Summary of viability assessment process

GL Hearn was instructed to undertake a review of Bilfinger GVA's (BGVA) viability assessment in respect of Clarendon House, Watford on behalf of Watford Borough Council. The site comprised surface car parking, a substation and a three storey office building which we were informed comprised 964 sq m of office accommodation. The applicant was seeking to demolish the existing office unit and provide a development of a mixed use tower of part 14, 9 and 4 storeys incorporating 41 residential units and 1,800 sq m of office space. The applicant proposed office accommodation on the ground to 3rd floors with the residential accommodation situated above.

The applicant demonstrated that based on their assumptions that the scheme was unable to achieve their target profit margin and therefore proposed no on-site affordable housing but offered a financial contribution of £150,000.

We therefore undertook a review of the assumptions in regard to their benchmark land value and the proposed development in order to consider the reasonableness of this position.

<u>Benchmark Land Value (BLV)</u>

This element of the viability review was not agreed upon by the respective consultants. The applicant's consultants argued that purchase price should be used in this situation given that they had recently purchased the site in April 2016 for £2,660,000.

GL Hearn considered this approach to vastly overstate the actual value of the property. The site was previously purchased for £1,520,000 in August 2015 which represented an increase of £1,140,000 in less than 12 months. GL Hearn considered the site value on an Existing Use Value approach which derived its value from the current office use. GL Hearn therefore considered the estimated rental value and yield based on local comparable evidence. Based on the application of a rental value of £18psf and an applied yield of 8% we arrived at a value of £2,080,000 to which we applied a premium of 15%, not uncommon when adopting this approach which is usually to incentivise the landowner to bring forward the development. Therefore in our opinion the site was worth £2,392,000.

We considered that when bidding on land, a purchaser should be aware of the planning policy position in respect of LPA's affordable housing requirements, and should they choose to pay a figure in excess of that, they should certainly not expect to pass this overpayment on to the Council in the form of reduced affordable housing. If guidance/legislation indeed allows for benchmarking at price paid regardless of planning policy, no landowner would ever agree to dispose of a site at a price which allowed for any affordable housing and no purchaser would have a problem with paying that price as they would automatically get back the 'overpayment' from a concessionary planning consent.

In this case we considered the purchaser had overpaid for the site in April 2016, as can be seen from the 77% increase in value in less than a year, and our position of £2,392,000 remained throughout the negotiation.

This figure was applied in the final appraisal.

Residual Appraisal

Sales Values

BGVA originally applied an average value of £440psf to the total floor area of the proposed residential accommodation based on limited evidence. We highlighted the scheme as Junction Court which was producing values in the region of £500psf plus which we applied in our appraisal.

BGVA responded and refreshed their position to £495psf based on three units for sale within the development. GL Hearn held the position of £500psf which was used as the final figure in the appraisal.

Ground Rents

BGVA had not applied any value in respect of the residential ground rents. We considered that value should be attributed to the ground rents and adopted £250 per annum for the one bedroom units and £350 per annum for the two bedroom units capitalised at 5%.

BGVA accepted this and the value was included in the final appraisal.

Office Values

BGVA applied a rent of £22psf and a yield of 7% which GL Hearn agreed.

Build Costs

BGVA original applied demolition costs of £100k and base construction costs of £143psf and £147psf for the office and residential elements respectively. An additional allowance of 5% was allowed for in respect of services, utilities and externals. This was then refreshed after time had passed and increased to £162psf and £167psf. BGVA evidenced this using BCIS (Building Cost information Service of the Royal Institute for Chartered Surveyors).

We considered the costs to be reasonable and accepted their refreshed position given that BCIS does tend to understate build costs, which is generally a factor of it being based on limited evidence much of which comes from affordable housing which is often at lower build costs.

<u>Contingency</u>

BGVA applied 3% to which we accepted.

<u>Professional Fees</u>

BGVA applied 10% which we considered reasonable.

<u>Sales & Letting Fees</u>

BGVA applied the following which we considered reasonable;

Sale Agent Fee – 1% (Residential & Office)

Sale Legal Fee – 0.5% (Residential & Office)

Letting Agent Fee – 10% (Office Accommodation)

Letting Legal Fee – 5% (Office Accommodation)

<u>Community Infrastructure Levy (CIL)</u>

BGVA originally adopted a figure of £366,664. The Council's CIL officer calculated the CIL to be £249,525 which we applied in our initial appraisal.

BGVA revised their CIL figure to £308,394 which was applied in the final appraisal with final sign off to come from the Council CIL officer.

<u>Finance</u>

BGVA applied a debit rate of 6% and a credit rate of 0% which we considered to be in line with market levels.

<u>Profit</u>

BGVA argued a 20% on GDV profit margin across both the residential and commercial elements of the scheme. GL Hearn challenged the profit level in respect of the commercial which usually assumes a lower profit margin in most scenarios and therefore applied a blended profit margin of 17.5% in the initial appraisal.

BGVA argued that we had been unreasonable in reducing the profit margin on the offices and took the position that the office market in Watford was in fact weaker than the residential market and if anything should command a higher profit. GL Hearn considered this point reasonable, however, the level of risk could be mitigated if the applicant could secure a pre-let. However with this unknown it is fair to say that there is a higher level of risk involved with the provision of the office accommodation which at current is on a speculative basis.

It is also worth noting that for the offices they had assumed a 6 month rent free but no letting void. It is probably fair to say that if they had included a 6-12 month letting void in their appraisal we would not have found that especially problematic (though we might have argued that letting risk was priced in through inclusion of such a letting void). That being the case, we are probably more sympathetic to their argument on level of profit.

A profit level of 20% was adopted for both residential and commercial elements in the final appraisal.