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Financial Viability – Response No. 2 to LB Richmond Post-Submission Review

Sharp Refinery Service (Hydro-Carbons) Ltd

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Private & Confidential

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1. Introduction

1.1. Grimshaw Consulting Limited ('GCL') is instructed by Sharpe Refinery Service (Hydro-Carbons) Ltd ("the Applicant") and has prepared a Financial Viability Assessment ("FVA") of a mixed use development proposal with a total GIA of 29,364sqt (2,728sqm) and comprising demolition of existing workshops, oil recycling facilities and telecommunications mast and the retention and refurbishment of a Victorian mews for Class B1 commercial use and erection of 24 No dwellings in two buildings of between three and four storeys at Arlington Works, Arlington Road, St Margaret's TW1 2AZ ('the Property' or "application site").

1.2. A planning application has been submitted to the London Borough of Richmond ("the Council") and is being considered by the Council with a view to determination by Committee in December 2018.

1.3. Our Financial Viability Assessment dated 2nd August 2018 led to the following conclusions:-

a) Our assessment of a reasonable Viability Benchmark is £1,800,000. This opinion has been based on the Existing Use Value of the Premises, assuming current passing rents from tenants capitalised at an all risks yield of 8.50% and a landowner premium of 30%.

b) Our financial appraisals indicate that the maximum reasonable amount of affordable housing that can be provided on site, is 4 No apartments (2 No 2-bedroom and 2-No 3-bedroom) for sale on a shared ownership basis. This development scenario would generate a viability surplus of £99,578 and in addition, would generate a total of £529,950 in CIL and Carbon Off-set contributions. The on-site affordable housing provision of 4 No units within the smaller residential block, equates to 17% of total dwellings and 19% of residential habitable rooms and floor area (NSA).

1.4. The Council have appointed Bespoke Property Consultants ("BPC") to undertake a review of our Financial Viability Assessment and BPC issued their initial report in November 2018 and we responded to that report on 7th December 2018, agreeing many points as matters of Common Ground.

1.5. The purpose of this report is to consider the points raised in BPC's second review dated February 2019 and respond to matters where there is a difference of opinion relating to development revenue and development cost financial appraisal assumptions.

1.6. We note that BPC continue to prepare financial appraisals using the GLA Development Control Toolkit ("the Toolkit"). Whilst the Toolkit is an acceptable financial appraisal model, it does not allow the same level of detailed input as the Argus Developer appraisal software used by GCL. There may be minor differences in appraisal outcomes generated by each respective software model, so to ensure clarity, we have prepared revised appraisals based on assumptions that are agreed as common ground and our opinion of appropriate assumptions where there is disagreement between the parties.

1.7. We also note that BPC have only modelled a scenario providing 100% Market Housing and have not provided any comment on assumptions relating to development revenue relating to affordable housing that are set out in our FVA. We have discussed this point with the Development Project Officer within the Council's Housing and Regeneration Department and agreed to consider only the viability position generated by a proposal for 100% Market Housing at this stage. Once this viability position has been agreed between the parties as matters of common ground, we will discuss the Council's position in terms of affordable housing tenure and grant availability and will contact local registered providers of affordable housing to confirm pricing.

1.8. This report refers to matters set out within our Financial Viability Assessment Report dated 2nd August 2018, our first post-submission response dated 7th December 2018 and should be read in conjunction with those reports and indeed, the reports prepared by BPC in November 2018 and February 2019.

1.9. This report has been prepared by Robert Grimshaw – a Director of Grimshaw Consulting Limited, who has extensive experience of both client-side and consultancy roles in the residential, commercial and mixed-use development sector, gained during a career of more than 25-years.

1.10. This report has been prepared for planning application purposes and is provided for the sole use of the party to whom it is addressed. The report is confidential to the addressee and their professional advisors and Grimshaw Consulting Limited accepts no responsibility whatsoever to any person other than our client. The contents of this report do not constitute our opinion of Market Value (as defined by the RICS Valuation – Global Standards 2017) and should not be relied upon as such by our client or any third party under any circumstances. Neither the whole nor any part of the report, or any reference thereto may be included within any published document, circular, or statement, or published in any way, without the prior written approval of Grimshaw Consulting Limited.

