicate:

Scenario	Affordable Output	IRR
15% Affordable	156 mixed tenure	9.95%
10% Affordable	105 mixed tenure	10.50%
Commuted Sum	£20m	9.58%

13.2 The applicant's agent asserts that in all three scenarios the models fall short of the threshold IRR at 20% which they are seeking to rely upon as the risk reward threshold return.

Outturn Model

13.3 The applicant's outturn financial models based upon the applicant's assumptions indicate:

Scenario	Affordable Output	IRR
15% Affordable	156 mixed tenure	15.29%
10% Affordable	105 mixed tenure	15.57%
Commuted Sum	£20m	16.10%

13.4 The applicant's agent asserts that in all three scenarios the models fall short of the threshold IRR at 20% which they are seeking to rely upon as the risk reward threshold return.

13.5 However, in having regard to our various comments and assumptions set out above we are of the opinion the IRR on an outturn model would be 17.5%.

14. Conclusions

14.1 In summary, we have assessed the applicants 3 appraisal models which comprise a £20m commuted sum, 10% onsite affordable housing contribution and 15% onsite affordable housing contribution and we tabulate our viability conclusions below.

14.2 Our opinion of the IRR hurdle rate for this project is 17.5%. However, the applicant has requested that we model a sensitivity showing the applicants 20% IRR hurdle rate

	DVS Sensitivity Models	
Applicant Offer	**6% Uplift & 17.5% IRR**	**6% Uplift & 20% IRR**
	Surplus generated in addition to the applicant offer in left hand column	
£20m Commuted Sum	£23.20m	£8.35m
10% Onsite Provision	£26.30m	£13.25m
15% Onsite Provision	£24.10m	£12.15m

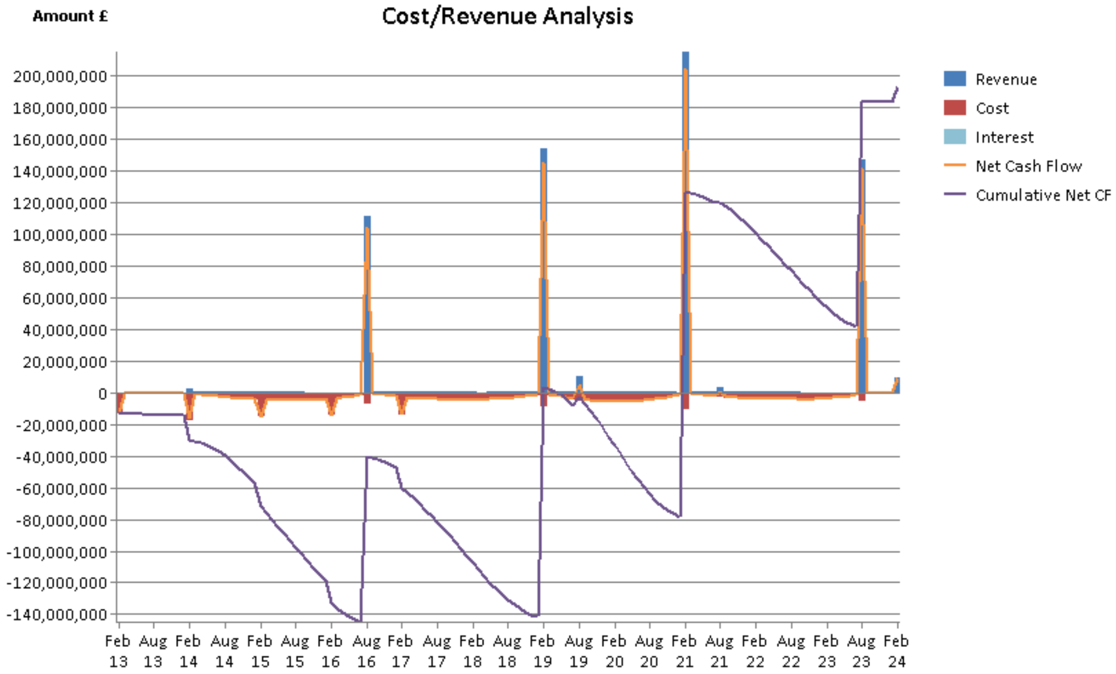
14.3 In summary, the above table indicates the potential surplus based upon a 6% uplift in the applicants residential revenue blended rates per sq ft and a 17.5% and 20% IRR hurdle rate.

14.4 Our assessment of the proposed scheme with a 17.5% IRR can support an affordable housing offer equivalent to c. 25% by area on the basis of the affordable housing being accommodated in Buildings E1 and C1.

Phase 1

14.5 The LPA have requested a breakdown of the performance of phase 1 in order to show the pattern of expenditure relative to revenue and more specifically the accumulative cashflow profile of the development scheme.

14.6 We set out below a graph showing the performance of the scheme which shows the scheme does not generate a positive return until February 2019:



14.7 More specifically in terms of phase 1 the total costs equate to c. £170m whilst revenue is c. £111m which generates a shortfall in excess of £59m.

<u>Review Mechanism</u>

14.8 A fundamental area of concern to us is the level of detail that informs the applicants FVA model as Phase 1 of the proposal is the only element of the scheme that is subject to a detailed planning application and Phase 2 – 4 are subject to an outline application and may be subject to change which will impact upon the metrics of the FVA models.

14.9 The project has a programme of c. 11 years and the model relies upon forecast revenue growth and cost inflation. These factors coupled with the stage of design development of the scheme highlight the opportunity for the scheme as a whole to either outperform or underperform the current assumptions.

14.10 With this in mind we recommend the scheme should be reassessed by way of a mechanism to test viability of a phase closer to the point of implementation to more accurately assess viability having regard to more detailed design information to inform construction costs, revenue and assumptions as the scheme is refined.

14.11 A review mechanism can set out the methodology of review which in this case should entail a comprehensive review of any given phase ahead of implementation as the inputs i.e. values and costs will have a greater degree of accuracy with a detailed scheme to consider together with site specific scheme revenue and cost evidence drawn from earlier phases at that time.

