GERALDEVE

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Land at Mount Pleasant delivery and sorting office, in London Borough of Camden, and in London Borough of Islington.

On behalf of Royal Mail Group

Position Note Four: Inputs, Results and Conclusions

[Redacted Version]

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Appendices

1 Introduction

1.1 Gerald Eve LLP is instructed by Royal Mail Group ("RMG") to undertake a financial assessment of a mixed-use development proposal at Mount Pleasant delivery and sorting office, more specifically land knows as Calthorpe Street and Phoenix Place ("the Site" or "the Mount Pleasant Site"), which is the subject of a Supplementary Planning Document ("the SPD") adopted in February 2012 by both London Borough of Camden ("LBC") and London Borough of Islington ("LBI"). A Scheme prepared by Terry Farrell architects and Schemeners was developed that informed the SPD. The Scheme and therefore the SPD propose a holistic approach to development across the Mount Pleasant Site[1].

1.2 Subsequent to the publication of the SPD, RMG has instructed a team of consultants to prepare and submit two[2] detailed planning applications for the Mount Pleasant Site. One application to LBC in respect of the Phoenix Place Site, and one application to LBI in respect of the Calthorpe Street Site. It is anticipated that these applications will be submitted in 2013.

1.3 This document is the fourth of a series of detailed "Position Notes" ("PNs") which form part of pre-application discussions with the District Valuation Service ("the DVS") who are jointly appointed by LBC and LBI to independently review viability in respect of the Mount Pleasant Site.

1.4 The previous notes, PN1, PN2, and PN3 provided an introduction into RMG's overarching strategy for its central London operations; a background into the Site including obstacles which need to be overcome to enable development; a reconciliation and justification of the operational costs associated with Phases 1 and 2 which we consider to be enabling costs for the development of the Scheme; and our approach and method of identifying a Site Value having regard to the definition as set out in the RICS GN (see 1.7 below).

1.5 The information used in this PN and from all supporting documentation will ultimately inform a holistic financial viability assessment ("FVA") which will look at the entirety of the development proposals. When finalised, the financial assessment will seek to

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[1] See paragraph 4.3.40 of the joint SPD

[2] NB in previous PNs we state hree, however since the writing of these previous reports the application strategy has changed.

establish an appropriate level of affordable housing and planning obligations as an aggregated "pot". In other words, to assess what the proposals can afford as planning contributions to both Boroughs having regard to what is the maximum reasonable level.

1.6 The FVA will be prepared having regard to the National Planning Policy Framework ("NPPF"), London Plan, LBC's and LBI's (collectively known as "the Councils") Core Strategies, saved UDP Policies and generally accepted principles and guidelines in undertaking FVAs.

1.7 All the PNs will be prepared having regard to the RICS Guidance Note "Financial Viability in Planning" ("the RICS GN"), which was published in August 2012. The PNs should be considered as a whole and, as stated above, when combined, will form a major part of the FVA.

1.8 Specifically, this PN provides a detailed opinion of residential and commercial values, construction costs, inflation and abnormal costs including rights of light having regard to the RICS GN. The information in this PN is in a form where the DVS will have the opportunity to review and comment accordingly.

1.9 We understand that the Greater London Authority ("GLA"), if involved, will also rely upon the findings of the DVS.

1.10 The remainder of this PN is therefore set out under the following headings:

- Sales and market data;
- Construction and associated development costs;
- Inflation and forecasts;
- Basis of Viability Assessment;
- Planning Obligations (notional)
- Financial Appraisal
- Viability, Analysis, Sensitivity and Risk Assessment; and
- Concluding Financial Justification Statement.

1.11 This report and its appendices are commercially sensitive and therefore will only be provided to the Councils' advisers on a confidential basis.

1.12 In order to inform the PNs we have and will be relying upon information provided by a number of other consultants which includes five architectural practices. The principal members of the planning application team are as follows:

- Terry Farrells (Architects/Schemener) – original Scheme informing the SPD (Islington)
- Wilkinson Eyre (Architects) – roofing over yard, operations and residential (Islington)
- Allies & Morrison (Architects) – residential (Islington)
- Feilden, Clegg & Bradley (Architects) – museum and residential (Camden)
- Allford, Hall, Monaghan & Morris (Architects) – residential and commercial (Camden)
- Davis Langdon (Cost consultants – enabling works and development)
- Rider Levett Bucknall (Cost consultants – RMG operational work)
- DP9 (Planning consultants)
- Knight Frank (Residential advisors)
- Knight Frank (Office and retail advisors)
- Camlins (Landscape Architects)
- Gordon Ingram Associates (Rights of Light Surveyors)
- M3 (Development Managers)
- Royal Mail Group (Owner)

1.13 A number of appendices are introduced and referred to in the text of the report.

1.14 This PN has been prepared as at February 2013 in the context of the prevailing uncertain economic climate (both UK and in the Eurozone). As a result, it may be necessary to revise and update the inputs prior to the preparation of the FVA, and therefore resulting outturns.

1.15 In accordance with best practice and the RICS guidance (paragraph 4.5.4 RICS Financial Viability in Planning), we confirm that this report has not been prepared on the basis of performance related or contingent fees or similar arrangements. We further acknowledge and confirm that in undertaking this assessment, we have acted reasonably, fairly and with transparency.

2 Sales and Market Data

Introduction

2.1 An analysis of both the commercial and residential elements has been undertaken by KF, on behalf of the Applicant (along with a pricing schedule), attached at **Appendix 1**. The key points of KF's analysis are summarised in this section and are supplemented by our own internal research in order to provide an overview of the four key areas of value. These are as follows:-

- Private Housing;
- Retail;
- Office; and
- Affordable Housing.

Breakdown of scheme

2.2 The proposal is for a residential led mixed use development with retail and office space. The proposal also consists of plans to create areas of open space, including hard and soft landscaping.

2.3 The Site is located in Farringdon, an area between Finsbury to the north, Clerkenwell to the east, Holborn to the south and Bloomsbury to the west. Farringdon and the surrounding area are mixed in use with light industry, offices, government buildings, educational facilities and residential accommodation. The most recent new residential developments have been in the area along City Road, to the north east of Farringdon as well as in the Kings Cross area, to the north west of Farringdon. KF understand that there are also plans to build a landmark office building at 119-141 Farringdon Street which is designed to meet new demand created by the delivery of the Crossrail route.