2. Matters Agreed as Common Ground

2.1. GCL and BPC agree that the following points are matters of Common Ground:

a) <u>Ground Rent Investment Value</u> – BPC propose at paragraph 4.3.4, a total value for Ground Rent Investment sale income of £143,000. We confirm our agreement to this assumption.

b) <u>Development Timescale</u> – BPC confirm agreement of our assumption at paragraph 4.6.1.

c) <u>Professional Fees</u> – BPC confirm agreement of our assumption of 12% of construction costs at paragraph 4.8.1.

d) <u>Contingency</u> – is included within the Order of Cost Estimate prepared by Stace LLP, which has been reviewed by K2 Rider Hunt on behalf of the Council. K2 Rider Hunt confirm agreement to the Contingency (“Risk Allowance”) provisions proposed by Stace LLP at rates of 7.5% in respect of refurbished commercial buildings and external works, 5% for new build residential buildings, and 10% in respect of ground remediation works.

e) <u>S.106 Contributions</u> – BPC confirm at paragraph 4.8.3 that no allowance has been made, pending agreement on whether a viability surplus is generated by the proposal. We agree that this is an appropriate approach.

f) <u>Community Infrastructure Levy</u> – BPC confirm at paragraph 4.8.4 that the sum estimated by GCL (a total of £625,000 for a 100% Market Housing scenario) has been input into their Toolkit appraisal. This is a matter of common ground, but the level of CIL will be dependent on the level of affordable housing that might be provided on-site and confirmation of indexation by the Council. Our current financial appraisals assume CIL indexation to November 2018 – any significant delay in determining and implementing the planning application will result in an increase in the CIL that is calculated by the Council.

g) <u>Marketing / Letting and Disposal Costs</u> – BPC have confirmed at paragraph 4.8.5 that they assumed a flat rate of 3.0% to include all residential marketing / sales agent and legal fees. BPC’s report is silent on the matter of marketing / letting & disposal fees relating to the commercial use, but we note that the Toolkit appraisal includes an allowance of 15% of “Capital Value”. We confirm agreement of these assumptions and our revised financial appraisal (Appendix 1) reflects this position.

h) <u>Finance Costs</u> – BPC confirm at paragraph 4.8.6 that they have assumed an interest rate of 7.0%, inclusive of all fees. We confirm our agreement to this assumption and this is reflected in our financial appraisal provided at Appendix 1.

i) <u>Developer Profit</u> – BPC confirm agreement to our assumption of 20% profit on GDV in respect of Market Housing, at paragraph 4.8.7. We note that the BPC report is silent on the profit margins for commercial use, but that the BPC Toolkit appraisal allows 15% profit on GDV. We confirm that this is a matter of common ground.

j) <u>Landowner Premium</u> – in our original report, we set-out our approach to establishing the Benchmark Land Value (BLV), based on the EUV of the Property, with an appropriate landowner premium. The BLV proposed in our original report was £1,800,000, which equated to £6.07m per hectare – slightly above the £6.0m per hectare benchmark established for industrial sites in the LB Richmond Whole Plan Viability Assessment (Adams Integra - December 2016). Whilst the landowner premium equated to approximately 30%, we considered this to be appropriate because the value per hectare accorded with the Whole Plan Viability Assessment assumption and the land has been held in the same ownership as an operational facility for a period of more than 35-years.

BPC maintain their position that a landowner premium of 20% is appropriate, because this has been agreed on other planning applications within Richmond and have asked for transactional evidence of comparable properties to further support our case. We have considered industrial property transactions in the West London sub-region within the last 2-years and find that there are considerable inconsistencies in the price at which investment properties transact – ranging from approximately £130 per sqft to £891 per sqft on the NIA of existing premises. This leads us to conclude that any transactional evidence is likely to be distorted by the purchase of land on an unconditional basis for residential development, as small industrial sites such as the subject Property are not suited to larger format, modern industrial and distribution premises. Therefore, in the interests of reaching a compromise position with BPC on the viability of the project, we are willing to concede this point and accept BPC's opinion of £1,665,000 for the BLV, representing a landowner premium of 20% above the agreed EUV.

k) Commercial Use Value – BPC confirm at paragraph 3.1.9 that they have not allowed for a separate rent free period in their financial appraisal, as they consider that a capitalisation rate of 6.5% represents an "all-in" rate. Whilst we consider our assumption to be reasonable, we are willing to concede this point in the interests of reaching an agreed viability position.