14.12 As the implementation of the project is currently envisaged to be phased over 11 years the inputs and evidence will be drawn from project based costs incurred and residential sales prices which will more accurately indicate the revenue the scheme is capable of generating and the reasonable costs of construction that can be anticipated.

14.13 Clearly as and when the viability of individual phases is understood in more detail the parties can then assess whether or not the LPA put in place a mechanism to capture any improvement in the schemes actual performance relative to the individual viability review or whether to roll-over to pump prime future development phases of the scheme.

Appendices

Appendix 1 - DVS Draft Report V.02 March 2013

Appendix 1

DRAFT VIABILITY ASSESSMENT REPORT

Sites C & E Canada Water Development Proposal

On Behalf of:

London Borough of Southwark

Reference: 1358541

Date: March 2013

Version: 0.2

1. Introduction

1.1 We have been instructed to consider the applicant's Financial Viability Assessment (FVA) dated January 2013 that was initially provided to us 25 January 2013 and this was augmented with further information on 20 & 21 February 2013 following a meeting with the applicant on 6 February 2013.

Viability

1.2 Financial viability has become an increasingly important material consideration in the planning system. While the fundamental purpose of good planning extends well beyond financial viability, the capacity to deliver essential development and associated infrastructure is inextricably linked to the delivery of land and viable development.

1.3 The RICS published a First edition guidance note "Financial Viability in Planning" in August 2012 which is a best practice guidance note to guide practitioners in the assessment of site wide and site specific viability assessments as part of the Planning process.

1.4 *'Financial viability has become an increasingly important material consideration in the planning system. While the fundamental purpose of good planning extends well beyond financial viability, the capacity to deliver essential development and associated infrastructure is inextricably linked to the delivery of land and viable development.'* – extract from RICS Guidance

National Policy

1.5 The National Planning Policy Framework (NPPF) emphasises deliverability and the provision of competitive returns to willing land owners and developers to enable sustainable development to come forward.

1.6 In respect of affordable housing, paragraph 50 of the NPPF aims to boost significantly the supply of housing and states that where local planning authorities have identified that affordable housing is needed, they should set policies for meeting this need on- site, unless off-site provision or a financial contribution of broadly equivalent value can be robustly justified. Such policies should be sufficiently flexible to take account of changing market conditions over time.

1.7 The NPPF also recognises that development should not be subject to such a scale of obligation and policy that threatens schemes viability. This reinforces the need for viability testing in order to allow willing landowners and developers to receive competitive returns which in turn enable the delivery of development.

1.8 In the context of achieving sustainable development the NPPF refers to ensuring viability and deliverability at sections 173-177. Section 173 in particular states:

> *"…. To ensure viability, the costs of any requirement likely to be applied to development, such as requirements for affordable housing, standards, infrastructure contributions or other requirements should, when taking into 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."*

1.9 The RICS GN addresses "competitive return" as follows:

> *"A "Competitive Return" in the context of property transactions is usually acknowledged as the highest overall offer accepted for land or premises, at that time, and should be constructed in accordance with the definitions of Site Value in this guidance. A "Competitive Return" in the context of a developer bringing forward development should be in accordance with a "market risk adjusted return", as defined in this guidance, to the developer in viably delivering a project."*

1.10 In assessing the applicant's Viability Assessment we have had regard to the national policy background and the RICS Guidance Note First Edition August 2012.

1.11 We set out our comments under the numbered sections of this report below.

2.0 Property Description and Location

Location

2.1 Canada Water is located on the Rotherhithe Peninsula in south east London and it is served by the Jubilee underground line and is situated two stops east of London Bridge and one west of Canary Wharf. The two development sites referred to by the applicant as Site C & E are the subject of the development proposals are located within the Rotherhithe Ward and are located immediately east of Canada Water underground station.

Site C

2.2 We are advised by the applicant that Site C extends to 2.31 hectares (5.7 acres) and the site currently provides 224 surface car parking spaces and two large retail units which are currently occupied by Decathlon. We are advised by the applicant the retail warehouses are let to Decathlon by way of two leases expiring 2028, with tenant break option in December 2016 and 2022.

2.3 We have not been provided with copies of the lease agreements that are in place or the areas of the buildings. The applicant sets out the leases are subject to fixed annual uplifts in accordance with RPI uplifts.

Site E

2.4 We are advised that site E extends to an area of c. 0.78ha (2.11 acres) and is situated east of Surrey quays Road and south of Canada Street which is adjacent to Harmsworth Quay. The site accommodates a single detached retail warehouse unit providing a retailing space with a gross internal area of c. 2,000 sq m (21,528 sq ft).

Ownership

2.5 The applicant's advisor (DS2) sets out the freehold interests of Site C & E (title number TGL215017 & TGL218564 respectively) is currently held by Canada Water (Development) Limited. DS2 set out in the FVA that Canada Water (Development) Limited is a subsidiary of Sellar Design & Management although no documentary evidence has been provided.

Site C

2.6 We are advised by the applicant's consultant that site C is currently let to Decathlon by way of two occupational lease expiring in 2028, with tenant break options in December 2016 & 2022. We have not been provided with copies of the leases although we have been provided with extract title reports dated July 2012. We are advised that Decathlon have no intention of exercising the break clauses in the respective leases.

2.7 However, we have been provided with a redacted copy of a conditional Agreement for Lease relating to units 1, 2 & 3 Canada Water Retail Park dated 14 December 2012.

Site E

2.8 We have not been provided with any tenancy information regarding this property and have drawn the conclusion that it is currently vacant and does not generate an income.

3.0 Development Planning Proposal

3.1 The planning application submitted by the applicant is a hybrid application being part detailed/outline and proposes to provide 5 separate buildings and are referred to as C1, C2, C3, C4, and E1.

3.2 The application seeks outline permission for the demolition of all buildings and the erection of 5 buildings (C1 – C4 and E1) ranging from 5 to 40 storeys (150.86m AOD) and comprising a maximum overall floor space of up to 137,614 Sq m GEA.

