Public Document Pack

ISLINGTON

PLANNING COMMITTEE

2 March 2017

SECOND DESPATCH

Please find enclosed the following items:

Enquiries to : Jonathan Moore
Tel : 020 7527 3308
Email : democracy@islington.gov.uk

This page is intentionally left blank

William Martin Court, WC1X 0JH

Independent Viability Review

Prepared on behalf of the London Borough of Islington

20 January 2017

BPS Chartered Surveyors

82 South Street, Dorking, RH4 2HD
www.bps-surveyors.co.uk

Planning Reference: P2016/2405/FUL

1.0 INTRODUCTION

1.1 BPS Chartered Surveyors have been instructed by the London Borough of Islington ('the Council') to undertake a review of a financial viability analysis in connection with a retrospective planning application for the change of use of William Martin Court. The applicant is Imperial London Enterprises Limited.

1.2 The proposals are for the "us*e of premises as a hostel providing residential accommodation for hotel staff (Sui Generis).*" We understand that the application site extends to an area of approximately 0.10 hectares.

1.3 We understand that the last legal use of the subject property was a care home (C2 Class). The property was subsequently sold and became an emergency relief hostel, however, planning permission was not granted for this use. The property was then sold to the applicant who currently uses the premises to provide accommodation for its staff employed at a local hotel. We understand that the applicant carried out internal works to the property in order to better facilitate this use.

1.4 The submitted planning statement refers to a study by Islington Council in 2003 where William Martin Court was deemed not fit for continued use as a care home in its condition.

1.5 We have been advised by the Council that as the previous emergency relief hostel use was not granted permission, the care home use cannot be reverted back to when analysing the existing use value for viability purposes. It is considered therefore that the property has nil use which is a very unusual situation. This means that when considering the potential existing use value as part of the normal viability process, no value can effectively be ascribed to the property. We have been advised by the Council to benchmark the site on the basis of a policy compliant residential development.

1.6 We understand the current owner operates the hostel for staff who are employed within its London hotel portfolio. The occupiers pay subsidised rates as part of their overall employment package. The applicant's consultants have provided a valuation based on actual rents and costs within the submission.

1.7 The applicant's consultants have also provided a scenario with various assumptions to estimate Market Value as a hostel, were the property to be run on a commercial basis. This analysis provides a value of approximately £5.2 million, assuming it was able to secure planning consent for this purpose.

1.8 The applicant's consultants have modelled 5 variants of residential development options to provide an alternative use approach to establishing a site value. The residual land values derived from these development scenarios range from £9.1 million to £16.18 million. On this basis, it is proposed that the current proposals cannot viably provide any contribution towards affordable housing.

1.9 We have assessed the cost and value inputs within the financial appraisal in order to establish whether the current hostel use is more viable than other potential uses. In the preparation of our review we have had reference to the documents set out on Islington Councils planning portal as well as the viability information submitted by the applicant's consultants, received 20th December 2016.

2.0 CONCLUSIONS AND RECOMMENDATIONS

2.1 The applicant's consultants have provided appraisals which value the subject site as a commercially run hostel to represent the proposed use at a figure of £5,245,000, albeit there are buildings on site currently operating as a hostel but without consent. This is not a development appraisal but a valuation of the current buildings on site.

2.2 In order to test scheme viability, the consultants have modelled various residential development scenarios to provide a land value for benchmarking purposes. As aforementioned, the site does not have a current consent, however it is illogical that because of this it should be perceived as having no value.

2.3 The Council's Development Viability SPD 2016 seeks to test viability by reference to EUV as a preferred benchmark. Given the very unusual circumstances of this site and the absence of a valid consent, we consider an AUV approach to represent the most realistic alternative approach. This also accords with PPG which reflects the idea that a landowner would consider its options in terms of EUV or AUV as informing its minimum land value expectations.