2.4 KF has set out the proposal for private accommodation on each plot, by reference to the following table.

Table 1: Scheme proposal by phase

Plot	Location	Architect & responsibility	Use Height (including plant)	Description
P1 - Camden	Located on the southern section of Phoenix Place.	**Allford, Hall, Monaghan & Morris** – residential and commercial	Residential Range from G+8 to G+13 storeys	New build residential block consisting of a variation of heights from 7 to 13 storeys (136 units). Plot 1 has a central courtyard consisting of soft and hard landscaping. The southern section of the block contains an element of retail.
P2 - Camden	Located on the northern part of the Phoenix Place site.	**Feilden, Clegg & Bradley** – museum and residential	Residential Range from G+5 to G+8 storeys	Three new build residential blocks arranged around a single level of undercroft car park, separated by two external spaces. The blocks range in height from 5 to 8 storeys above the height of the car park.
P3 - Islington	Backs onto the Royal Mail sorting office.	**Wilkinson Eyre** – roofing over yard, operations and residential	Residential Range from G+4 to G+11 storeys	New build residential building consisting of three core sections of G+5, G+6 and G+6 storey residential and 4 intersections of G+4 storey residential. G + 5 storeys of commercial office space adjoining the residential section onto Farringdon Road. Separate block of G + 11 storeys of residential facing onto Phoenix Place.
P4 - Islington	The plot is located on the northern part of the Calthorpe Street site.	**Allies & Morrison** – perimeter buildings	Residential Range from G+1 to G+7 storeys	The proposal consists of 5 blocks with a central courtyard of hard and soft landscaping. The proposal contains an element of retail at ground floor. There is also a freestanding building between C3 and C4.

Pipeline competition

2.5 When pricing the proposed development KF has been conscious that there is a significant development pipeline which will deliver a large number of competing units. [redacted]

2.6 KF believe that there is sufficient demand to absorb this pipeline; however, the large number of competing schemes will ensure that pricing is highly sensitive and if a development is to succeed it must take this into account whilst not compromising on quality or amenities.

Specification

2.7 To achieve the maximum value, KF are of the view that it is imperative the specification rivals or exceeds that of other pipeline developments. KF comment that purchasers at the pricing level envisaged are highly discerning and will demand the highest standards of specification and quality of finish and a failure to meet these standards could have a negative impact on value.

2.8 KF consider the principals for the specification and facilities as follows:

- General location;
- General external profile;
- General communal services;
- General and specific principles.

Private Residential Values

2.9 KF has thoroughly studied the local market comparables, both second hand and new build (which can be seen in the comparables section and appendices in its report). This entailed reviewing locality, accessibility, sales rate pressure along with the mix, specification grades and their quantities and unit sizes.

2.10 Pricing was then determined for Calthorpe and Phoenix which, in turn, considers the orientation, outlook, proximity to public transport, amenity and height. In the process of doing this, each site price was tested against the mix. The exercise also took into account the build programme delivery timetable.

2.11 The following table identifies KF's high level summary of private residential values.

Table 2: KF's high level summary of private residential values

[Redacted]

Retail and office space

2.12 [redacted]

2.13 The following table is a summary of the deals KF consider are comparable to that of the proposed Scheme.

Table 3: Summary of comparable retail transactions

[Redacted]

2.14 The proposed office accommodation is proposed to be of good standard, however, it is expected to be provided on isolated floors (above retail units in a predominantly residential area), which would limit the scope for a prominent and impressive reception area. There would be a ceiling on achievable rents on isolated floors such as these. Furthermore office occupiers will view site accessibility as poor relative to accommodation near to an underground / overground station. Taking into account these KF consider the rates to be in accordance with the following:

Table 4: Commercial income assumptions

[Redacted]

2.15 There is an element of flexible use which we have assumed is retail.

Ground rent

2.16 KF have priced the ground rents for each residential unit at [redacted] These will be staggered depending on the number of bedrooms in the apartment. This falls in line with the below comparables put forward by KF:

- [redacted]
- [redacted]
- [redacted]
- [redacted]

2.17 [redacted]

Car parking

2.18 KF has recommended valuing the car parking at [redacted] per space. KF has provided the following developments offer relevant comparable evidence:

- Canaletto, EC1 [redacted]
- Arundel Square, N7 [redacted]
- Chelsea Creek, SW6 [redacted]
- Highbury Stadium, N5 [redacted]

2.19 KF consider that an appropriate level of parking in the development to be a key factor in creating value. Whilst a number of the smaller one and two bed units will not require parking larger family units (3 bed) as well as penthouses will require a minimum of one space to maximise value. If parking was not available there would be a negative impact on values and a slow down in the rate of sale. To help mitigate this impact KF recommend reconfiguring the unit mix and sizing to create a far greater proportion of smaller studio and one bed units.

2.20 The table below is a summary of the residential car parking available:

Table 5: Private car parking

Site and Phase	Spaces
Phoenix Phase 1	40
Phoenix Phase 2	14
Calthorpe Phase 3	-
Calthorpe Phase 4	65

Source: M3 Consulting

Rates of sale

2.21 KF has thoroughly studied the sales rates achieved at comparable new build developments. The general trend observed was for a large number of units to be sold through initial launches which then tapers towards the end of the development. Anecdotal evidence suggests this is due to the cheaper units being offered from the start and the more expensive units that take longer to sell generally comprising the latter phases of sale. There is also a link to market exposure, with newly available developments enjoying a period of exclusivity relative to other new build but latter phase developments. The overall long term trend in large scale development is for an average of [redacted] units to be sold per annum albeit this varies significantly over the life of the development. KF has provided a number of benchmarks.

2.22 KF has created a sales program that is in line with comparable developments. [redacted]

2.23 KF's predicted sales rate for the development averages approximately 100 units per annum which is at an optimistic level. In order to increase this rate of sale pricing would need to be discounted to attract a wider variety of buyers.

2.24 M3 have provided us with assumptions in relation to the rates of sale. Below is a summary table of these assumptions.

Table 6: Assumed unit sales

[Redacted]

Key comparable information

2.25 KF set out an overview of the key schemes considered when valuing Mount Pleasant, as follows:

- Central Square, EC1;
- Eagle House, EC1;
- Art House, King's Cross, N1; and
- Canaletto, EC1.