3.3 This includes a maximum of up to 97,5741 Sq m of residential accommodation (Class C3) (equating to up to 1,046 residential units), 12,308.9 Sq m Class A1 retail store (including 10,178 Sq m (net) sales area, 745 Sq m ancillary office accommodation and 308 Sq m (ancillary café); 4,335 Sq m of other Class A1/A2/A3/A4 floorspace); 2,800 Sq m office floor space (Class B1) up to 658 Sq m health centre floorspace (Class D1) and up to 698.2 Sq m of cinema floorspace (D2); 19,271.8 Sq m ancillary parking, plant, and storage accommodation, including the provision of basements to provide vehicle and pedestrian access and new public amenity space and landscaping including new public square.

Proposed Phasing of Development

3.4 Phase 1 – C1 a mixed use building ranging in height from 5 to 17 storeys, providing a new decathlon store of 12,103 Sq m GIA, 235 residential dwellings, 173 Sq m GIA of mixed retail space, basement car parking, storage and plant areas and landscaping.

3.5 Phase 2 – C2 & C3 two mixed use buildings C2 is an 8 storey building to provide 112 residential dwellings and 1,892 Sq m of mixed ground floor retail space. C3 is a 16 storey building to provide 190 residential units, mixed retail 753 Sq m GIA and a cinema of 640 Sq m GIA and at basement level phases 2 & 3 are connected.

3.6 Phase 3 – C4 A mixed use 40- storey tower to provide 273 residential dwellings and 709 Sq m GIA mixed retail to be linked at basement to Phase 2.

3.7 Phase 4 – A mixed use building to provide 21,999 Sq m GIA of residential accommodation of up to 236 dwellings and up to 507 Sq m GIA of mixed retail and up to 2,460 Sq m GIA mixed commercial a health centre of up to 573 Sq m GIA together with basement car parking, storage, plant and associated car parking.

- Phase 1 is submitted in full detail and no reserved matters,
- Phase 2 & 3 are submitted in outline and the floor layouts of the buildings and disposition of uses between floors and landscaping will be subject to a separate reserved matters application.
- Phase 4 is submitted in outline with layout, scale access, appearance and landscaping all subject to reserved matters application.

3.8 The design and disposition of uses and layout of phases 2 – 4 will be capable of amendment which will impact upon the revenue and cost variables of the scheme we are being asked to consider and it follows this will vary the scheme metrics and with that viability.

Floor space by Building

Building	Maximum GIA (Sq m)	Maximum GEA (Sq m)
C1	42,263 (fixed)	46,483.1
C2	14,410	14,648.2
C3	18,411	19,141
C4	26,371	27,431
E1	27,769	29,907
Total	**128,924**	**137,612**

Floor Space by Use

	Land Use	GIA Sq m	GEA Sq m
Residential	C3	90,337	97,541
Office	B1	2,460	2,800
Decathlon Retail Store	A1 – A4	12,103	12,308
Other retail	D2	4,035	4,334
Cinema	D1	640	698
Health Centre	D1	573	658
Parking, Plant & Storage	Ancillary	18,775	19,271
Total		**128,924**	**137,612**

4.0 Information Relied Upon

4.1 In preparing this report we have had regard to a comprehensive amount of information and correspondence. The key documents relied upon are:

- Financial Viability Assessment (FVA) prepared by DS2 dated January 2013.
- CD containing a copy of FVA together with scheme plans;
- A copy of Savills Residential Property Focus Q4 2012;
- An analysis of Residential Forecasts for London (Non prime) drawn from Savills Residential Property Focus Q2 2012, Knight Frank UK Housing Market Forecast Q4 2011;Jones Lang LaSalle UK Residential market Forecast Nov 2011;
- ProVal Appraisals for scheme proposal that include New Build Home Buy and Affordable Rent Tenure mixes dated August 2011;
- Use of IRR in Financial Viability Assessments Commentary prepared by DS2 dated September 2012;
- Cost inflation Forecasts – Davis Langdon Summary letter addressed to R Goodlet dated 1 November 2012, Gleeds Economic and Regional inflation report dated Q4 2012, G& T Tender Price Indicator Q1 2013.
- A redacted extract from a Conditional Agreement For Lease between Canada Water (Developments) limited and Sportstock Limited and Decathlon Limited and Decathlon SA and Sellar Design & Development Limited relating to Units 1, 2 and 3 Canada Water Retail Park – NB. The agreement refers to annexures 1 – 15 and these have not been provided.
- Revised Argus Electronic models which capture JLL Residential Values
- Email correspondence dated 20 February timed at 19:47 setting out information would be provided to support:
  - Justification of 4% marketing and sales fees
  - Details from Savills to support the Market Value they have assessed Sites C & E to support the benchmark land value relied upon at £25m
- Copy correspondence from JLL dated 21 February 2013 addressed to R Goodlet re: Pricing Rationale

5.0 Methodology

5.1 The methodology adopted by DS2 reflects the nature of the proposed development and they consider this on a present day basis and on an outturn as the project period envisages a phased programme over 11 years, therefore a growth model approach (revenue growth and cost inflation) having regard to an Internal Rate of Return (IRR) as a measurement of risk reward has been adopted.

5.2 The approach is not a common method of considering viability assessments but it is an appropriate measurement of return for multi-phased schemes over the anticipated project programme.

5.3 The application scheme has been assessed on both a current cost and revenue basis, which is the usual approach for considering viability, and an outturn approach which adopts revenue growth and construction cost inflation in the development appraisal.

5.4 The applicant has contended the scheme is not viable on a present day cost and revenue basis and it is therefore necessary to consider on an outturn approach which adopts revenue growth and cost inflation over the duration of the assumed project programme.

5.5 The merit of using an out-turn approach is that it can secure a known amount of affordable housing and S106 planning obligations when the scheme on a current cost and revenue approach is not viable.

5.6 The downside, however, is that growth and cost inflation is difficult to predict and the amount of affordable housing and S106 contributions secured could look insufficient if the market grows at a faster rate and the scheme outperforms current forecast revenue and cost inflation projections.

<u>Financial Model</u>

5.7 DS2 have used industry standard development appraisal software to appraise the applicant's project viability. The software calculates the development revenue and costs subject to variables that are input to the model and the project programme assumptions that inform the project cashflow.