2.4 The applicant proposes the following resultant land values from its residential alternative use scenarios which we summarise as follows:

- 9 x 5-Bed Houses (0% affordable housing): £16,180,000
- 9 x Large 4-Bed Houses (0% affordable housing): £12,675,000
- 12 (Terraced) 4-Bed Houses (33% affordable housing): £11,893,500
- 12 (Terraced) 4-Bed Houses (50% affordable housing): £10,110,000
- 24 Flats (21 x 2-Beds & 3 x 1-Beds) (38% affordable housing): £10,430,000
- 24 Flats (21 x 2-Beds & 3 x 1-Beds) (50% affordable housing): £9,115,000
- 24 Flats (6 x 3 Beds, 9 x 2 beds & 9 x 1-Beds) (38% affordable housing) £10,500,000
- 24 Flats (6 x 3 Beds, 9 x 2 beds & 9 x 1-Beds) (50% affordable housing) £9,190,000.

2.5 The applicant argues that grant of consent for hostel use would confirm an investment value of £5.2 million for the buildings on site. Because there is no current valid use, the grant of consent would constitute development which would give rise to an obligation to provide affordable housing.

2.6 Through establishing an alternative use for the site which can be seen in terms of all the variants explored in 2.4 above to generate a higher residual value than the investment value of the hostel, the applicant argues that the grant of consent for hostel use would not generate a positive net value.

2.7 This approach broadly mirrors the approach modelled in respect of all development scenarios except in this instance the proposed use would not involve a development appraisal as the buildings are already on site. In this respect, we accept the approach proposed reflects the principles of planning viability to establish viability.

2.8 In consultation with Council Planning Officers we have considered residential development scenarios for the site and consider there is a narrower scope of development options than the applicant. We have focused our valuations on a hypothetical scheme providing 18 residential flats. We have researched relevant cost and value inputs for our appraisal and allowed for 50% provision of affordable housing reflecting a policy compliant mix of intermediate and social rent housing. Our Cost Consultant has provided a cost rate in line with BCIS data in order to calculate a total construction cost. We have also allowed for professional fees, marketing fees, disposal fees, finance costs, s106 costs and an appropriate market drive profit target. On this basis, we calculate a total residual value of £3.4 million. This forms the basis of our benchmark land value. It will be noted that this is significantly below the applicant's assessment of value.

2.9 In valuing the hostel, we have considered two scenarios to calculate is potential value, these are:

a) An owner operator. This scenario assumes that the market value reflects the risks and values associated with operating the hostel as a business.
b) Assumes a conventional lease from an operator to calculate a capital value.

2.10 Both scenarios reflect market hostel rates and 85% room occupancy. From this, deductions for staff and operating costs have been made to derive earnings before indexation tax and amortisation EBITDA.

2.11 Under scenario a) there is a higher level of risk to the gross earnings as they directly reflect the risks of operating such a business but value is calculated by reference to the total EBITDA. Under scenario b) we have considered a model where the EBITDA is split equally between rent and a return to the hostel operator. The valuation is based on the land owner's right to receive the rent. This is a lower risk investment as it reflects the covenant strength of the operator and a contractual commitment to pay a fixed rent. There are further scenarios which reflect turnover rents but these are likely to generate lower overall capital values than the two approaches considered due to the higher level of income risk involved.

2.12 Under these two scenarios we calculate the GDV for scenario a) to be £7.75m and £5.32m for scenario b).

2.13 We are of the view that the applicant's approach is conceptually incorrect in simply deriving an investment value of the hostel. The simple grant of consent for hostel use would not of itself generate an investment value of a fully completed and operating hostel, it would simply confer rights to develop the site for hostel use. However, there are buildings on site representing an investment or sunk cost and we are firmly of the view that this should be reflected in the valuation of the property to differentiate site value from completed and operating investment value.

2.14 For this reason, we have undertaken residual valuations of scenario a) and b) to factor in a present-day cost of the on-site buildings. This generates a residual value of £2.55m for scenario a) and £520,000 for scenario b). We have then compared these figures to our AUV benchmark figure of £3.4m.

2.15 On this basis scenario a) generates a net deficit of say -£797,000 and scenario b) a much greater deficit of -£2.83 m. Reflecting our analysis we are of the view that grant of consent for hostel use would not generate sufficient value reflecting a conventional approach to planning viability such that there would be capability to deliver a viable contribution towards affordable housing.