Affordable housing - Affordable Rent

2.26 For the purposes of this assessment we have taken a cross section of market rents across both boroughs and in a range of postcodes. We have also had regard to LBC and LBI affordable rent studies. We are therefore making our assumptions on capital value inputs (which are to be adjusted to take account of potential costs, voids and repairs) for the aforementioned, on the following:

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

2.27 Our blended capital value for affordable rent is aggregated from the net cash flows and required yield. We use an all-risk yield to value the fixed property income streams to perpetuity. We appreciate that RP's often use inflated cash flows over 30 years and is the common approach used by some of the affordable housing software available. Either method is appropriate provided suitable risk adjusted capitalisation rates are used.

2.28 It is worth noting that our blended capital value is not driven by the amount a RP may agree for a purchase transaction, as this may include internal cross subsidy or competitive considerations. We are assuming that the affordable units would not be cross subsidised by the individual RP. Also, given the affordable housing will be delivered under a S106, no social/affordable housing grant or public sector funding is provided for.

2.29 In practice we would expect a range of bids from potential RPs in the bidding process and whilst we are using a spot figure for Affordable Rent, we appreciate that there will be a variance around this. We have therefore sought to test the variance through the sensitivity analysis, which is detailed further in Section 8.

2.30 For the purposes of this FVA we are therefore using a capital value of [redacted]

Affordable housing – Intermediate

2.31 By Intermediate we group together the entire variance of products available under one canopy. For example we include: New Build HomeBuy; Shared Equity; First Steps etc.

2.32 Shared ownership valuation, similarly, is made from estimates of expected net cash flows. Primarily this is the addition of the initial sales tranche plus the capital value of the net rent on the unsold proportion. The two capital valuation methods (all-risk yield approach or inflated cash flows over 30 years) can be used, and again we use an appropriate all-risk yield. In line with other toolkit guidance, it is also possible to make some speculative estimates of potential values arising from future staircasing sales, albeit we have not used this technique in our assessment of a suitable rate.

2.33 Average prices of the private units in the scheme are in accordance with KF's work, and can summarised as follows:

Table 7: Average prices of the private units in the scheme

[Redacted]

2.34 The intermediate tenures are valued on the basis of a 30% equity sale and a 2.75% rent on the un-sold equity, with a risk adjusted yield to take account of the income into perpetuity. We have then applied these across the Intermediate affordable housing of the scheme and taken a rounded average.

2.35 For the purposes of this FVA we are therefore using a capital value of [redacted] for the Intermediate affordable housing.

Summary of Affordable Housing Values

2.36 Fundamentally, we have been involved in other planning applications in both LBI and LBC whereby bids are received from RPs for affordable housing. This knowledge and experience, along with knowledge from other schemes we have (and are currently) working on in other London boroughs has been used to inform, underpin and back up our objective assessment of suitable rates.

2.37 The Scheme will provide 132 affordable housing units, equating to 21.3% based on habitable rooms, 19.4% based on Net Saleable Area, or 19.2% by unit. A mix of social rented and intermediate housing has been provided based on a 69:31 split by habitable rooms.

2.38 We consider that a capital value of [redacted] is a reasonable for the social element and a capital value of [redacted] for the shared ownership or Intermediate element, and have included these figures in our appraisal.

2.39 The affordable housing has been valued on the basis that a developer builds the accommodation for which a RP is contracted on a turn-key basis to take a long-lease upon completion.

2.40 The table below is a summary of the affordable housing income.

Table 8: Summary of capital receipts from affordable housing

[Redacted]

3 Construction and associated development costs

Introduction

3.1 In this section we set out the headline costs associated with the Scheme. The main elements considered are as follows:-

- Construction Costs;
- Car parking costs;
- Professional Fees;
- Disposal Fees and Marketing costs;
- Developer's contingency;
- Construction timings;
- Rights of Light;
- Value Added Tax; and
- Works in kind.

3.2 The costs associated with enabling works and costs, and Site Value, are addressed in other PNs.

Construction costs

3.3 Davis Langdon has prepared a full costs report for the Scheme. Given the many iterations associated with developing a scheme of this scale the cost report does not fully reflect the final drawings. Assumptions have therefore been made to address the alterations on the basis of increase/reduction in cost to reflect changes in area. We attach at **Appendix 2** Davis Langdon Stage C Cost Plan (Rev. 2_22 January 2013); and, a Cost Update (01 March 2013 - rev.4 - Planning areas based upon scheme freeze information) is attached at **Appendix 3**.

3.4 The Cost Update represents the Mount Pleasant scheme as issued by the Architects. The update reflects a 'snapshot' of the Scheme as at March 2013. For the costs as a result of area change, DL has utilised the "Scheme Freeze" information issued by each architect, and, adjusted pro rata. Other costs have been based upon DL's assessment following the issue of information by the various designers. The adjustments are set out in Table 9 below.

3.5 The cost plan reflects present day prices. It includes Design Reserve and Construction Contingency of [redacted]

3.6 The proposed new building costs have been based on a range of costs derived from generic cost models for each of the building types. These rates represent all inclusive rates for the construction of the buildings, including contractors management, overheads and profit and a design reserve/contingency base date at 1Q 2013 excludes professional fees, VAT amongst other items listed in Section 3 of **Appendix 3**.

3.7 For the purpose of preparing the Cost Model, DL has assumed a competitively tendered single stage 'lump sum' procurement route. The allowances for the Main Contractor's Preliminaries and OHP are summarised below, which DL believe are reflective of the current market conditions, size and nature of this project:-

- Preliminaries @ [redacted]
- Overheads and Profit @ [redacted]

3.8 [redacted]

3.9 [redacted]

3.10 The table below shows a summary of the headline construction costs associated with the Scheme. The total figure excludes professional fees as set out in the cost report, and is a summary of **Appendix 3**.

Table 9: Summary headline construction costs

[Redacted]

Car parking costs

3.11 The car parking facilities are included as part of the Scheme as current car parking on the site will need to be provided elsewhere during development. Clearly it is unfeasible for staff to park their cars on a development site during construction, and only when the underground car park is complete will staff be able to use RMG's "in-house" parking facilities once more.