Appraisal Land Use Area Assumptions

5.8 Details of the proposed floor space for each land use that inform the financial model are set out above (Para 3.8) and this input field is informed by the architects area schedules for the various phases for the land uses which are envisaged.

5.9 Apart from the first phase the residential unit numbers are based upon average unit sizes and are calculated having regard to the applicant's proposed mix of units within each building envelope.

Efficiency

5.10 We have considered the gross to net floor areas assumptions that inform the financial model and these appear to fall within an acceptable range, given the stage of design of the scheme.

5.11 But as the scheme evolves these should be reviewed as changes to the scheme design and layout may serve to increase/decrease gross to net sale areas. Clearly any change in floor layouts will serve to impact upon construction costs and revenue that may currently be anticipated and it follows the viability of the applicant's proposals.

5.12 Phase 1 of the applicant's proposals is the only phase to have been designed together with layouts on the individual apartments. The remaining phases 2 – 4 are outline and therefore may be subject to change.

Internal Rate of Return

5.13 The IRR is calculated using a discounted cashflow appraisal at a discount rate which equates the total costs and total revenue over the cashflow programme period. An IRR measurement takes full account of the time value of money and is used as the measure of profitability having regard to the time the project takes to complete.

5.14 An IRR has been applied to the growth models where as an annualised percentage this provides a measure of the rate at which the scheme generates a return.

5.15 The applicant's IRR hurdle benchmark at 20% is not considered reasonable for this residential led scheme as at the date of this report.

5.16 The applicant's advisor DS2 refers to IRR returns at Battersea Power Station, Goodman Fields, New Covent Garden Market and Olympic Legacy Project which they set out range between 17.5 – 18.0%.

5.17 In adopting the IRR for Canada Water the applicant has adopted a 2.5% margin above a base IRR 17.5% to reflect the scale and speculative nature of the Canada Water proposals.

5.18 In considering the IRR threshold return which the applicant is seeking to reserve it would be helpful understand the scale of the projects which they are seeking to rely upon (Battersea Power Station, Goodman Fields, New Covent Garden Market and Olympic Legacy Project) as these projects will have different site specific characteristics, project durations and will therefore be subject to different patterns of revenue and costs to inform the relative risk threshold returns.

5.19 Therefore, without a better understanding of the projects which DS2 refer it is difficult to consider and arrive at a reasoned opinion in respect of the base IRR they are seeking to rely upon before turning to consider the additional margin of 2.5%.

5.20 In the absence of the applicant providing further information we would anticipate an ungeared IRR falling at the lower end of a range of 15 – 17.5% for this project on an outturn (growth model) model.

5.21 In assessing on a present day model we would anticipate a reduced IRR threshold below 20% as a risk reward threshold. The applicant has not reduced their IRR hurdle rate.

5.22 We would expect a reduction to reflect the fact the metrics are not reliant upon any revenue growth or cost inflation forecasts. We would expect a present day model IRR to fall within a range of 12 – 14%.

6.0 Assessment of Benchmark Land Value

Decathlon Store

6.1 In October 2010 a planning consent was secured in respect of site C by way of a detailed planning consent for the redevelopment of the site.

6.2 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 9,104 Sq m, 1,287 Sq m of other Class A1/A3/A4/A5 space, 644 Sq m of office space, 528 Sq m of community space, access, basement car parking for 340 cars, public realm, landscaping and communal space.

6.3 We are informed that it was not possible to implement this proposal as the retail accommodation proposed as part of the scheme is not acceptable to Decathlon. Therefore in the absence of either their agreement or statutory powers to assemble the site the scheme is frustrated until expiry of the lease.

Conditional Agreement for Lease

6.4 The applicant has entered into a conditional agreement for lease relating to Units 1, 2 and 3 Canada Water Retail Park dated 14th December 2012. We have been provided with a redacted extract of the agreement albeit we have not been provided with a complete copy together with the annexures that form part of the agreement between the parties.

6.5 The recitals of the document set out:

'The Landlord (Canada Water (Developments) Limited plans to redevelop Canada Water retail Park'…'and intend to apply for the necessary planning permission for such development to take place;

Once planning permission has been secured in terms of satisfactory to the Landlord it will be necessary for the two existing units on the site that are presently occupied by Decathlon to be demolished in order that a mixed use development can be constructed on the site of the northernmost unit currently occupied by Decathlon by way of a lease;

Decathlon has agreed to vacate and surrender its interests in the two existing units on the site it currently occupies and to take a lease of the retail part of the said mixed use development;

The tenant has agreed to take long leasehold interest in the retail unit forming part of the said mixed use development subject to and with the benefit of the Decathlon Lease (as hereinafter defined);

The parties have agreed a temporary trading solution which will enable Decathlon to continue trading from the southernmost unit that it presently occupies (after enabling works have been undertaken by the Landlord, part of the cost of which will be reimbursed to the Landlord by Decathlon) whilst construction of the mixed use development take place, including the grant to Decathlon of a temporary licence to occupy other premises within the site in order immediately to provide a temporary Head Office facility for Decathlon;

The Landlord has appointed Sellar as development manager for the development to be undertaken at the site in order to drive the development through from application for planning permission to completion of the leases to Decathlon and Sportstock respectively and the Agreed Programme identifies the key milestones for the development; and

The parties have agreed to enter into this Agreement for Lease to govern their respective rights and obligations in connection with the intended transaction.'

6.6 As part of the agreement Decathlon will pay a [redacted] premium to the Landlord for the lease on completion of their new store to be located in building C1. It is unclear how the premium has been determined and the terms of the new lease.

<u>Benchmark Land Value</u>

6.7 To date the applicant has provided a letter from Savills dated 6 November 2012 which sets out their "view" which is referred to as a "Red Book Valuation letter".

6.8 In looking at the letter the author refers to valuation work relating to sites C & E on behalf of Investec and it is unclear when this work was undertaken and the author sets out some very broad ranging information regarding the areas of Unit 1 & 2 and site E.

6.9 In arriving at the Market Value it is unclear what precisely the valuer is assessing (freehold or leasehold) and the assumptions the valuer has made to inform their opinion of value at £18m and £7m.