2.16 This recommendation hinges on the optionality in PPG for a land owner to seek the optimum value for its land given its options for an EUV or AUV. In this instance, and acting on the advice of Planning Officers, we are satisfied the AUV approach represents a valid basis for benchmarking the hostel use.

3.0 BENCHMARK LAND VALUE

Viability Benchmarking

3.1 Development appraisals work to derive a residual value. This approach can be represented by the formula below:

3.2 Gross Development Value - Development Costs (including Developer's Profit) = Residual Value

3.3 The residual value is then compared to a benchmark land value. Existing Use Value (EUV) and Alternative Use Value (AUV) are standard recognised approaches for establishing a land value as they help highlight the apparent differences between the values of the site without the benefit of the consent sought.

3.4 The rationale for comparing the scheme residual value with an appropriate benchmark is to identify whether it can generate sufficient money to pay a realistic price for the land whilst providing a normal level of profit for the developer. In the event that the scheme shows a deficit when compared to the benchmark figure the scheme is said to be in deficit and as such would be unlikely to proceed.

3.5 We note the Mayor's Housing SPG published March 2016 states a clear preference for using EUV as a basis for benchmarking development as this clearly defines the uplift in value generated by the consent sought. This is evidenced through the following extract:

> "…….either 'Market Value', 'alternative use value', 'existing use value plus' based approaches can address this requirement where correctly applied (see below); their appropriate application depends on specific circumstances. **On balance, the Mayor has found that the 'Existing use Value plus' approach is generally most appropriate for planning purposes, not least because of the way it can be used to address the need to ensure that development is sustainable in terms of the NPPF and Local Plan requirements, he therefore supports this approach**. The 'plus' element will vary on a case by case basis based on the circumstances of the site and owner and policy requirements." [Emphasis original]

3.6 We find the Market Value approach as defined by RICS Guidance Viability in Planning 2012 if misapplied is potentially open to an essentially circular reasoning. The RICS Guidance promotes use of a modified standard definition of "Market Value" by reference to an assumption that the market value should reflect planning policy and should disregard that which is not within planning policy. In practice, we find that consideration of compliance with policy is generally relegated to compliance somewhere on a scale of 0% to the policy target placing land owner requirements ahead of the need to meet planning policy.

3.7 Furthermore, the RICS guidance is in conflict with PPG in that PPG adopts a different level of emphasis in respect of the importance of planning policy. This is evident from the PPG extract set out below:

> *reflect policy requirements and planning obligations and, where applicable, any Community Infrastructure Levy charge;*

The requirement to reflect policy is unambiguous.

3.8 There is also a high risk that the RICS Guidance in placing a very high level of reliance on market transactions is potentially exposed to reliance on bids which might

a. Represent expectations which do not mirror current costs and values as required by PPG.
b. May themselves be overbids, and most importantly
c. Need to be analysed to reflect a policy compliant position.

To explain this point further, it is inevitable that if site sales are analysed on a headline rate per acre or per unit without adjustment for the level of affordable housing delivered then if these rates are applied to the subject site they will effectively cap delivery at the rates of delivery achieved of the comparable sites. This is an essentially circular approach which would effectively mitigate against delivery of affordable housing if applied.

3.9 The NPPF recognises at paragraph 173 identifies the need to provide both land owners and developers with a competitive return. In relation to land owners this is to encourage land owners to release land for development. This has translated to the widely accepted practice when using EUV as a benchmark of including a premium. Typically, in a range from 5-30%. Guidance indicates that the scale of any premium should reflect the circumstances of the land owner. We are of the view that where sites represent an ongoing liability to a land owner and the only means of either ending the liability or maximising site value is through securing a planning consent this should be a relevant factor when considering whether a premium is applicable.

The Proposed Benchmark

3.10 We have obtained the Land Registry title register and plan which states that the subject site was purchased in 2013 for £8.0 million by Imperial London Enterprises Ltd. We consider the purchase price alone insufficient to determine the benchmark land value in line with PPG as bids can be 'significantly above the market norm'.

3.11 During a meeting with the Council and the applicant's consultants we were made aware that the last lawful use of the premises was as a care home. The property was subsequently sold and used as a hostel although no permission was granted. The applicant purchased the site and decided to invest to convert the space into rooms to house employees of its local hotel.

