DEVELOPMENT VIABILITY REVIEW – HIGH ROAD WEST

In December 2021, the London Borough of Haringey ("the Council") commissioned BNP Paribas Real Estate to advise on a viability assessment of the redevelopment ("the Development") of High Road West ("the Site") submitted by DS2 LLP ("DS2") on behalf of Lendlease (High Road West) Limited ("the Applicant").

Our report provided an independent assessment of DS2's Viability Assessment Report to determine whether the affordable housing offer and Section 106 contributions as proposed have been optimised.

DS2 concluded that the proposed Development with 35% affordable housing (by units) generated an IRR of 6.6% against their target IR of 14%. DS2 therefore considered that the scheme generates a deficit against the target profit level. In contrast, we concluded that the proposed Development including 35% affordable housing (by units) generated an IRR of 11.32% against a target IRR of 12%. Therefore, we concluded that although generating a deficit, the level of deficit was significantly smaller than DS2's reported deficit.

For the reasons outlined in Section 5.4 of our original report, we recommended the Council include early, mid and late stage review mechanisms within the Section 106 Agreement.

In our review of DS2's appraisal assumptions, we recommended the following amendments:

- Increase private residential values as a result of introduction of a 'maturity factor';
- Increase affordable housing values to reflect current market expectations;
- Adjust commercial revenue and yield to reflect what is achievable in the current market;
- Reduce construction costs in line with advice received from CDM;
- Reduce infrastructure costs in line with advice received from CDM;
- Adjust contingency allowances in line with CDM advice;
- Adjust disposal costs to reflect what is achievable in the current market;
- Reduce profit levels to reflect risk profile of the scheme; and
- Adjust programme timetable to reflect current market expectations.

In addition to the amendments identified above, we also requested further information / substantiation / clarification on the following appraisal assumptions:

- Confirmation from the Council as to whether London Affordable Rent tenure should be viability tested at the proposed Development in place of social rent;
- Clarification with regards to the number of car parking spaces within the proposed Development;
- Further information in relation to the timings and quantum of grant that has been made available;
- CDM cost review is subject to substantiation, clarification and further information requests on 21 separate items. We requested that this information is provided;
- A number of items within the Compensation costs that require further information, clarification or substantiation; and
- A schedule of rents to be provided for the LBH residential properties. We requested that this information is provided.

DS2 further correspondence

DS2 have provided a response dated 14 February 2022 within which they have provided further justification / evidence in support of their viability conclusion. We have reviewed the additional information provided and have responded in the same structure for ease of reference:

- **Private residential values:** In our original assessment, we uplifted the residential values from those assumed within the DS2 submission. Whilst we agreed with the base position of £700 per square foot, we applied a maturity factor of 2.5%.

  We stated that it would not be appropriate to simply apply the current values achievable in each area. We noted that in a scheme of this scale and nature, once it has achieved maturity and 'bedded down' it is common to see an uplift in prices resulting from the regenerative effects of the scheme itself. This increase is not related to wider market movement but is more as a result of the scheme itself having become established. Given the wider regenerative effects of the proposed Development in particular, we consider that it will create a sense of place and a new urban quarter.

We applied a 'maturity factor' of 2.5% from Phases 2 onwards in our assessment. In their most recent correspondence, DS2 state that "future market movement is difficult to forecast" and as a result, the base value should be utilised within the appraisal. For the avoidance of doubt, the maturity factor is not market 'growth', but rather a current day view on the values that would be achieved as a result of 'placemaking' from the earlier phases. We have maintained our position regarding maturity factor in our appraisals.

- **Affordable housing revenue:** In our original assessment, we increased the capital values for the social rent and shared ownership units from £110 per square foot and £420 per square foot, to £132 per square foot and £471 per square foot respectively.

  In their most recent correspondence, DS2 have included the current rent schedule for the existing Love Lane Estate "*which demonstrates that units are currently let below or at target rent levels*". We have taken this into account in our assessment of the social rent units and have reduced our capital value from £132 per square foot to £124 per square foot.

  With regards to the shared ownership units, we had previously adopted a capital value of £471 per square foot. This capital value was based upon the GLA affordability cap of £90,000 per annum income. DS2 have stated in their most recent correspondence that they have revised their assumptions "*to accord with the draft Section 106 head [sic] of terms which are based upon the LBH Intermediate Housing Policy Statement ('IHPS') 2018 income caps".* The one and two bedroom shared ownership units will be available at gross household incomes of £40,000 per annum, with the larger units available at £60,000 per annum for the first three months post completion. If the units remain unsold, they will all revert to £60,000 per annum affordability criteria, followed by the GLA cap of £90,000 per annum after 6 months post PC. We have therefore updated our assessment of the shared ownership units and consider the capital value of £380 per square foot proposed by DS2 to be reasonable.