6.10 On the information presented by the applicant the Freehold of site C will have the benefit of 3 years term certain income reflecting the opportunity for the tenant to exercise the first break clause in 2016. Thereafter there could be some value attributable to "hope value" for redevelopment of the site. Albeit DS2 set out in the FVA the extant permission is not viable without Decathlons agreement to surrender their leases ahead of expiry date of 2028.

6.11 Therefore, to consider in broad terms if the leases in place for site C generates an income of c. £800,000 per annum subject to RPI uplifts. This could broadly account for c. £3m of value.

6.12 But without an understanding of the development scheme Savills had in mind to reflect the hope value of the reversionary development scheme to inform a Market Value of £18m - It is difficult to assess and determine a robust Market Value as a benchmark for the applicant's proposal.

6.13 In looking at site E Savills value of £7m has been arrived at having regard to short term gross income of c. £150,000 per annum and after deduction for service charge and business rates a net rent receivable of c. £46,000 per annum an existing use value of £2m and a Market Value of £7m.

6.14 But it is worth noting the FVA prepared by DS2 is silent regarding any lease or licence income in respect of site E and the uncertainties regarding alternative use land values that could be reasonably be anticipated – similar to site C it is difficult to arrive at any robust conclusions.

6.15 However, for the purpose of assessment we have adopted the applicant value at £25m but will expect the applicant to rationalize and support the benchmark land value which they have relied upon to inform the FVA.

7.0 Residential Revenue

Market Housing

Residential Revenue

7.1 Section 8 of the applicants FVA comments upon the residential revenue adopted for the application scheme.

7.2 The applicants appraisal model adopts the following blended capital values per sq ft for each building and we list these as follows:

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

7.3 We understand Block C1 has been designed in detail whilst C2, C4 and C4 are currently at an outline stage of design whilst Block E has yet to be designed in any detail.

7.4 Consequently, if any changes are made to buildings C2, C3, C4 and E (i.e. in terms of layout, configuration, specification etc), it would follow that the sales values could also change.

7.5 The applicant's commentary in respect of Maple Quays makes reference to historic sales values from 2008 / 2009 in Toronto House in addition to sales in Brampton House, Vancouver House and Ontario Point ranging from March 2012 to September 2012.

7.6 However, it should be noted that the sales referred to in Brampton House, Vancouver House and Ontario Point are off-plan sales and the buildings have not yet reached practical completion.

7.7 Consequently, there is a dearth of current available evidence that can be interpreted as reliable market evidence. In addition, it should be noted that when these sales transact, the values will be historic as they would have been agreed with contract dates significantly pre-dating the practical completion of the building.

7.8 For example, we understand Ontario Point is due to reach practical completion in June 2013 and at present there are only 5 units available in this building. The apartments sold off plan will be shown as transacting in June 2013, however, the apartment values will reflect historic values as shown in the applicants with sales occurring in March – September 2012.

7.9 As a result, these sales values will be fall behind the current market in terms of revenue growth.

7.10 Jones Lang LaSalle have prepared a unit by unit pricing schedule for blocks C1, C2, C3 & C4 in addition to providing letters to support their pricing dated 22 January and 21 February 2013.

7.11 In preparing their values, JLL have provided a schedule of sales figures on the adjacent Ontario Point Tower at Maple Quays and Marine Wharf located at Surrey Quays.

7.12 As Ontario Point is located within the same immediate locality as the application scheme we comment on these sales figures provided by JLL below.

7.13 As with the Maple Quays sales figures quoted by the applicant in section 8 of the FVA, the sales figures are not completed transactions and reflect prices that have been agreed during construction of the building.

7.14 Whilst the schedule of values provide a contextual background to agreed prices for apartments in the tower, the schedule does not provide sufficient detail in terms of when the sales were agreed.

7.15 We understand the building was launched in early 2012 and consequently, if JLL have placed reliance upon sales that were agreed a year ago, it is doubtful whether the values used by JLL as a base for pricing the application scheme reflect current values.

7.16 In addition, the prices tabulated by JLL reflect “Net Prices” and we would expect to be provided with the prices the properties will transact at and not prices which we have assumed deduct costs incurred by the developer.

7.17 In their letter dated 21st February 2013, JLL have provided a pricing rationale which provides a “high level” over-view on how they have approached the pricing of the scheme and we set out our comments using the same headings as set out in their letter.

<u>Location</u>

7.18 The JLL letter states:

> “ *we have assessed the scheme in terms of where it sits in relation to transport connections, local amenities and access to key employment areas of the City. In addition, we have focused on the micro-location of the site looking at the amenity provision on site as well as the communal open space allocated to future residents*”

7.19 Whilst JLL have stated they have assessed the scheme against a number of factors, their letter does not provide an over-view/conclusions of their assessment in terms of transport, local amenity etc and it is unclear where JLL view the scheme in terms of these attributes against other locations and residential values.

7.20 In addition, it is unclear what amenity provision has been considered and in what context.

Unit Positioning

7.21 JLL have stated they have attributed premiums for apartments in accordance with “prescribed standards” and when attaching premiums to units they have considered floor level, desirability of view and amount of natural light.

7.22 It is unclear what JLL mean by using the term “prescribed standards”, we are unaware of any prescribed standards used to undertake a unit by unit pricing exercise as each scheme will be valued upon its own merits/characteristics.

7.23 Whilst JLL intimate they have attached premiums to units considering floor level and views, they have not provided any information to inform which apartments warrant a premium, how much this premium is and why.

7.24 In addition, buildings C2, C3 and C4 have only been designed in outline and it is unclear from the indicative layouts whether apartments have a dual aspect or outside space etc as this will have a significant impact on an assessment of whether apartments values are negated by poor natural light and impact on views etc.

7.25 JLL have termed the Tower (C4) as an iconic building and it is unclear what JLL understand an iconic building to comprise. In considering whether the building at present is iconic we consider the following points:

1) We have been provided with an outline specification for the scheme that provides unbranded fittings/appliances and consequently there is no differentiation of product in the apartments in terms of specification (Ontario Point provides a branded specification with improved specification on the upper floors).