3. Matters Requiring Further Discussion

3.1. The following points require further discussion between the parties, due to disagreement on appraisal assumptions; or because BPC's report is silent on the point or the Toolkit appraisal assumptions are unclear due to the limited level of detailed input that this software allows; or because there has been a material change in circumstances since our original report was issued in August 2018:

a) Affordable Housing Appraisal Assumptions – as stated at paragraph 1.7 above, we are willing to set aside discussions on this point until all other viability points have been agreed and we can open discussions with the Council relating to tenure and grant availability and confirm pricing assumptions with local registered providers.

b) Acquisition Costs – in our response dated 7th December 2018, we pointed out a significant discrepancy in BPC's Toolkit appraisal, which included acquisition costs of only £97,546. BPC now explain at paragraph 3.1.4 that this input represents acquisition costs "…based on the Benchmark Land Value and not the Residual Land Value…". This is incorrect treatment of acquisition costs – they should be based on the Residual Land Value generated by the financial appraisal, with Developer Profit as a fixed percentage of GDV (as agreed). This error highlights the limitations of the Toolkit Appraisal model and should be corrected in line with the acquisition costs shown in our summary appraisal provided within section 4 of this report below.

c) Construction Costs – K2 Rider Hunt have reviewed the Response to Commercial Review prepared by Stace LLP and included within our response dated 7th December 2018 and consider that construction costs of £7,246,729 are appropriate. Stace LLP have reviewed K2 Rider Hunt's report and their Second Response to Commercial Review is attached at Appendix 2. Stace LLP have conceded on several areas of disagreement and consider that a construction cost of £7,699,538 can be supported as a compromise position. There remains a significant difference of £452,809 between Stace LLP and K2 Rider Hunt and we recommend that these professionals discuss the issues raised in the respective reports and seek to reach agreement. It is particularly notable that K2 Rider Hunt have not accounted for the recommendations of the Leap Environmental Ltd report relating to remediation of the site, which is currently in use as a registered waste disposal facility, specialising in the recycling of waste oil. Due to this over-sight, K2 Rider Hunt have removed remediation allowances totalling £235,875 and we would urge them to re-consider their position following review of the Stace LLP response and the Leap Environmental Ltd report, which is attached at Appendix 4 (Appendices readily available on the on-line planning application case file). We also note an increase in the BCIS All-in Tender Price Index from 320 to 325 between Q3 2018 when our original report was issued and Q2 2019 – a forecast increase of 1.02% - which has not been accounted for in Stace LLP's latest cost estimate. For the purposes of this response, we do not accept the cost reductions proposed by K2 Rider Hunt and our revised financial appraisal (Appendix 1) reflects the position presented by Stace LLP in their second response.

d) Network Rail Asset Protection Costs – in our response dated 7th December 2018, we added an allowance of £60,000 for Network Rail Asset Protection costs that our original FVA report did not include. Brookes Architects advise that the works to the existing building right on the boundary will require special scaffolding agreements and a license from Network rail for scaffolding to stand on their side (or overhang) and guarding to the trainlines. Furthermore, there will be a need for temporary protections and limitations / special requirements for tethering back piling rigs / cranes etc that would be required in such close proximity to the railway – not to mention additional temporary ground retention measure if the remediation of impacted soils requires excavations and reduced level dig in close proximity to the railway. At paragraph 3.1.6, BPC have requested a breakdown and more detailed justification for these costs. At this stage, when planning permission has not been secured, Network Rail will not supply a quote for their costs, but we note that as a Statutory Consultee, they have confirmed that an Asset Protection Agreement (APA) will be required (see Appendix 5). Stace LLP have provided example APA's from sites that they are dealing with (Appendix 5) and we note a wide range of costs – from £6,300 + VAT (East Croydon) to £75,000 plus VAT (Juniper House, Walthamstow). Given the wide range of costs and in the interests of reaching agreement, we are willing to reduce our allowance to £30,000 and this is reflected in our revised financial appraisal.