  It should be noted that should the Council not seek to apply the above affordability thresholds, we reserve the right to revisit our affordable housing assumptions. If the shared ownership units are sold at the higher household income thresholds, this will be picked up in the review mechanism, subject to appropriate drafting of the formulae.

- **Commercial revenue and yield (retail):** In our December 2021 report, whilst we agreed with the rental value and rent free period assumed by DS2 for the commercial space, we reduced the yield from 7% to 6.75% to reflect what is achievable in the current market. In their most recent correspondence, DS2 have adopted the 6.75% yield on a 'without prejudice' basis. We therefore consider these assumptions to be agreed between the parties.

- **Commercial revenue and yield (office):** In our December 2021 report, whilst we agreed with the rental value and yield, we reduced the rent free period from 18 months to 15 months. In their response, DS2 have referred to the Carter Jonas London Office market report Q3, 2021 which refers to rent free periods at Stratford as well as Hammersmith, White City and Chiswick. The rent free periods range from 12-16 months for 5 year leases with 10 year leases achieving rent free periods of between 25-28 months. We are in agreement with DS2 that these locations are more established as office destinations; however, we do not consider that as a result, the proposed Development should adopt an 18 month rent free period as we consider this to be excessive.

  In the interests of achieving an agreed position, we propose a mid-point of 15 months within our assessment which we have adopted on a 'without prejudice' basis.

- **Commercial revenue and yield (sporting facilities):** In our December 2021 report, whilst we agreed with the yield of 7%, we increased the rental value from £15 per square foot to £16.50 per square foot. In their most recent correspondence, DS2 consider our adjustment to be within an acceptable tolerance and have therefore adopted our assumption on a ‘without prejudice’ basis. We therefore consider this assumption to be agreed between the parties.

- **Car parking:** DS2 referred to 382 existing car parking spaces and 75 proposed spaces within section 1.3.4.9 of their original report; however, in their appraisal, DS2 assumed 44 car parking spaces with a revenue of £25,000 per space. We requested clarification as to the quantum of car parking spaces for sale within the scheme.

  In their most recent correspondence, DS2 have stated that the car parking is to be provided as replacement and therefore is not for sale. DS2 have therefore removed all car parking revenue from their appraisal. We have adopted this position on a ‘subject to confirmation’ basis pending discussions with the Council. In the event that the car parking is not to be revenue generating, we recommend the Council include provisions with the Section 106 Agreement that ensure that the car parking spaces cannot be sold or rented at any value higher than a peppercorn.

- **Grant funding:** In their original submission, DS2 included grant funding within their appraisal; however, they had not provided any information regarding the timing and quantum of the grant across the development programme. We therefore requested further information with regards to how the grant funding had been cashflowed.

  In their most recent correspondence, DS2 have provided a breakdown of the grant funding in Appendix 4. We have adopted the timeframes referred to on a ‘subject to confirmation’ basis pending discussions with the Council.

- **Construction costs:** DS2 had relied upon a construction cost plan prepared by Rider Levett Bucknall (“RLB”). RLB concluded that the total construction cost (inclusive of contingency) equated to £728,290,563. A copy of the RLB cost plan was provided in Appendix 6 of the original DS2 report.

  The Council instructed CDM Project Services (“CDM”) to undertake a review of the RLB cost plan. CDM concluded that the construction costs were above what is reasonable in the current market. We therefore adopted a total construction cost of £681,568,503 (excluding contingency) within our appraisal in line with advice received from CDM.

  In their most recent correspondence, DS2 included a rebuttal prepared by RLB which we provided to CDM. A copy of the CDM response can be found in Appendix 1; however, in summary, the total construction cost remain at £681,568,503 (exclusive of contingency). We have therefore adopted this cost within our appraisal.

- **Construction costs – site wide infrastructure:** DS2 had relied upon a construction cost plan prepared by RLB who concluded that the total site wide infrastructure cost should equate to £73,233,798. As with the construction costs, the Council instructed CDM to undertake a review of the RLB cost plan. CDM concluded that the total site wide infrastructure costs should equate to £72,414,082.

  In their most recent correspondence, DS2 included a rebuttal prepared by RLB which we provided to CDM. A copy of the CDM response can be found in Appendix 1; however, in summary, the total site wide infrastructure costs have increased to £74,414,082 (inclusive of contingency). We have therefore adopted this cost within our appraisal.