3.12 The provision of car parking facilities is intrinsic to the operations of RMG, given the nature of a 24-hour a day, seven-days-a-week business. Consolidation and rationalisation of business operations has meant that a higher number of staff will be working at the sorting office. Notwithstanding this, RMG is planning to re-provide less than the existing parking capacity, through a system of car stackers and double parking to maximise space usage. Not only will they increase, but there is a requirement to maintain a provision of staff car parking at all times during any development.

3.13 To maintain the ability for staff to use car parking facilities, RMG has undertaken a survey review of the use of the Phoenix Place Site for car parking. This has informed RMG as to a suitable budget to allocate for the purposes of staff car parking during the proposed development phase of the Phoenix Place Site.

3.14 This is a real cost to enable redevelopment and a reasonable allowance should be included within any financial assessment to reflect cost. We have therefore assumed that 150-200 spaces need to be temporarily relocated over two years at NCP at Bowling Green Lane during the construction of the replacement facility. [redacted]

Professional Fees

3.15 Consideration should be made to the professional fees that are likely to be incurred as part of the development process. In this instance we consider it reasonable to assume that the developer [redacted] for professional fees on construction costs. Given the scale and complexity of the Scheme's proposals it would not be unreasonable to assume a higher proportion.

Disposal Fees and Marketing costs

3.16 As part of our assumptions it is correct to allow for fees associated with the sale of the individual residential units. We should also allow for industry standard selling and letting costs for the respective commercial and residential elements.

3.17 Marketing such a scheme will be a costly affair, with frequent trip overseas, heavy national advertising and at least two different marketing suites required onsite

3.18 KF highlight Neo Bankside and The Heron as exemplar marketing campaigns and recommends a similar strategy is adopted for the Scheme. Marketing costs for a comprehensive campaign are significant and typically range from [redacted] dependent on the scale of the development. Neo Bankside and The Heron's marketing costs equated to approximately [redacted] of the Gross Development Value (GDV).

3.19 Where developments have tried to reduce costs by limiting advertising or choosing not to create an onsite marketing suite KF has seen relatively slow sales rates and values can be impacted.

3.20 KF recommend a minimum marketing budget for the Development of [redacted] of the GDV, with this potentially increasing subject to market conditions. Marketing costs are likely to commence from an early stage in the development process to give potential buyers an impression of the product and amenities. This will be crucial to ensuring the required pre-sales numbers are met to allow construction to commence.

3.21 [redacted]

Developer's contingency

3.22 [redacted]

Construction timings

3.23 The following table is a summary of our assumptions in relation to construction and delivery of units to the market place.

Table 10: Summary of construction timing assumptions

[Redacted]

3.24 These assumptions are reflected in our cash flow, and are in accordance with advice received from KF and project managers M3.

Rights of light

3.25 RMG has been provided with Rights of Light advice from Gordon Ingram Associates, who have prepared a global cut-back assessment.

3.26 Appraisals adopting the "Tamares Principles" (Tamares (Vincent Square) Ltd -v- Fairpoint Properties (Vincent Square) Ltd 2007) have not been undertaken. Applying the Tamares Principles whilst the owner of the right to light would normally be expected to receive some of the likely profit of the development, the size should not be so large, that as a result, the development would not take place.

3.27 The following calculation would need to be undertaken:-

The profit of the Scheme

Less

The profit of the "cut back" Scheme

Equals

The profit of the area to be cut back

3.28 A proportion of the profit of the area to be cut back would be taken as being the reasonable level of the potential payment to claimants for loss of rights of light.

3.29 We have calculated an appropriate allowance of [redacted] as suitable global rights of light payment. Further details on the cut backs, costings and general approach can be provided to the DVS, should this be considered necessary in the context of this report.

Value Added Tax

3.30 Royal Mail is a partially exempt business for VAT purposes, which means that in general terms it cannot recover all the VAT it incurs on expenditure.

3.31 The extent of recovery is quite complex, but in simple terms for Mount Pleasant it would apply as follows:

[redacted]

3.32 [redacted]

3.33 [redacted]

3.34 Further clarification can be provided by RMG's tax accountants when necessary.

Works in kind

3.35 The Scheme is been designed around the provision of a number of public and private squares which will be works in kind provision in this location. In providing the public space, the Scheme is designed to ensure that it will be open to the public and maintained. The works in kind public space represents a significant opportunity cost. We have not measured the potential opportunity cost, although we do consider the point is material in assessing viability.

4 Inflation and forecasts

Introduction

4.1 The Scheme outlines a major development which would involve a commensurate programme of works, undertaken over a number of years. We therefore consider it necessary to have regard to anticipated future movements in both costs and values in order to consider the effect of an outturn approach to viability, in comparison with a more conventional present-day approach that may be more appropriate for a much smaller scheme.

4.2 In this section we set out the underlying assumptions associated with the forecasting of cost and value inflation over the course of the proposed indicative development period. We begin with a brief overview of cost inflation/deflation and then set the background to the key contributions to value of residential, office and retail accommodation.

Cost Inflation / Deflation

4.3 [redacted]

4.4 2015 remains positive with a stronger recovery in London but significantly lower projections for the regions. Given the volatility of predictions over that last four years, long term forecast must be treated with caution.

4.5 The UK is faring better than the Eurozone and the economy may emerge from recession when the next inflation forecasts are published. At present though it is too early to tell if this would be a sustained return to growth, albeit modest, as the general outlook remains uncertain.

Table 11: Summary of cost inflation forecasts

[Redacted]

4.6 Post 2017 inflation is assumed at [redacted].

Residential Growth Forecasts

4.7 Forecast growth rates for the private residential sector between 2012 and 2017 are set out in KF's Q4 2012 residential market forecast report, attached as **Appendix 5**. Beyond 2018 we have adopted an average year on year growth rate having regard to the previous shorter term forecasts.

4.8 The completion of the initial phases of development will provide improved amenities, on-site retail facilities and public realm increasing the attractiveness of the area, which is assumed to generate price inflation over and above that forecast for the wider market.

Table 12: Summary of KF Residential Growth forecasts

[Redacted]

4.9 Post 2017 inflation is assumed at [redacted].

Office Growth Forecasts

4.10 Whilst Midtown forecasts provide a guide for the likely pattern of growth in Clerkenwell, rental growth will be more gradual. We have therefore applied an adjustment to the Midtown growth rates for inclusion within our appraisals, as set out in the table below:

Table 13: Summary of Mid-Town office growth forecasts

[Redacted]

4.11 Post 2017 inflation is assumed at [redacted]

Retail Growth Forecasts

4.12 The economic downturn and the continuing uncertainty have negatively impacted on the UK retail market. There is need for caution and this is particularly applicable to Mount Pleasant as it is not currently a retail location.

