BISCUIT FACTORY BERMONDSEY C 3776a
GLA FINANCIAL VIABILITY REVIEW

GLA initial review 9 March 2018

I have now reviewed the FVA prepared by DS2 for Grosvenor Estates and the review of this by GVA for LB Southwark. This relates to a multi phase mixed used development of 1,343 BtR flats together with 25,398m2 (GIA) mixed commercial space and a secondary school.

DS2's FVA shows an unviable assessment assuming 27.5% DMR affordable housing (Discounted at 25% of market rent.) with a loss of over £70m.

GVA's review disagrees with a number of inputs and considers that the scheme can viably deliver 27.5% AH at DMR levels consistent with LB Southwark emerging policy for BtR: 12% at SR equivalent levels; 18% at AR equivalent levels; 5% at 1/3rd of income levels of between £60-90k. GVA do not consider that additional AH is viable.

Reviewing the two reports:

DS2 FVA:
This has been assessed on growth modelling and as such is a departure from PPG recommended current day levels. However, PPG does recommend that growth modelling may be appropriate in multi-phase schemes. Where this is done, an assessment on a current day basis should also be provided for context. Inputs in to the assessment are evidence based, although some of this is historic (NB Commercial property evidence.) Looking at the inputs, I consider the following, in particular, are incorrect:

1. BtR discount from gross: net rent. This has been shown at 30-40%, with a further allowance for sinking funds. Typically, operators allow an overall 25% across both market and affordable rent for all management costs including sinking funds.
2. Discounted Market Rent: The rent levels at 75% of MR are generally in excess of the 1/3rd of local household incomes and are therefore inappropriate as affordable housing.
3. Commercial rent evidence: This is historic and in some cases significantly understates current evidence.
4. Build costs. The overall rate at £3400/m2 GIA is high for this type of development. In addition, in the Argus assessment £86,880,500 is shown as 'Other Construction'. This sum was already included in the build costs and is therefore double counted.
5. Contingency: An overall rate of 10% is shown. Typically, 5% all in is considered typical at this stage in viability testing.
6. Development management: This is shown as 3% of costs. This is part of the profit assumption and is double counted.
7. Finance: This is shown, reasonably, at 6%. However, the overall finance cost is shown in Argus at £145,213,354 on a total development cost of £987,516,966. As a sense check, finance costs usually come to between 5-10% of total development costs. This may be a programming error, but is excessive for this type of scheme.

GVA Review:
The review complies fully with PPG and AH&V SPG. It reaches conclusions on a number of inputs that vary to those assessed by DS2. In particular, the assessment of market rent is about ~27% higher, the discount from gross rent to net rent is 25% and build costs are ~4% below the DS2 costs. I generally consider that the inputs assessed by GVA are appropriate, although recognise that the housing market rent estimate is a matter of opinion. I disagree with the following:

1. Build costs: Like DS2, GVA have included 'Other Construction' costs at £67,711,999. This was already in the main build cost estimate and is therefore double counted.

2. Contingency: GVA assess this at 7.5% overall. Typically, 5% is applied overall and I see no particular reason for a higher rate here. I am not clear, but the QS commentary implied that 2.5% contingency was also applied on some of the cost figures. This should be reviewed.
3. Finance is agreed at 6% but shown in the Argus assessment at 5.75%. This is academic in measuring viability on an IRR basis, but should be reviewed.

GLA conclusion:
Given what appear to be a number of areas of disagreement/ errors, I would recommend that both FVA and review are re-considered. I am not clear at this stage as to whether additional AH would be viable, but this may become clear following further consideration.