- **Resident disturbance allowance:** We adopted the allowances of £3,500 per secure tenant, £5,000 per resident leaseholder, and £1,500 per non-resident leaseholder in our assessment on a ‘subject to confirmation’ basis pending further information from DS2. In their most recent correspondence, DS2 have provided further justification; however, they have not provided evidence of the build-up of costs, rather they have provided an explanation of what the allowance would be used for. It should be noted that we do not consider the allowances to be outside of the reasonable range; however, we are concerned as to why DS2 are unable to provide a breakdown of what each of the elements they have referred to will cost. We have therefore adopted the costs on a 'subject to confirmation' basis.

- **Commercial leaseholder professional fees:** Whilst we agreed with the inclusion of the commercial leaseholders' professional fees, we noted that DS2 had not provided any justification to support their assumed allowance of 1.5% of the EUV. In response, DS2 have stated that the 1.5% allowance is split into agency and legal fees. After due consideration, we have adopted this assumption within our appraisal.

- **Disposal costs (residential sales legal fees):** In our December 2021 review, we reduced the residential sales legal fees from £1,000 per unit to £800 per unit to reflect what is achievable in the current market. In their response, DS2 have stated that they "*note this is below the industry standard approach and 0.5 per cent of GDV which is the generally accepted figure*". We do not agree with DS2's assertion that 0.5% of GDV is the 'industry standard figure'.

  Notwithstanding the above, we note that DS2 have adopted our allowance of £800 per unit within their appraisal on a 'without prejudice' basis. We therefore consider this assumption to be agreed between the parties.

- **Disposal fees (commercial marketing and agency fees):** We removed the commercial marketing allowance from our appraisal of £2.50 per square foot; however, we increased the commercial sales agency fee to 1% of GDV to take account of the all-inclusive nature of the agency and marketing allowances. DS2 have adopted our assumption within their appraisal. We therefore consider this assumption to be agreed between the parties.

- **Developer's profit:** DS2 assumed an Internal Rate of Return ("IRR") requirement of 14% on a current day cost / value basis. We considered this to be above what is reasonable in the current market and assumed a 12% IRR on a current day basis in our assessment.

  We stated that DS2 had not provided any evidence to support their assumption and note that DS2 have still not provided any evidence in their latest submission.

  DS2 appear to have completely ignored the schemes we have referred to where IRRs of 12-13% have been agreed, clearly identifying a 14% IRR is above what is reasonable in the current market. Rather, DS2 have referred to a cross-referencing of the traditional approach of profit on Gross Development Value ("GDV"). Whilst we agree that the two approaches should be examined, the outcome does not result in a shift from the 12% IRR that we have adopted.

  DS2 have referred to the development programme being in the region of 10 years and therefore subject to greater risk of changes in sales values and build costs. On the contrary, we consider that due to the scheme timetable, the Applicant will be able to better mitigate (to a reasonable degree) the fluctuations in market conditions in comparison to a significantly smaller scheme. DS2 also appear to state that historic costs incurred and project history should warrant a higher return to the Applicant.

  We note that DS2 have maintained their assumption of a 14% IRR. For the avoidance of doubt, we have also maintained our assumed IRR of 12%.

- **Project timetable (private sales rates):** Whilst we agreed with the off-plan sales of 50%, we increased the subsequent sales rate from 5-6 units per month to 8-10 units per month. In their response, DS2 have referred to schemes in the surrounding area that have achieved between 5-6 units per month. However, we have undertaken our assessment taking into account both the off-plan sales and sales rate for remaining units. The schemes that DS2 have referred to achieved off-plan sales in excess of 50%. If we are required to reduce the sales rate, then we will increase the quantum of off-plan sales. Our assessment is analysed in balance with one element impacting the other.

  For the avoidance of doubt, we have maintained our position regarding off plan sales and the sales rate thereafter.

- **Project timetable (commercial void period):** We disputed the 6 month void period assumed by DS2 in their appraisals and assumed that the commercial units would be sold on PC. Although DS2 have referred to one example of an estate regeneration scheme where the commercial units were vacant after the build completion, we maintain our opinion that, after taking into account the construction periods, the commercial units would be sold at PC.

- **Viability benchmark (Consented Development at 44-52 White Hart Lane – Goodsyard Site):** We note that DS2 have accepted our position in relation to this site and this part of the EUV is therefore agreed.

- **Viability benchmark (summary of BLV):** DS2 note that they have omitted various properties from their EUV schedule, which is unsurprising as it was opaque and somewhat confused. DS2 have added the following properties:

  - 33-34 Nesta Works (£800,000);
  - Plot 24 (£505,000)
  - 9 Whitehall Street (£85,000).