4.13 In our appraisals we have assumed growth in accordance with the Retail Price Index (RPI), as detailed in the table below.

Table 14: Summary of RPI growth forecasts

[Redacted]

4.14 Post 2017 inflation is assumed at [redacted].

Affordable Housing Growth Forecasts

4.15 We have not been provided with explicit forecasts for the affordable residential. However, we believe that these uses will be subject to growth over the development period in line with inflation, based upon the Retail Price Index (RPI), as per the following table

Table 15: Summary of affordable housing growth forecasts

[Redacted]

4.16 Post 2017 inflation is assumed at [redacted]

Summary Growth Forecasts

4.17 We provide in Table 16 below annual growth rates applied to each of the sectors described above.

Table 16: Summary forecast growth rates

[Redacted]

4.18 It should be noted that, as with all forecasts, these represent estimates made at a particular time and are clearly subject to change. They are provided to enable an outturn (growth model) approach to be presented in contrast to a present-day model. It follows that the outturn model has been tested in order to review the robustness of the value and cost assumptions and the forecasts presented accordingly in this section.

5 Basis of Viability Assessment

Introduction

5.1 This section of the report sets out the basis upon which the viability assessment has been produced in respect of the Scheme proposals. As a result an analysis, sensitivity and risk assessment can then be undertaken in order to assess the viability in terms of the planning contributions of affordable housing, S106 obligations and MCIL, or the "pot".

5.2 We set out this section under the following headings:-

- Viability Model;
- Present Day and Growth;
- Development Return;
- Interest Rates; and
- Interpretation of Results.

Viability Model

5.3 A bespoke financial model has been built to assess the Scheme proposals. The viability model inputs values and costs to produce an output that either shows a profit or a loss. Assuming that the output shows a profit, it is then necessary to judge this against industry benchmarks in order to conclude whether this is an acceptable level of profit or not given the risks of the scheme.

5.4 The appraisals contained in this report are run on a cashflow residual basis where the output is the development return resulting. Whether the Scheme proposals are viable or not will depend on the level of profitability having regard to the risks of implementation. The cashflow approach calculates the Gross Development Value ("GDV") of the scheme from which the Gross Development Costs (including the base land value and finance costs) are deducted in order to show the developer's profit (return). This can be benchmarked against an industry accepted return and where possible empirical evidence of similar schemes.

5.5 The Net Development Value ("NDV"), the GDV less purchaser's costs, is made up of the constituent commercial and residential uses of the development appraisal. The retail and office components of value are calculated by the likely rent that can be achieved and a capitalisation rate (or yield) that can be applied.

5.6 The residential component would comprise revenue received from the sale of the private and affordable units. Private residential space has been valued on a unit by unit basis based on individual unit analysis carried out by KF (see **Appendix 1**). Where reservations are made prior to completion of the phase, with the balance being received upon Practical Completion and occupation.

5.7 Scheme costs comprise: Site Value, construction costs, rights of light and other additional costs, professional fees and costs, notional Section 106 costs, and finance.

Present Day and Growth

5.8 Uncertainty in the property market should be accommodated within the appraisal and subsequent analysis. The present day estimates of construction costs of the Scheme and achievable values of the various components of the completed development have been outlined earlier in this PN. A present day approach will not necessarily provide an indication of a viable scheme.

5.9 As a result, this assessment will demonstrate that the Scheme proposals can only be fully justified in financial terms, through using an growth based outturn which in turn will specify the level of contribution of affordable housing and planning obligations package that can reasonably be provided.

5.10 We have therefore assessed the Scheme proposals using both a present day approach to costs and values and a growth model in order to illustrate the difference in viability terms. The reasons for this approach are as follows:-

- That a current day approach to assessing viability does not always provide a true reflection of the potential returns that are available, particularly given that the Scheme is not due to be completed until 2022;
- That the current economic climate and prevailing poor property market do not potentially reflect the medium to longer term growth prospects for this part of London; and

- In order to test the robustness of the appraisals explicit account needs to be taken of variances in values and costs over time.

5.11 The growth model has regard to capital and rental growth within the commercial and residential elements as well as tender price and build cost inflation up to and over the duration of construction, through to practical completion and assumed notional sale of each component of the development (residential and commercial investment elements).

5.12 The following should be noted when reviewing the growth model:-

- Present day residential values are multiplied by the appropriate growth factor relating to the period elapsed between commencement and reservation or sale whichever the earlier;
- The current day achievable rental levels for the commercial elements are grown on the basis of the time elapsed up to the actual letting (this is notwithstanding rent free periods after the letting has taken place);
- The commercial space created as an investment has an assumed notional disposal date, i.e. when fully let and income producing. This is valued on a simple term and reversion approach; and
- Tender price and subsequent build cost inflation are incorporated into the financial appraisal as set out in Section 4.

Target Rate of Return

5.13 A significant factor in undertaking viability assessments is the level of profit which a developer might reasonably require from undertaking the development. This will depend on a number of factors including the size of the development, the perceived risks involved, the degree of competition for the site from competing developers, the state of the market in terms of demand for and value of the completed development, etc. It will also have regard clearly to the nature of the scheme involved, i.e. residential or commercial or a mix, etc.

5.14 Development profit is necessary if private sector investment is to deliver any given project. The level of profit is essentially the reward to the developer for the time, expertise and risk involved in carrying out the process of development. It is also necessary for the land owner to exceed existing investment value. When the developer / land owner are one and the same this may be reflected in the development return.

5.15 The level of profit will vary between projects and will reflect a range of factors including market demand, competition, scheme complexity, financial risk and exposure particularly in relation to up-front or abnormal costs together with the anticipated timescales for development and for receiving a return.

5.16 Measurements of return such as "profit on cost", “profit on value", "development yield", or "internal rates of return" (IRR) ratios are commonly used as comparable ratios, and the benchmark level against which the profitability of a scheme should be tested will depend on the degree of risk involved with the scheme.