e) Carbon Off-set Payment – BPC have requested confirmation of how the carbon off-set payment has been calculated. This is provided within the Sustainability & Energy Statement (prepared by Bluesky Unlimited) at Appendix 3). The calculated payment is slightly lower than included in our original report, at £44,089 and we confirm that we have corrected our financial appraisal (Appendix 1) to reflect this. We trust that this satisfies BPC on this point

f) GDV – Market Housing – whilst this point was previously agreed at a total of £14,408,000, there has been significant change in market conditions since our original report was issued in August 2018, due in part to a general slow-down in the London housing market and influenced by the current uncertainty about when and on what terms the UK will leave the European Union. We note that the HMLR House Price Index for flats & maisonettes in Richmond upon Thames was 113.1 as at August 2018 but fell to 109.9 as at January 2019 (the latest dataset available). Given that the majority of RICS Registered Valuers are now limiting opinions to a period of 3-months and the clear change in market conditions, we consider that a correction to the GDV relating to Market Housing in line with the fall in the HMLR House Price Index as stated above is reasonable. Accordingly, our revised financial appraisal includes a GDV for Market Housing of £14,000,000.

4. Revised Financial Appraisal Result

4.1. We have prepared a revised financial appraisal for the development proposal using Argus Developer – industry recognised software for the provision of development viability models.

4.2. Based on matters agreed as common ground and in cases where matters are disputed, our own opinion of appropriate inputs as set out in section 3 above, we have tested the following development scenario:-

- All 24 residential dwellings are provided for Market Sale (Appendix 1)

4.3. Our financial appraisal results are summarised in the table provided below:

Arlington Works - Financial Appraisal Outcome		
Development Cost / Revenue		Second Response - 100% Market Housing
Development Revenue - Market Housing	£	14,000,000
Development Revenue - Affordable Housing	£	-
Development Revenue - Residential Ground Rents	£	143,000
Development Revenue - Commercial Units	£	2,517,308
Total Development Revenue	£	16,660,308
Acquisition Costs – SDLT	£	120,296
Acquisition Costs – Agent Fee	£	21,675
Acquisition Costs – Legal Fee	£	10,838
Construction Costs	£	7,699,538
Network Rail Asset Protection Fees	£	30,000
Contingency		included
Mayoral CIL Contributions	£	115,000
Borough CIL Contributions	£	510,000
Carbon Off-set Payment	£	44,089
Professional Fees	£	923,945
Marketing, Letting & Disposal Costs	£	801,886
Finance Costs	£	1,010,094
Developer Profit	£	3,205,443
		(19.24% of GDV)
Total Development Costs	£	14,492,804
Residual Land Value	£	2,167,504
Viability Benchmark	£	1,665,000
Viability Surplus / (Deficit)	**£**	**502,504**

5. Conclusion

5.1. We have considered the points raised by Bespoke Property Consultants ("BPC") in their second response to our financial viability assessment, which they have prepared on behalf of the Council. Many points are agreed as matters of common ground.

5.2. There are notable differences of opinion that remain to be resolved before final agreement can be reached. These relate primarily to Construction Costs and to the impact of a weakened housing market on the viability of the project since our original report was issued in August 2018. To a lesser extent, agreement of appraisal assumptions relating to Acquisition Costs and the costs of complying with Network Rail Asset Protection costs are required.

5.3. In their latest review dated February 2019, BPC suggested that a development scenario providing 100% Market Housing would generate a residual land value of £3,165,000, equating to a viability surplus above their opinion of Benchmark Land Value of £1,500,000. Our revised financial appraisal for 100% Market Housing generates a residual land value of £2,167,504 – a surplus of £502,504 above the agreed Benchmark Land Value of £1,665,000.

5.4. Our financial appraisal for a 100% Market Housing Scenario, generates a surplus that is within a few hundred pounds of our original conclusion in August 2018 and our conclusion that the maximum reasonable amount of affordable housing that can be provided on site, is 4 No apartments (2 No 2-bedroom and 2-No 3-bedroom) for sale on a shared ownership basis remains unaltered. The on-site affordable housing provision of 4 No units within the smaller residential block, equates to 17% of total dwellings and 19% of residential habitable rooms and floor area (NSA).

5.5. We look forward to discussing this proposal further with the BPC and the Council, once the contents of our response and appendices have been considered in more detail.

Robert Grimshaw
Director
Grimshaw Consulting Limited
28th March 2019

6. Appendices

Appendix 1 – Financial Appraisal – 100% Market Housing

Appendix 2 – Stace LLP Second Response to Commercial Review

Appendix 3 – Sustainability & Energy Statement (Bluesky Unlimited)

Appendix 4 – Site Investigation Report (Leap Environmental)

Appendix 5 – Network Rail Consultation Response & Example Asset Protection Agreements