  Both Nesta Works and Plot 24 were included in our EUV schedule but 9 Whitehall Street needs to be added.

  DS2 suggest that the following properties are omitted from our schedule:

  - Plot 83-86 (omission of residential units above retail – difference of £702,030 to be added);
  - Plot 35 (DS2 suggest the rent should be increased from £12.20 to £12.50 per square foot, which is not disputed). This equates to an additional £36,825.

  Reflecting these adjustments, the EUV increases from £75,015,593 to £75,033,250.

  Rented local authority accommodation

  DS2's response does not provide any additional information or response to our comments on their inputs to their appraisals of the existing local authority accommodation. Our report noted that the assumptions they had applied in their valuation of the existing units appeared to us to reflect new build rented affordable housing, rather than existing stock which is more difficult and expensive to manage and maintain.

  We have now received DS2's rental schedule for the existing units and have constructed a discounted cashflow with management and maintenance costs which are reflective of the age and management requirements of the stock. These assumptions reflect the costs applied to the existing stock at Phase 3 of the Wornington Estate, as follows:

  - Management: £450 per unit per annum;
  - Reactive maintenance: £900 per unit per annum;
  - Capital investment/sinking fund: £1,125 per annum.

  We have applied a discount rate of 5% and inflation of 3% (applied both the income and costs). This results in a total value of £15,216,000 or an average of £61,000 per unit.

  Our adjusted EUV is therefore summarised in Table 1.1.

  Table 1.1: Adjusted EUV

	South	North	Totals
Value of planning consents	-	£17,561,000	£17,561,000
Industrial	-	£14,654,909	£14,654,909

	South	North	Totals
Care Home	£220,000	-	£220,000
LBH Residential	£15,216,000	-	£15,216,000
Residential	£7,225,000	£2,080,000	£9,305,000
Retail/Residential	£1,837,031	£4,507,969	£6,345,000
Commercial	£165,000	-	£165,000
Garages	£80,000	-	£80,000
Other	£1,235,500	-	£1,235,500
Workshops	£165,000	-	£165,000
Healthcare	£571,154	-	£571,154
Timber yard		£2,491,385	£2,491,385
Totals	**£26,714,685**	**£41,295,262**	**£68,009,947**

Appraisal Results

We have undertaken an updated appraisal of the proposed Development taking into account the amendments identified above. The scheme with 35% affordable housing (by units) generates a 8.94% IRR against a target IRR of 12%. Therefore, we consider the proposal of 35% affordable housing (by units) to be reasonable.

8 March 2022

Appendix 1 – CDM Cost Plan Review Update

CDM
Project Services

Development

High Road West
Tottenham
London N17

Draft

Response

March 2022

CDM Project Services Limited
14 Green Lane
Purley
Surrey
CR8 3PG

1.0 INTRODUCTION, COMMENTS AND CONCLUSION

Introduction and methodology

We were requested to carry out an independent review of the masterplan benchmark cost validation report Nr2 dated 21st September 2021 prepared by Rider Levett Bucknall (RLB) in the sum of £728,290,563 equivalent to £285/ft2 or £3,070/m2 GIA based on a GIA of 241,076m2

We were requested to review the infrastructure costs within the appraisal. The amount in the appraisal is £73,233,796 which includes contingency

In our report dated December 2021 we stated in our opinion the construction costs for the buildings for use in the appraisal should be £681,568,503 equivalent to £263/ft2 or £2,827/m2 GIA being a difference of £46,721,610 or 6.42% with the amount in the appraisal. This excludes contingency

We also stated in our opinion the construction costs for the infrastructure for use in the appraisal should be £72,414,082 equivalent to £27/ft2 or £286/m2 GIA being a difference of £819,716 or 1.12% with the amount in the appraisal.

Attached to an email dated 23rd February we received a response which we comment on below

4.2.1 Construction Costs

Within the illustrative masterplan viability appraisal was indicated a 5% separate contingency but this in fact only amounted to £3,323,102 hence why we excluded contingency

We note the differences stated on preliminaries, overheads and profit

We do not agree with the statement that CDM's current cost would not deliver the expected standards, we have generally accepted RLB's rates and would question why the difference in preliminaries and overheads and profit will affect the design and quality of materials.

4.2.2 Site wide infrastructure costs

The comment on the early stage of design is noted but we have based our comments on our own benchmarks

We do not agree with DS2 statement in regard to quality, a majority of our adjustments relate to items which have no effect on the quality of the public realm. We have accepted a majority of the public realm rates. We adjusted the rate of £175/m for the granite kerbs as our benchmark rate is £100/m, it is still granite so no difference in quality. The trees we benchmarked against a supplier and are the same height so no difference in quality, raised river stone beds we questioned rate but it is still river stone beds, we questioned play space allowances and feature lighting allowances and hear again these should not affect quality.