5.17 Profit on cost is defined as the overall scheme profit expressed as a percentage of total costs. As a measure of development return, it is commonly used as a benchmark for qualifying the risks of a development project when calculating a residual value, and as a simple measure of return in development appraisals. This measure however is not appropriate when using a growth based model as it represents a return over the entire development period and therefore fails to take account of the length of time that money is committed to the project.

5.18 The IRR is calculated using a discounted cashflow appraisal as the discount rate which equates the total costs and total revenue over the lifetime of a scheme. Unlike profit on cost, the IRR takes full account of the time value of money. It does this by discounting at a rate where the development will have a zero Net Present Value ("NPV). The resultant discount rate therefore used is the measure of profitability having regard for the time the project takes to complete and is a more appropriate measure for projects that have a long duration.

5.19 Given the complexity of the Scheme, length of development programme and inclusion of growth forecasts, we have used the Internal Rate of Return (IRR) as the measure of return. The IRR has been applied to both the present day and growth models where as an annualised percentage it provides a measure of the rate at which the scheme generates a return.

5.20 The wider scheme has a development pipeline of [redacted] which carries a higher level of risk than shorter, smaller schemes. The developer's return must reflect this and compensate for the time, management and risks associated with a scheme of this nature and it would be expected that an IRR of over [redacted] would be appropriate.

5.21 We therefore consider that a minimum target rate should be [redacted] However, we would stress that whilst it is perfectly acceptable to set target rates, these may not be achieved in practice given the numerous uncertainties with projects at this stage in the development process, (i.e. in part pre planning permission).

Interest Rates

5.22 As indicated above, the interest rate applied in the appraisals represents a total cost of capital in financing the revised scheme. This reflects both debt and equity financing with the banks requiring a larger element of the latter relative to the former having regard to the economic crisis. The debt element reflects both a margin and risk premium above 5 year swap rates. The equity element should in theory reflect an equity return which may be calculated by reference to the weighted average cost of capital (WACC). However, this would also need to have regard to the level of development return, which is reflected, as set out above, in the amount of profit a scheme is producing. It follows that to avoid double counting, the equity element should broadly follow the level of debt interest plus a margin to reflect the more costly equity.

5.23 As far as financing is concerned, we have adopted a total cost of capital for financing the Scheme of [redacted] The total cost also takes into account arrangement, monitoring and related fees.

Interpretation of Results

5.24 The outturn values and costs shown in the growth model are therefore inflated figures and not at present day levels. As this report is concerned with absolute viability and the ability to meet affordable housing and other planning obligations, it is not considered necessary to bring values and costs back to present day levels by applying a discount factor.

5.25 It should be noted that a small difference in the IRR is significant. In other words, even a 1% or 2% change in the return represents a considerable change in the return and this has to be set off against the risk of undertaking the project.

5.26 No explicit return has been factored in for equity financing and in respect of the Site Value from a landowner perspective. Given that the landowner is the Applicant in this instance, this should be reflected in the overall return. Also, no growth has been factored into the Site Value.

Interpretation in the context of Mount Pleasant

5.27 The Mount Pleasant Site is an iconic and substantial site and its redevelopment to provide residential and retail accommodation is anticipated to revitalise the surrounding area, complementing and completing the neighbouring area.

5.28 Due to the particular development obstacles and enabling works associated with the Site, the Applicant is significantly constrained by existing structures and therefore the Scheme must be developed with these in mind.

5.29 The vast open space being made available by the operational and enabling works being undertaken by RMG, makes the site ideally suited to residential accommodation and the provision of 688 units, equating to 628,000 sq ft (NSA), means that the majority of development value is attributed to the residential units. As a result the Scheme is reliant on the performance of the residential market.

5.30 Practical Completion is anticipated in [redacted] and whilst we are currently expecting growth in residential values, there remains a risk that this growth may not occur at the rate anticipated.

Sensitivity, Scenario and Simulation Analysis

5.31 Sensitivity, scenario and simulation analysis allow the robustness of the financial model and the resultant rate of return to be tested from a quantitative perspective. The overall viability of the Scheme can then be assessed having regard to the potential for any upside or downside and the likelihood of these. This is outlined in further detail in Section 8.

6 Planning Obligations (notional)

Introduction

6.1 One of the requirements of the financial appraisals is to determine the level of affordable housing, and planning obligations contributions as an aggregated "pot". In other words, to assess what the Scheme can afford taking into account the financial impact of these items as a whole.

6.2 This section sets out a resultant output with regard to differing affordable housing, S106 obligations and CIL provisions in respect of the Scheme. We however present this prior to the following sections showing the different returns for the sake of clarity. In addition, the ranges suggested will be subject to discussions between RMG and the Councils in terms of the appropriate division and timing of delivery. The resultant overall pot is the output that the appraisals seek to test as being financially viable on both a present day and outturn basis, through the growth model having regard to the target rate of return as outlined in the previous section.

6.3 DP9, the Applicant's planning consultant has undertaken a S106 and MCIL assessment which includes an analysis of the proposals against the requirements of the LBI "Planning Obligations SPD (2009)" and LBC "Planning Guidance 8: Planning Obligations". DP9 has also provided estimates of MCIL/Crossrail charges for the Scheme. DP9's assessment assumes that the applications will be permitted prior to the adoption of local CIL Charging Schedules by LBI and LBC. DP9's assessment is attached as **Appendix 5** to this PN, a summary of which is provided below.

Community Infrastructure Levy

6.4 The Mayoral CIL is levied at a rate of £50 per sq.m. (GIA) per net increase in floorspace within LB Islington and LB Camden, excluding affordable housing which benefits from relief. Payment is calculated at the time of permission, but not payable until commencement.

6.5 An approximate calculation of Mayoral CIL for the whole site is set out as follows:

Total GIA (86,835 sqm) - GIA Affordable – (14,484 sqm)

= 72,351 sqm x £50

= £3,617,550

Crossrail

6.6 The Mayor has taken the view that the best way of ensuring that developers do not have unreasonable demands made of them by having to make both CIL and section 106 payments towards Crossrail is to treat CIL payments as a credit towards any payment sought under Crossrail should the former be less than the latter, and not to seek a contribution at all should the obverse be the case.

6.7 Crossrail is payable on the commercial (retail and office) elements of the scheme only, and is £1,191,693.

6.8 The Crossrail payment is substantially less than the Mayoral CIL payment for the site as a whole (and when each application site is considered separately) and therefore will not be paid in this case. The development will however be liable to the full CIL payment outline above.

