WESTFERRY PRINTWORKS
GERALD EVE REVIEW OF SCHEME VIABILITY

The GLA have appointed Gerald Eve ('GE') to review DS2's viability appraisal and our review of DS2's work. This note summarises our observations on GE's assumptions and conclusions.

The GE review is conducted in accordance with the RICS Guidance Note 'Financial Viability in Planning' (August 2012), which is in direct conflict with the Mayor of London's 'Housing SPG' with regards to how site value is treated. It is unclear why GLA officers did not instruct GE to follow guidance on this matter in the Housing SPG.

GE suggest that the 'existing use value plus' approach does not accord with the NPPG, but this is incorrect. The NPPG[1] notes that "*a competitive return for the land owner is the price at which a reasonable land owner would be willing to sell their land for the development. The price will need to provide an incentive for the land owner to sell in comparison with the other options available. Those options may include the <u>current use value</u> of the land or its value for a realistic alternative use that complies with planning policy*". GE's position is therefore incorrect. It is odd that GE actually quote this paragraph in their report, yet go on to disregard it in its entirety.

We note that GE have undertaken their assessment using a 'bespoke excel model', although it is unclear whether or not this model has been externally audited. The clear risk of using bespoke models is that they are prone to error in formulae, which could have a significant impact on the outputs.

We note that GE have adopted a target IRR of 14% on a present day basis and 18% on a grown basis. This is slightly higher than the 17.5% grown IRR we adopted, but lower than DS2's assumption of 20% (on a present day basis).

Private sales values

GE agree that DS2 have undervalued the development, but their opinion of £850 to £950 per square foot is still significantly below our opnion of £1,015 per square foot. Their rationale for adopting a value at the low end of the range is not explained in their report.

GE have made no comment on the impact of large unit sizes on the rates per square foot. This is clearly a significant issue; if units were sized in line with normal market standards, the rates per square foot would increase.

Affordable housing values

GE adopt our value for shared ownership units, but a lower figure of £187 per square foot for affordable rented units (compared to our £210 per square foot).

However, GE indicate that their own modelling suggests that a higher (but unspecified) value could be achieved from the shared ownership units. Rather than using this figure in their appraisal, they have adopted our lower figure. Using the higher figure would have improved the outputs of GE's modelling.

Commercial rental values

GE have concurred with our view that DS2's rental values were too low and have agreed with our £22.50 per square foot, compared to DS2's £17.50 per square foot.

[1] Paragraph: 024 Reference ID: 10-024-20140306

Development programme

Although GE comment on the timing issues raised in our report, they duck the issue by stating that "*whilst there is likely to be a degree of variance in the programme, our role is to make sure the assumptions put forward by DS2 are reasonable and not to comment on the range of possible scenarios which could take place*". In our view, the delivery of 100 units per annum is simply too low a number in comparison to other developments. It is possible that the lengthy programme has been contrived to drive down the Scheme's IRR. Clearly a more realistic programme length would increase the IRR and the Scheme's capacity for providing affordable housing would increase.

Site value

As noted above, GE rely solely on the 'market value' approach to determining site value, contrary to the Mayor of London's Housing SPG and the NPPG. As noted in our report, there are serious weaknesses with the market value approach for determining benchmark land values for viability purposes. Most importantly, the market values are merely based on prices paid for other sites, with no analysis of whether the developers concerned 'got it right', or whether their offers were overbids based on assumptions of growth or an ability to squeeze planning obligations.

GE rely on a very crude approach to testing the validity of DS2's market values, which in essence compares the site values as a percentage of GDV. These range from 4% to 19%, with Westferry coming in at 7.1%. No information on the other sites is provided, so it impossible to understand the characteristics of those sites which might give rise to a higher or lower percentage. On this test alone, GE conclude that DS2's market value of £45 million is not overstated.

GE have adopted a site value of £45 million (which is £10 million higher than our assumption). This will have a negative impact on the Scheme's IRR, as site value is entered into the appraisal as an upfront cost.

Appraisal results

GE have modelled the scheme with 20% affordable housing by habitable rooms, which is reflected in the Applicant's revised offer. On this basis, the IRR of 18.3% is marginally higher than their target of 18%.

It is important to note, however, that GE's sensitivity analysis indicates that the IRR could increase to 23.7% if values increase above GE's starting assumption by 10% and costs are reduced by 5%. This 'super-profit' could deliver a significant increase in affordable housing. However, GE do not go on to test additional affordable housing that could be delivered, but suggest instead that a review mechanism be included in the Section 106 to capture uplifts in profitability.

Notwithstanding the observations above, it is clear that GE's assessment is deficient in the following areas which would – if addressed – enhance scheme value and capacity for increased affordable housing:

- Private sales values
- Development programme
- Site value

Interestingly, the review GE have undertaken is the second they have been commissioned to provide by the GLA in the last few months and both have concluded that the revised offers made by the applicants in both cases represent the maximum viable proportion, despite the conclusion of other advisors that more could be provided.

BNP Paribas Real Estate
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