Original preliminaries and contingency we stated in our report these were low and increased these. Overheads and profit in our opinion is reasonable

The infrastructure costs includes a large number of utilities related allowances which amounts to circa £18m of the £68m net cost or circa 26%. These will be direct orders with reduced preliminaries requirements and as they are normally paid direct by the client no contractor overhead and mark up allowance. We therefore are of the opinion that our allowance is generous and reserve the right to adjust

Revised assessment, we do not know how the £88,280,803 is arrived at but is over 20% higher than the amount used by DS2 of £73,233,798 which is of some concern and is higher than the difference in preliminaries, overheads and profit and contingency of circa 12%.

Preliminaries these have been stated as 18.2% being an increase of 7.2%. This is approximately the same rate for the buildings but there will be a much lower requirement for infrastructure and public realm e.g. no cranes, scaffold, hoists etc. and also the number of direct costs such as utilities and potential separate demolitions contracts. The starting point should be 15% as our assessment relating to the buildings and for the reasons stated above in our opinion 13% is more than reasonable

In addition there are large allowances for phasing amounting to £5,250,000 which we have reduced to £3,750,000 which will include elements of preliminaries

Overheads and profit and contingency the difference between both is 1% and for the reasons stated above in our opinion our position is more than reasonable

<u>RLB / Gleeds build and infrastructure cost queries</u>

1 Contingency- noted see above

2 Shared ownership specification being the same as private comment noted, we will relay this to BNP Paribas

3 BREEAM standard very good, our understanding this is not in accordance with London Plan requirements, we will relay this to the planners via BNP Paribas

4 Our comment arrives out of review of the drawings, our position remains the same

5 Contamination allowance, no further evidence provided so reserve right to adjust quantities

6 Contaminated water, no further evidence provided our position remains the same

7 River stone beds, no further evidence provided our position remains the same

8 Gas connection, noted but does not explain allowances ion North and South side sections

9 Foul water diversion – noted

10 Additional drainage – no further evidence provided, this is a contingent item, our position remains the same

11 Electrical reinforcement, quote provided cost clarified

12 Water reinforcement, no further evidence provided

13 Temporary works allowance, no further evidence provided, our position remains the same

14 Additional works allowance, no further evidence provided, our position remains the same

15 North/ South network link, no further evidence provided

16 External transformation allowance- no explanation or substantiation provided, we reserve the right to adjust this allowance

17 Smart initiatives no explanation or substantiation provided, we reserve the right to adjust this allowance

18 Water feature allowance – basis clarified but substantiation, we are of te opinion this could be value engineered but as value engineering allowance was introduced by Gleeds we have not adjusted

19/20/21 Mast relocation, this is noted and photograph is useful but allowances have not been substantiated, our position remains the same

Value Engineering -Gleeds in their cost plan had a 3.1% reduction for value engineering which came to £2,456,897, in our assessment due to our adjustments this reduced to £2,206,336, however we do appreciate these will be more difficult to achieve taking into account and are of the opinion £2,000,000 should be added back making our assessment

CDM
Project Services

Conclusion

Having reviewed the response provided by DS2 and RLB in our opinion the construction costs for the buildings for use in the appraisal should remain the same at £681,568,503 equivalent to £263/ft2 or £2,827/m2 GIA being a difference of £46,721,610 or 6.42% with the amount in the appraisal. A summary of differences is attached.

This is broken down
Phase 1 £124,083,795
Phase 2 £110,167,107
Phase 3 £141,910,729
Phase 4 £166,722,690
Phase 5 £138, 684,181

The above building costs above exclude contingency which is added separately in the appraisal

Having reviewed the response provided by DS2 and Gleeds In our opinion the construction costs for the infrastructure for use in the appraisal should be £74,414,082 equivalent to £29/ft2 or £309/m2 GIA which is £1,180,284 or 1.61% higher than the amount in the appraisal.

This is broken down
Phase 1 £6,697,267
Phase 2 £8,185,549
Phase 3 £18,603,520
Phase 4 £17,859,380
Phase 5 £23,068,366

The infrastructure costs above includes a 5% contingency

Both the above above costs exclude professional fees

It should be noted the costs assume the intermediate/ shared ownership dwellings are to the same specification as the private

It should be noted that the applicant is only delivering "very good " BREEAM standard which may not meet current policies.

General and RICS Requirement Statements

These are as our report of December 2021

Steve Brown
CDM Project Services
March 2022