LBI Planning Obligations SPD (July 2009)

6.9 A summary of the likely obligations and contributions to be sought for a consented development as set out in the Planning Obligations SPD (July 2009) is set out in in DP9's assessment in **Appendix 6**.

6.10 The total estimated contribution to LBI is £2,343,513 plus an approximate education contribution of £1,307,692. Therefore a total of £3,651,205, which assumes payments in lieu of Construction training placements and excludes any TfL/transport contributions required to make the development acceptable and also landscaping contributions.

Camden Planning Guidance 8: Planning Obligations

6.11 A summary of the likely obligations and contributions to be sought for a consented development as set out in the Camden Planning Guidance 8: Planning Obligations is set out in DP9's assessment in **Appendix 6**.

6.12 The total estimated contribution to LBC is £1,973,793. This figure does not include a number of possible obligations including health, landscaping, and highways/TfL contributions etc. as there no standard charges for these elements.

Notional affordable housing

6.13 The Scheme will provide 132 affordable housing units, equating to 21.3% based on habitable rooms, 19.3% based on Net Saleable Area, or 19.2% by unit. A mix of social rented and intermediate housing has been provided based on a 69:31 split (by habitable rooms).

Summary

6.14 The table below summaries the MCIL and S106 financial contributions:

Table 17: Summary (only) of financial element of contributions

MCIL	£3,617,550
LBI	£3,651,205
LBC	£1,973,793
Sub-total	**£9,242,584**

6.15 As observed above, the LBI notional offer assumes payments in lieu of Construction training placements and excludes any TfL/transport contributions required to make the development acceptable and also landscaping contributions; and the LBC offer does not include a number of possible obligations including health, landscaping, and highways/TfL contributions etc as there no standard charges for these elements.

6.16 The following table identifies the notional affordable housing to be delivered in each Borough:

Table 18: Notional affordable housing proposed

Affordable Intermediate		sqm	sqft	units	hab rooms
	Phoenix Phase 1	1,406	15,130	21	51
	Phoenix Phase 2	550	5,920	6	22
	Calthorpe Phase 3	771	8,295	12	27
	Calthorpe Phase 4	1,120	12,056	16	40
Sub Total		**3,846**	**41,401**	**55**	**140**
Social Rent		**sqm**	**sqft**	**units**	**hab rooms**
	Phoenix Phase 1	2,334	25,126	23	89
	Phoenix Phase 2	1,514	16,298	16	72
	Calthorpe Phase 3	1,564	16,833	19	67
	Calthorpe Phase 4	1,991	21,431	19	83
Sub Total		**7,403**	**79,688**	**77**	**311**
Totals		11,249	121,088	132	451

Source: M3 Consulting

6.17 The Applicant therefore is proposing 132 affordable housing units, with £9.2million worth of (understood) planning obligations.

7 Financial Appraisal

Introduction

7.1 This section provides the appraisal outputs for the Scheme having regard to inputs outlined in the previous sections of this report along with the notional planning obligation package. These results are subsequently tested using sensitivity, scenario and simulation analysis.

7.2 The previous section of this report provides guidelines for interpreting the results set out in this section and the following two sections of the report (namely Section 9 Viability, Analysis, Sensitivity & Risk Assessment).

7.3 We present our results as follows:-

- Present day appraisal; and
- Outturn (growth) model.

Present Day Appraisal

7.4 We attach as **Appendix 7** full details of the appraisal results based on the Scheme. We summarise the outcome together with a chart showing the cumulative cashflow as follows:-

Table 19: Present day appraisal summary – The Scheme

[Redacted]

7.5 The present day appraisal does not take account of anticipated growth in values and costs during the course of the development.

Chart 1 : Cashflow - Present day appraisal – The Scheme

[Redacted]

7.6 The results indicate that in overall terms, the Scheme, based on a present day approach achieves a return significantly below the benchmark return level of [redacted]

Outturn (Growth) Model

7.7 We attach as **Appendix 8** full details of the appraisal results based on the Scheme with the application of forecast growth rates on costs and values as set out in Section 4. We summarise the outcome in the table below together with a chart showing the cumulative cashflow as follows:-

Table 20: Growth model appraisal summary - The Scheme

[Redacted]

Chart 2: Cashflow – Growth model appraisal – The Scheme

[Redacted]

7.8 From the two charts above it can be seen that on a present day basis, assuming the level of planning obligations that the Scheme would not be viable. If the Scheme is run on a growth basis the return improves considerably, albeit still not to a minimum target level. It is therefore necessary to test further the appraisal by applying sensitivity, scenario and simulation analysis in order to see whether the Scheme is potentially capable of being viable. This is examined in Section 8 and conclusions drawn in Section 9.

8 Viability, Analysis, Sensitivity and Risk Assessment

Introduction

8.1 The purpose of this section is to test the robustness of the growth model of the Scheme, from a quantitative perspective via a sensitivity scenario and simulation risk assessment. As a result of the assessment of the Scheme, the level of affordable housing contribution in-lieu and planning obligations when aggregated are also tested having regard to the target rate of return.

8.2 In order to assess the robustness of the viability of the proposals, it is necessary to consider the pricing and cost inputs to the financial model. For the purposes of this exercise, we have employed three forms of analysis:-

- Sensitivity;
- Scenario; and
- Monte Carlo Simulation.

8.3 The first of the above is a fairly simplistic approach (but widely used) for testing the viability and the robustness of the Scheme. In essence, uncertainties can be identified in respect of the inputs and their effect can then be looked at in terms of the development return. In short, this is a straightforward deterministic approach from which a judgement needs to be made as to the appropriateness of the outcome. Benchmarks can be used as performance measures. A prudent developer will also consider the sensitivities of a development and assess the risks of the particular project.

8.4 A more sophisticated approach, and one which is used in practice with the more complex development schemes, is to run a Monte Carlo simulation analysis on the financial model which quantifies the robustness of a development in terms of risks and return.

8.5 A Monte Carlo simulation exercise considers the probability of outcomes given certain variances applied to key inputs within the financial model through a stochastic process. The resultant forecast provides the most likely returns or the ability to achieve an acceptable IRR. The key inputs identified in the financial model are:

- retail rental levels and yields;
- residential capital values and sales rates per month; and,
- build cost contingency for the Scheme.