GLA assessment dated 9 October of Quod FVA dated 19 September 2019:

Introduction:
Revised planning application:
"A hybrid planning application comprising: Full Planning Permission for demolition, alternations and extension of existing buildings and erection of new buildings comprising a mixed use scheme providing up to 1,418 residential units, up to 3,436 sqm GEA of flexible A1/A3/A4 floorspace, up to 14,666 sqm GEA of flexible Class D1/D2 and up to 3,311 sqm GEA of multi-use floorspace (A1/A3/A4/D1) within Building BF-F, a new secondary school, in buildings ranging from 5 to 35 storeys in height as well as the creation of a single storey basement. The development also includes communal amenity space, landscaping, children's playspace, car and cycle parking, installation of plant, new pedestrian vehicular and servicing routes, the creation of two new pedestrian routes through the Railway Arches and other associated works; and

Outline planning permission (with all matters reserved) for the part demolition and part retention of existing buildings and erection of two new buildings comprising a mixed use scheme providing up to 130 residential units and up to 780 sqm GEA of flexible A1/A3/A4/D1/Sui Generis Uses and other associated works."

The development will provide the following space:

Land Use	GEA (sq.m)	GEA (sq.ft)	GIA (sqm)	GIA (sq.ft)	NIA (sqm)	NIA (sq.ft)
Residential Class (C3)	160,176	1,724,134	141,320	1,521,168	94,409	1,016,218
Retail (Class A1/A3/A4)	3,436	36,985	3,095	33,315	2,447	26,340
Multi Use Floorspace – building BF-F only (Class A1/A3/A4/D1)	3,311	35,640	3,151	33,917	2,656	28,589
Commercial (Class B1)	14,666	157,865	14,206	152,913	10,548	113,539
School (Class D1)	6,973	75,057	5,250	56,511	3,786	40,753
Community and Leisure (Class D1/D2)	869	9,354	816	8,783	659	7,093
Detailed Sub-Total	**189,430**	**2,039,035**	**167,837**	**1,806,608**	**114,506**	**1,232,532**
Residential (Class C3)	13,103	141,041	11,783	126,832	8,484	91,322
Flexible (Class A1/A3/A4/D1/Sui-Generis)	780	8,396	710	7,642	627	6,749
Outline Sub-Total	**13,884**	**149,437**	**12,493**	**134,475**	**9,111**	**98,071**
Overall Total	**203,314**	**2,188,472**	**180,330**	**1,941,083**	**123,617**	**1,330,603**

Quod's FVA for the applicant states that revised the proposals will provide up to 1,548 residential units of which 482 will be affordable homes (35% habitable rooms) in a Build to Rent scheme. The AH tenure will be all at Discounted Market Rent (DMR), with 30% being at Social Rent equivalent rent levels and 70% at rent levels capped to a maximum income of £60k. AH units will be managed by a Registered Provider.

This proposal based on FVA estimated inputs shows a profit of 6.53% on an Internal Rate of Return (IRR) measure. This level of profit is less than the typical target profit level for this type of development.

Site description:

the Site is located in Bermondsey, situated c. 0.3 miles south of Bermondsey Underground Station. The Site measures 5.4 ha and comprises two parts, the former Peek Frean Biscuit Factory and the Bermondsey Campus. There are 13 existing buildings on the Site, a number of which are interconnected and linked. The total combined area of the existing buildings is 42,518sqm (GIA) comprising a mix of uses including office, light industrial (B1); general industrial (B2); storage and distribution (B8); education and community (D1) including an existing Compass School; along with some sui generis and meanwhile uses.

Viability assessment:
The FVA has been prepared fully compliant with PPG & the Mayor's AH&V SPG. Inputs are based on current day values and costs. The most important inputs (ie Sales values, build costs and benchmark) are supported by detailed evidence and cost analysis. The inputs have been assessed in an Argus model to determine the profit level as the residual output with the benchmark land value as an input. I agree with this approach as it accurately shows the total cash flow/ finance cost.

The inputs have mainly been based on those considered reasonable by GVA in their earlier review of the DS2 FVA. The main departure from this relates to the appropriate market rents for this development. In my opinion, the rent levels assessed by GVA in the 2017 assessment were optimistic and unsupported by market evidence. Savills have provided detailed evidence of similar developments in comparable value localities to justify their rent levels. In my opinion, these rent assessments are realistic for this scheme and have been calculated on an individual building/ unit characteristic.