2) The building has not yet been designed in detail and therefore layouts/unit mixes of apartments could change as the scheme evolves.

3) There is no differentiation of product through the building, for example, the unit mix/apartments remains standard through all floors. We would expect an “iconic” building to provide a broad range of product to include Penthouse apartments, duplex apartments etc.

7.26 In terms of the values attributed to the Tower (C4), JLL have stated the units at the lower levels will be affected by road noise and pollution and that the lower levels will be visually impacted by natural light and by being overlooked.

7.27 We have considered where the Tower is situated within the overall proposal and the Tower is not located next to a road and is not overlooked by other buildings as the Tower sits opposite a large pedestrianised area. Therefore, it is unclear how JLL have arrived at their conclusions.

7.28 JLL have attached what they believe to be industry standard premium increments per floor of £2,000 for 1 bed units, £3,000 for 2 bedroom units and £4,000 for 3 bedroom units.

7.29 In support of this uplift per floor they have quoted development schemes where similar increments have been used (Providence Tower, The Landmark and Baltimore Wharf), however, we have not been provided with any examples of values of apartments from these schemes that serve to illustrate this point.

7.30 The adjacent Maple Quays scheme (Ontario Point) is the most comparable scheme in terms of assessing base values for the application scheme and consequently it is unclear why JLL have not cited Ontario Point as a comparable for assessing floor increments.

7.31 We have considered JLL’s letter dated 22nd January 2013 in which they provided details of “Net Prices” for apartments at Ontario Point. In considering these prices, we have noted a £21,850 floor level differential between 2 apartments of the same layout etc on levels 13 and 14.

7.32 Consequently, the floor differential of between £2,000 - £4,000 is clearly not prescriptive and we would expect the premiums per floor for the upper floors of the Tower with uninterrupted views to attract premiums in excess of this.

7.33 However, as stated above, Ontario Point has yet to reach practical completion and at present clear-cut evidence of the premiums for apartments on the upper floors of Ontario Point are not yet available.

7.34 Whilst the development schemes JLL had regard to may provide indicative guidelines for increments of value on a floor by floor basis, the most reliable evidence would be that of sales for Ontario Point. Albeit adjustments would need to be made for capital value growth for sales that were agreed during construction significantly prior to practical completion.

7.35 When analysing unit positioning JLL have assumed social rented accommodation is separated from the private accommodation by core, and that there is no affordable in the upper levels of the towers.

7.36 However, we understand the applicant is only proposing that affordable housing is provided in Building E and consequently is unclear whether the apartment values put forward by JLL reflect the application scheme proposals.

Phasing

7.37 JLL have stated “in principle the plots in some of the later phases should be able to achieve higher values than the pioneering plots, all other elements being equal, as these blocks will benefit from the infrastructure being delivered and the vision of the scheme being clear”

7.38 We agree with the comment that the latter phases of the scheme will achieve the highest values as the scheme evolves creating a sense of place-making with the introduction of commercial space comprising bars, restaurants etc.

7.39 However, we understand there is no infrastructure being delivered as part of the scheme and it is unclear why JLL have made reference to this.

Residential Revenue Conclusion

7.40 We have reviewed the values relied upon by the applicant in addition to the supporting information provided by JLL.

7.41 In summary, the values proposed by JLL for Building C1 and the general price points for the rest of the scheme from a “high level perspective” do not appear to be unreasonable.

7.42 However, as set out above there is a dearth of recent transactions at Maple Quays as currently Brampton House, Vancouver House and Ontario Point are nearing practical completion. Bearing this in mind, once transactions within these buildings complete, a high percentage of these sale prices will be historic as prices would have been agreed between the developer and purchaser off-plan during the buildings construction period.

7.43 In considering the sales values, as the majority of the scheme is at an outline stage of design there remains the opportunity that Buildings C2, C3, C4 and E will evolve over time giving rise to changes to unit mixes, layouts, apartments types, specification etc to respond to demand, changes in the locality and it would follow that sales values will also change as a result.

7.44 The application scheme will generate its own market with values that may outperform the immediate local market (Maple Quays/initial phases of application scheme) and this will be dependent upon the branding and place-making the scheme generates and this will evolve over the design process.

7.45 As the scheme evolves, the pricing of residential units will be influenced by the product on offer, demand and the price points at which previous sub-phases have sold.

7.46 Considerable product differentiation will be required across the scheme due to potential competition of “second hand” stock from previous phases competing with the release of “new” buildings coming forward and this could have a detrimental impact on achieving optimum scheme revenue.

7.47 JLL are of the view the main value drivers for the scheme are proximity to transport and the City, proximity to the river and the iconic status the developer can attach to the scheme.

7.48 We would agree with the main value drivers identified by JLL and bearing this in mind we would highlight the potential significance the impact of the introduction of Crossrail at Canary Wharf which is anticipated to open in 2017/2018 (which is mid-way through the application schemes project programme).

7.49 In March 2012, JLL forecasted over a 6 year period to 2018 that the impact of Crossrail at Canary Wharf will result in an increase in residential values of c. 46% due to improved transportation links to other parts of London.

7.50 In considering Canada Water in the context of the impact of Crossrail at Canary Wharf, we would also expect Canada Water to benefit in terms of uplift in residential values due to improved transportation links at Canary Wharf.

7.51 Putting this in context, Canada Water is one stop away from Canary Wharf on the Jubilee line and anticipated journey times from Crossrail at Canary Wharf are 39 minutes to Heathrow, 6 minutes to Liverpool Street and 11 minutes to Tottenham Court Road.

7.52 In summary, the JLL letter dated 22nd January 2013 refers to “net sales prices” for apartments in Ontario Point that have not yet transacted. In considering these values, we assume that a “net price” reflects a deduction made to the gross price to reflect developer’s costs etc. In addition, we would expect these sales figures to reflect historic agreed prices.

7.53 Consequently, to guide our initial assessment we have adjusted the values relied upon by the applicant by 10% to reflect that the pricing of the scheme has been based upon historic “net prices” for Ontario Point which would require adjustment to a gross prices plus revenue growth.