8.6 We have not included interest rate variability due to the complexities in real terms in financing a large project. We have also not simulated the growth rates (in accordance with common practice) and these remain as per Section 4.

8.7 In-between a simple sensitivity analysis and the more sophisticated Monte Carlo simulation, is a scenario analysis. This again uses a series of inputs, analyses them under different scenarios and then probability weights the outcome (i.e. the IRR).

8.8 We set out the result of our analysis using the three approaches of sensitivity, scenario and simulation below. In practice each inform to some degree the other to the extent that the key value and cost drivers of the proposals can be identified and therefore the uncertainties around each, can be arrived at in order to test the overall robustness of the Scheme. This therefore in turn informs the likelihood or resulting returns varying from the deterministic outputs outlined in Section 7.

Sensitivity Analysis –Scheme (Outturn Appraisal)

8.9 We have not provided in this report a sensitivity of the present day given the poor estimate result of the previous section (this can be provided on request), and the subsequent scenario and Monte Carlo analysis. We do present below key sensitivity tables for the Scheme on the basis of the growth model and IRR output:-

Table 21: Outturn Appraisal (Growth) Sensitivity Analysis – Residential Sales Values vs. Construction Costs

[Redacted][R/7]

8.10 It can be seen from the above that the Scheme is sensitive to movements in residential sales values. The effect of the change in costs is similar to the movements in residential pricing and the combined effect shows an equal downside and upside (albeit still well below the target rate of return).

8.11 In no instance does the IRR peak above the target rate of return of [redacted]

Scenario

8.12 By grouping together the inputs and varying them simultaneously, expected, optimistic and pessimistic case scenarios can be generated in terms of the IRR outturn. We have sought to apply a simplistic probability analysis having regard to the agents' and cost consultants' views as set out in their reports in the appendices to this assessment. In this instance a 50% confidence is placed in the expected outcome; 35% on the optimistic outcome; and 15% on the pessimistic case. As can be seen in the table below an IRR outcome of [redacted] is produced (still below the target rate of return), with a standard deviation of [redacted]

Table 22: Scenario Analysis

[Redacted]

8.13 The balance towards "optimistic" above is largely driven by a confidence in the market for residential underpinning the growth assumptions used and potential for market improvement within the scheme as it is developed out, but is tempered by uncertainty reflecting the higher probability expressed as "Expected".

Simulation Analysis

8.14 A simulation analysis has been run on the Scheme (see **Appendix 9**), [redacted] This is shown in the frequency chart below:-

Chart 3: Simulation analysis – Frequency Chart (Scheme)

[Redacted]

8.15 The above therefore shows that the Scheme is on the margins of being financially viable having regard to variances in respect of the inputs identified. [redacted] The potential to achieve a target rate of return of [redacted] IRR is however very small suggesting that the uncertainty going forward of the time period is a major risk. Whilst the viability of the Scheme is therefore within an appropriate margin of what may be capable of implementation, financial risk mitigation measures in respect of pre-letting, advanced residential sales and fixing costs will be critical in potentially increasing the returns to an acceptable level. Whilst the above provides the simulated average return for the revised scheme, it is also useful to ascertain the sensitivity of the various inputs. This is best considered by their contribution to variance and is illustrated in the tornado chart overleaf:-

Chart 4: Simulation Analysis – Tornado Chart

[Redacted]

8.16 [redacted]

Summary

8.17 Both the sensitivity and simulation analysis of the Scheme have also shown that the financial viability is currently on the margins of being acceptable. Even if this were to improve it is clear that any further financial contribution to affordable housing, planning obligations and Mayoral CIL could not be justified on viability grounds.

8.18 It follows that with the inclusion of a pot as set out in Section 6 as set out in Section 6 (of 132 affordable housing units, with £9.2 million worth of (understood) planning obligations), the Scheme is potentially capable of achieving the minimum target rate of return. Any further increase in affordable housing or planning obligations would reduce the chance of achieving the minimum target rate of return.

9 Concluding Financial Justification Statement

9.1 Mount Pleasant is the subject of two detailed planning applications which propose a comprehensive redevelopment.

9.2 Gerald Eve LLP are instructed by the Applicant to undertake a financial assessment of the above proposal in order to advise on appropriate level of planning obligations, including affordable housing, other S106 contributions and Mayoral CIL, to accompany the planning application.

9.3 Present day sales and market data have been used to establish the overall value of the Scheme. A cost report has been provided in respect of the Scheme, and PNs 1 and 2 set out enabling costs associated with the delivery of any development on the site, and full appraisals undertaken. Given that the Scheme is not due to reach practical completion until [redacted] an outturn (growth) model was considered most appropriate. It follows that cost inflation and value forecasts have been applied so as to reflect future movement and uncertainty in the market.

9.4 Given the use of a growth model the benchmark return used for the viability appraisals is the Internal Rate of Return (IRR). The resultant appraisals have been run on both a present day and growth basis, allowing comparison between the two.

The Scheme

9.5 The outturns of the appraisals in respect of the Scheme are summarised in the table below:

Table 23: Proposed Scheme Returns

[Redacted]

9.6 From the above table it can be concluded that the present day model shows an unacceptable level of return. The Scheme can only potentially achieve an appropriate target rate of return with the inclusion of growth.

9.7 The growth model produces a return of [redacted] which is still below the required rate of return, however via sensitivity, scenario and simulation risk assessment it has been shown that the Scheme is potentially capable of being financially viable. Any further planning obligation contributions would clearly erode the return and therefore the viability of the Scheme.

9.8 It follows that the notional planning obligations package proposed as set out in Section 6 (of 132 affordable housing units, with £9.2 million worth of (understood) planning obligations) is the maximum reasonable that the Scheme can afford in order for the Applicant to be able to deliver and implement a viable scheme.

Summary

9.9 To substantiate our assessment, sensitivity, scenario and simulation analysis have been undertaken in order to test the Scheme. The results concur with above conclusions and determine that it is only the Scheme that is potentially capable of achieving an appropriate target rate of return on an outturn basis. Any increase in planning obligations would diminish the return of the Scheme and threaten its overall viability.

9.10 In conclusion, this series of PNs have demonstrated that the Scheme has provided the optimal mix of uses, having regard to the level of affordable housing contribution, Mayoral CIL and other planning obligations in order to be able to deliver and implement a viable scheme. This has subsequently been presented and the results robustly tested.