Having considered the information provided, I agree with the inputs used in the FVA except for the contingency level overall at 10%. Typically, this is a combined rate of 5%. I note, however, that contingency has not been applied to 'other construction' costs (£67,122,948). Adjusting for this and reduced overall to 5%, the contingency total should be £30,581,314, a reduction from the FVA cost of £28,788,981. Professional fees have not been included on the 'other construction' costs which is an underestimate of £6,712,295.

Taking these differences in to account, together with consequential finance cost savings, the overall development cost is ~£25.5m overstated. This means that the profit level would increase from £13,293,773 to ~ £38.8m. This would change the profit level assessed on a % of GDV from 1.37% to 4.18%. This is still well below the target profit level at ~12.5% (Blended) for this development. **Therefore, I conclude that the offer of 35% AH as proposed is in excess of the maximum viable level for this development.**

No sensitivity testing has been provided in the FVA. It is helpful in arriving at an overall conclusion of viability to understand how key variations of inputs (Particularly market rents and build costs) can change the viability position. I estimate that an increase in market housing rent levels of 12%, assuming over values and costs remained as assessed, would make the development fully viable. Given the length of this development (7 years.), I consider that sensitivity and growth modelling would show the scheme would be viable.

Viability review mechanisms:
The applicant agrees to VRM for delayed commencement as well as at late stage. No specific details have been provided about this but I assume that the applicant would seek to include within the assessment the deficit of profit. For this reason, it would be appropriate to agree the deficit at this stage. Quod have assessed on an IRR approach, seeking a profit at 12%. Whilst I agree that an IRR at 12% is reasonable, this should be sense checked against a profit based on % of GDV, for which a blended average of 12.5% of GDV would be reasonable.

C Solomon 9 October 2019

GLA Final assessment 26 November 2019
The final assessment considers:

1. The final Avison Young report to LB Southwark.
2. The revised Quod Argus assessment which includes my recommendations in my 9 Oct 19 review- specifically the treatment of contingency costs.

Avison Young assessment of Quod revised FVA, dated 1 November 2019
The AY assessment considers the revised scheme Quod viability assessment. Shown below is a summary of building uses:

Plot	Total Units	Total Private	Total Affordable	Studio	1 Bed	2 Bed	3 Bed	4 Bed
R, S, T	517	517	0	70	227	204	16	0
U	55	0	55	0	28	22	5	0
V	75	0	75	0	35	28	12	0
W	58	0	58	0	15	16	27	0
D, E	183	183	0	16	72	72	23	0
F	177	177	0	36	55	61	25	0
P, O, Q	182	70	112	0	72	67	43	0
1 - 4	263	119	144	10	81	131	41	0
5	38	0	38	0	13	14	7	4
Total	1548	1066	482	132	598	615	199	4

Market rent assessment: AY have completed a thorough and detailed review of the rental market, both locally and in similar value areas more widely. They conclude that the rents adopted in the FVA on Blocks R, S and T, F and D and E are reasonable and consistent with the evidence. Blocks O and Q and 1 to 4 (Campus) are discounted by 10% from these other blocks. AY consider this quantum of reduction is not fully justified.

Blocks O & Q and 1-4 are predominantly AH tenures and the effect this has on market tenures is uncertain at this stage. Factors that may affect rent levels include the management provisions and services available. The level of appropriate discount (If any.) is a matter of judgement. The is a degree of uncertainty on the appropriate rent levels on the 189 market rent units in these blocks out of a total of 1066 market rents throughout the scheme. The overall effect on viability is not particularly significant.