7.54 Having regard to our comments the applicant will need to undertake some further work in order support the residential values. As they stand the JLL commentary and values would not satisfy 3rd party scrutiny, and as such are not considered to be robust.

Car Parking

7.55 The applicant has valued all residential car parking spaces across the scheme at £0.025m and for the purpose of this assessment we find this rate to be acceptable.

8.0 Commercial Uses

8.1 The application scheme comprises a mix of commercial uses including offices, retail, leisure, and other community uses. The proposal includes the following approximate floor areas for each of these uses:

	Land Use	GIA Sq m	GEA Sq m
Office	B1	2,460	2,800
Decathlon Retail Store	A1 – A4	12,103	12,308
Other retail	D2	4,035	4,334
Cinema	D1	640	698
Health Centre	D1	573	658
Parking, Plant & Storage	Ancillary	18,775	19,271

8.2 The conditional agreement to lease refers to replacement Decathlon retail store having a net internal area of not less than 5,000 Sq m and a gross internal area of not less than 5,700 Sq m at ground floor and an office unit having a gross internal area of not less than 600 Sq m at the ground floor mezzanine level.

8.3 The agreement to lease refers to a premium which Decathlon will pay to the Landlord. In addition it is not clear how long the lease term or indeed the lease terms to include any rent or management or service charges that may be payable over the term.

Retail Revenue

Overview

8.4 We are informed that a detailed design for the retail units does not exist for the scheme and whilst DVS requested details and values for proposed individual units this has not been provided. In addition we are informed that proposed breakdowns for the different classes (A1 – A5) within the retail is not available.

8.5 Both of these factors are value significant; smaller units tend to attract higher rental values per sq ft than larger units as do corner units and those with more prominence and return frontage. Use classes A3 – A5 tend to attract higher rental values than A1 – A2. Accordingly we would normally expect a more detailed valuation breakdown for the retail units.

8.6 The applicant has adopted the following valuation assumptions in respect of the retail units :

- Retail A1-A3 £20-£25 psf
- Local uses (i.e. dry cleaners/pharmarcies) £18 - £20 psf
- Gym £8 - £12 psf
- Cinema £6 - £8 psf

Retail Rents

8.7 In support of the proposed rental values the applicant's advisor refers to quoting rents

Retail Yields

8.8 Based on the applicant's current retail vision and strategy, the initial yields at 6.5% do not seem unreasonable. However, as a more detailed design and strategy evolves there will be a greater level of certainty. Furthermore a change in strategy to secure anchor tenants with stronger covenant strengths would see a reduction in yield for some of the units and thus a rise in value.

Rent Free & Void Periods

8.9 A rent free and void period of 12 months has been assumed in the applicant's models which we accept.

9.0 Growth Assumptions

9.1 The merit of using an outturn approach is that it can secure a known amount of affordable housing when the scheme on a current cost approach is not viable. The downside, however, is that growth is difficult to predict and the amount of affordable housing and S106 contributions secured could look insufficient if the market grows at a faster rate.

9.2 The applicant has provided residential forecasts for Non-Prime London from Savills, Knight Frank and Jones Lang LaSalle. The forecasts are historic insofar that the Knight Frank & JLL report dates to November 2011 whilst the Savills forecast is dated Q2 2012. In addition we have also been provided with JLL residential research document dated November 2012.

9.3 We have not been provided with the exact definitions for what the forecasts relate to. In addition, some of the forecasts relied upon by the applicant are some what historic and it is unclear whether these forecasts are relevant as at the date of this report.

9.4 For the purpose of this assessment we have adopted JLL growth forecast assumptions dated November 2012 which we set out below:

London Residential House Price Forecasts

	2013	2014	2015	2016	2017	2018 - 2022
JLL	2.0	3.5	6.0	7.5	7.5	5.3

Source: JLL Residential Eye November 2012

Construction Cost Inflation

9.5 In preparing the FVA the applicant adopted BCIS Tender Price Indices for Greater London in the outturn modelling this forecast the following – 1.4% until end of 2012, 1.8% in 2013, 3.2% in 2014, 3.5% in 2015, 4.2% in 2016 and 4.9% in 2017.

9.6 The applicant has also provided Tender Price Forecast prepared by Davis Langdon dated November 2012 together with a number of other forecasts prepared by Gleeds and G & T. Having considered these we have adopted the following blended average tender price growth:

	G & T	DL London (4Q 12)	ECH London (4Q 12)	Sweett London (4Q 12)	Blended Average
2012	-0.5	-0.5	-0.5	-1.0	**-0.625**
2013	0.5	0.75	0.3	2.0	**0.89**
2014	2.0	2.5	4.1	3.5	**3.03**
2015	3.0	4.0	4.0	4.0	**3.75**
2016	3.5	5.0	4.0	4.0	**4.13**

Commercial Value Growth

9.7 The applicant has not included rental growth on any of the rents that have been adopted in the FVA as they set out that they have adopted the higher order end of rents and lower voids.

9.8 However, after careful consideration we are of the opinion the outturn model should track inflation as a minimum and we have adopted 2% per annum growth over the project term as opposed to the straight line inflation forecast at Para 12.8 which reflects a straight line annualised RPI inflation for the period 2012 – 2017 at 3.2% per annum.

10.0 Construction Costs

10.1 We have been provided with Draft Feasibility Estimates for the scheme proposals prepared by the applicant's cost consultant which indicate the construction costs are c. £300.5m.

10.2 As part of our pre-application dialogue with the applicant in the summer and autumn 2012 we highlighted that at the next stage assessment we would require a full detailed cost plan. Despite our previous comments this has not been provided. Therefore, in undertaking our review we have had to benchmark against similar schemes.

10.3 This indicates construction costs could potentially be reduced by c. 5-8% without changing the contingency sum which is currently at 7.5% which indicates a cost reduction of c. £25m.

11.0 Additional Cost Headings

Professional Fees

11.1 The applicant has adopted professional fees at 14% and we would expect these costs to fall within a range of 10 – 12%. However, any developer taking forward this scheme would probably agree fixed fees at a rate lower than percentage sum allowances.