BtR investment yield: AY consider that the investment yield should be assessed at 3.25% on net rent; Quod have assessed at 3.5%. To support their assessment, AY have summarised market evidence as below:

Asset	Location	Deal Type	Date	Units	Sale Price	NIY
Hale Wharf	Tottenham	Forward fund	Dec-18	108	£42,000,000	3.90%
Legacy portfolio	SW London	Operational	Sep-18	200	£91,000,000	2.50%
Taberner House	Croydon	Forward fund	May-18	252	£94,000,000	3.80%
Hounshow Place	Hounslow	Forward fund	Dec-17	255	£98,000,000	3.95%
Montrose Crescent	Wembley	Forward fund	Nov-17	148	£64,000,000	3.80%
Cheviot House	Whitechapel	Operational	Nov-17	97	28900000	3.50%
Hampsted Portfolio	NW London	Operational	Jun-17	221	£84,000,000	3.10%
Bedford Park	Croydon	Operational	Jan-17	82	£23,700,000	3.50%
Vida House	Deptford	Operational	Jan-17	138	£43,700,000	3.50%

The evidence shows that operational properties (i.e. those that are let and 'stable'.) sell at yields of between 2.5%-3.5%, with 3 out of the 5 properties being at 3.5%. There are four forward funded sales at yields between 3.8%-3.95%. These are sales ahead of completion of construction/ letting and reflect uncertainty of assessment at that stage. For FVA testing the assumption is that the investment is sold on completion of construction and before the flats have been fully let. Factors to consider are uncertainty of values, the period required to let the flats and the 'stabilisation' level. AY conclude that the evidence is not conclusive and it would not be unreasonable to apply a yield of 3.5%. In my view, 3.25% yield is unsupported whereas there is good evidence to support 3.5% as an appropriate yield.

Other AY inputs are as per their earlier assessment. They consider the build costs are slightly high, but this is based on an increase based on indices changes rather than re- assessing based on the new proposals. In addition, they accept the overall contingency rate at 7.5% which GLA consider to be excessive. The AY conclusion is that the scheme outturn produces an IRR of 9.5%, suggesting the scheme is delivering the maximum reasonable quantum of affordable housing.

AY completed sensitivity testing showing variations in viability based on rent and investment yield variations. The following table shows how small changes materially affect viability:

	Rent: Rate /ft²				
Rent: Yield (Basis Point Change)	-5.00%	-2.50%	0.000%	2.50%	5.00%
3.00% (-0.50)	14.4862% 17.169%	15.3427% 18.695%	16.1827% 20.162%	17.0067% 21.558%	17.8156% 22.891%
3.25% (-0.25)	10.9829% 10.877%	11.8259% 12.506%	12.6525% 14.077%	13.4636% 15.590%	14.2597% 17.055%
3.50% (0.00)	7.8576% 4.400%	8.6879% 6.199%	9.5022% 7.940%	10.3012% 9.625%	11.0855% 11.256%
3.75% (+0.25)	5.0450% -2.028%	5.8634% -0.030%	6.6662% 1.794%	7.4538% 3.561%	8.2269% 5.272%
4.00% (+0.50)	2.4946% -8.560%	3.3019% -6.475%	4.0937% -4.457%	4.8706% -2.501%	5.6333% -0.605%

Quod revised Argus assessment including GLA changes:
Quod have made a further Argus assessment which is based on GLA proposals dealing with contingency. This has been correctly applied (It's not obvious at first glance, but the figures are correct.). The results are slightly better than GLA had expected, with profit now at £47,737,169 (an increase from £13,293,773) being 4.9% of GDV, and (more relevant in in this multi-phase assessment) an IRR of 8.25%.

GLA considers that this assessment correctly assesses the viability based on a BtR scheme based on current day values and costs.

In the GLA report of 9 October comment was made that no sensitivity or growth testing had been provided. These are helpful to determine if the development is likely to be carried out and, subsequently, if there is likely to be improved viability. At an IRR of 8.25% it is considered that the development will be deliverable. Modest growth increases in values over costs over the development period are likely because of improved economic conditions and 'place making' benefits which are not currently taken in to account. GLA consider therefore that there is potential for the scheme to achieve and exceed the target return which will be reassessed in viability reviews within the S106 agreement.

Charles Solomon
GLA Viability Team

29 November 2019