Development Management Fee

11.2 The applicant is seeking to reserve a 2% development management fee to reflect their costs of running the project. We do not accept the reservation of a development management fee as the costs of running a project for a market developer would be a business overhead and not an additional development cost.

Finance

11.3 The applicant has adopted a finance rate of 7%. This rate falls at the upper end of an acceptable range and we have used this for the purposes of our assessment.

11.4 The model assumes 100% debt funding which does not necessarily reflect a true market approach that would require equity participation.

Project Programme

11.5 We have adopted the application scheme's project programme, however, should the council wish to have this verified we will need to refer to a specialist construction planner to test and determine whether the applicant's proposed timelines contained within the programme for the site preparation, construction and fit-out works are reasonable.

11.6 Clearly any change in the programme i.e. extension or shortening of the programme will impact upon the metrics of the scheme proposal.

12.0 Planning Obligations

12.1 The applicant's FVA sets out a provision for total £12.547m and confirmation from the LPA is required to confirm this is correct. In parallel we require the applicant to double-check the breakdown as this appears to equate to £12,520,040 as shown below:

CIL	£4,154,850
Education	£1,131,079
Employment in the Development	£247,207
Employment during Construction	£1,073,018
Employment during Construction (management fee0	£84,092
Public Open space, Childrens Play Equipment & 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
Total	**£12,520,040**

Affordable Housing

12.2 In addition to the provision for planning obligations the applicant has taken into consideration a premium of £20m to reflect a commuted sum in lieu of providing affordable housing on site as part of their proposal.

12.3 The applicant has also prepared another FVA model which considers the provision of 10% and 15% on-site affordable housing but until we have addressed a number of issues concerning the information provided by the applicant we have not considered in any detail rather than incur abortive costs.

13.0 Developer Return

Present Day Model

13.1 The applicant's present day financial models based upon the applicant's assumptions indicate:

Scenario	Affordable Output	IRR
15% Affordable	156 mixed tenure	11.29%
10% Affordable	105 mixed tenure	11.96%
Commuted Sum	£20m	10.07%

13.2 The applicant's agent asserts that in all three scenarios the models fall short of the threshold IRR at 20% which they are seeking to rely upon as the risk reward threshold return.

13.3 However, we have not considered the applicant's affordable housing scenarios at this stage in any detail and have chosen to concentrate upon the commuted sum scenario.

13.4 Based upon the assumptions and comment set out above our model indicates an IRR return of 16.69% which exceeds the applicants assessment by c. 6.62% and indicates there would be a surplus in addition to the £20m commuted sum.

Outturn Model

13.5 The applicant's present day financial models based upon the applicant's assumptions indicate:

Scenario	Affordable Output	IRR
15% Affordable	156 mixed tenure	18.78%
10% Affordable	105 mixed tenure	15.84%
Commuted Sum	£20m	15.83%

13.6 The applicant's agent asserts that in all three scenarios the models fall short of the threshold IRR at 20% which they are seeking to rely upon as the risk reward threshold return.

13.7 However, in having regard to our various comments and assumptions set out above we are of the opinion the returns on an outturn model would fall between an IRR of 15% - 17% and in all scenarios the IRR exceed 15%.

13.8 We have only focussed upon the commuted sum scenario and based upon the assumptions and comment set out above our model and IRR range indicates a surplus falling between c. £45m – c. £58m.

14.0 Conclusions

Developers Return

14.1 We have considered the applicant's assumptions and we are of the opinion that an appropriate IRR for an outturn model would be at the lower end IRR range of 15 – 17.5% for this project. In considering an appropriate IRR for a Present Day model we are of the opinion this threshold would be lower and fall within 12 – 14%.

Outline Stage of Scheme Design

14.2 A fundamental area of concern to us is the level of detail that informs the applicants FVA model as Phase 1 of the proposal is the only element of the scheme that is subject to a detailed planning application and Phase 2 – 4 are subject to an outline application and may be subject to change which will impact upon the metrics of the FVA models.

Residential Revenue

14.3 The applicant will need to undertake some further work in order support the residential values as per our comments in section 7 of this report.

Commuted Sum Scenario

14.4 Our assessment has focussed upon the commuted sum scenario and based upon our assumptions and comment set out in the main body of our report this currently indicates a surplus falling between c. £45m – c. £58m (in addition to £20m commuted sum).

Benchmark Land Value

14.5 For the purpose of this assessment we have adopted the applicant's benchmark land value which has been assessed by applicant's valuer at £25m.

14.6 On a very broad ranging basis the term certain income equates to c. £3m and given the applicant has set out the extant consent for site C is not acceptable to Decathlon and therefore the site could not be assembled we are unsure how the applicant's valuer arrives at an opinion of £25m? Therefore it will be helpful to understand precisely how they arrived at their opinion of Market Value for sites C & E.

Programme

14.7 The project has a programme of c. 11 years and the model relies upon forecast revenue growth and cost inflation. These factors coupled with the stage of design development of the scheme highlight the opportunity for the scheme as a whole to either outperform or underperform the current assumptions.

Review Mechanism

14.8 With this in mind we recommend the scheme should be reassessed by way of a mechanism to test viability of a phase closer to the point of implementation to more accurately assess viability having regard to more detailed design information to inform construction costs, revenue and assumptions as the scheme is refined.

14.9 A review mechanism can set out the methodology of review which in this case should entail a comprehensive review of any given phase ahead of implementation as the inputs i.e. values and costs will have a greater degree of accuracy with a detailed scheme to consider together with site specific scheme revenue and cost evidence drawn from earlier phases at that time.

14.10 As the implementation of the project is currently envisaged to be phased over 11 years the inputs and evidence will be drawn from project based costs incurred and residential sales prices which will more accurately indicate the revenue the scheme is capable of generating and the reasonable costs of construction that can be anticipated.

14.11 Clearly as and when the viability of individual phases is understood in more detail the parties can then assess whether or not the LPA put in place a mechanism to capture any improvement in the schemes actual performance relative to the individual viability review or whether to roll-over to pump prime future development phases of the scheme.