3.12 As there is no legal use, the decision has been made to model a residential development on this site. The applicant's consultants have modelled various residential development scenarios which we summarise within the table below alongside the respective residual land values.

Scheme	% AH	Total Units	Benchmark Market Value
9 x 5-Bed Houses	0%	9	£16,180,000
9 x Large 4-Bed Houses	0%	9	£12,675,173
12 (Terraced) 4-Bed Houses	33%	12	£11,893,541
12 (Terraced) 4-Bed Houses	50%	12	£10,109,869
24 Flats (21 x 2-Beds & 3 x 1-Beds)	38%	24	£10,430,147
24 Flats (21 x 2-Beds & 3 x 1-Beds)	50%	24	£9,115,223
24 Flats (6 x 3 Beds, 9 x 2 beds & 9 x 1-Beds)	38%	24	£10,503,741
24 Flats (6 x 3 Beds, 9 x 2 beds & 9 x 1-Beds)	50%	24	£9,188,818

3.13 Following advice from the Council, we have assessed the benchmark land value in line with a hypothetical development for 18 residential units which includes 50% affordable housing with a mix of broadly 70:30 social rent and intermediate housing respectively in accordance with Policy. We have also been advised that the gross internal area of the existing building is 1,501 sq.m and therefore have sought to model this scenario on the basis as it is in line with the existing built form. The residential mix assumed has been summarised within the table below.

	1bed	2bed	3bed	Total
Market	3	5	1	9
Intermediate	2	1	0	3
Social Rent	0	3	3	6
Total	**5**	**9**	**4**	

3.14 In compiling our benchmark appraisal, we have had reference to the assumptions provided by the applicant's consultants. The applied sales values are as follows:

- 1 bed flats valued for £847,000 per unit (£1,575 sq.ft)
- 2 bed flats valued for £1,130,000 per unit (£1,500 sq.ft)
- 3 bed flats valued for £1,233,000 per unit (£1,450 sq.ft).

3.15 Ground rent has been applied at £300, £400 and £500 per unit per annum for one, two and three bed flats respectively.

3.16 The applicant's consultants have not provided comparable evidence in order to support the proposed residential values. The average unit value for the one bed units is £847,000. We have had reference to the following comparable information:

- A one bed flat is currently for sale at New River Head, Clerkenwell for £740,000 (£920 sq.ft / £9,908 sq.m). This unit is within a Grade II listed converted flat and residents have the benefit of a concierge service and gymnasium
- Flat 36 Angel Southside sold for a HPI adjusted figure of £624,038 (£1,010 sq.ft / £11,841 sq.m). This is a 3rd floor second hand unit in good condition
- Flat 3 Mytre Court, Johns Mews sold for a HPI adjusted price of £703,709 (£1,343 sq.ft / £14,456 sq.m). This is a refurbished second floor unit which is situated within a micro-location that tends to see similar residential sales values when compared to the subject site.

On the basis of our research, we have selected a sales rate of £1,400 sq.ft / £15,069 sq.m.

3.17 The two bed flats have been assigned an average unit value of £1,130,000. We have had reference to the following information:

- 65A Amwell Street sold in January 2016 for a HPI adjusted price of £1,069,103 (£1,034 sq.ft / £11,125 sq.m). This is a maisonette arranged over the top two floors of a period building. The property also has the benefit of a private entrance and was sold in excellent condition
- Flat A 16 River Street sold in March 2016 for an adjusted price of £1,042,739 (£1,496 sq.ft / £16,092 sq.m). This unit is situated over the lower ground and raised ground floor and has the benefit of a small garden area. This is a period conversion in excellent condition
- We have seen new build units on the Chronical Tower scheme on City Road which has sold within a range of £850,000 - £1,145,000 in the last year. The majority of units sold for £900,000 - £980,000.

On the basis of our research, we have adopted an average unit value of £1,050,000.

3.18 We have also had reference to three bed sales information:

- Flat 87 The Cooper Building sold in March 2016 for an adjusted price of £1,098,501 (£1,309 sq.ft / £14,093 sq.m). This is a new build property situated within a micro-location which sees similar residential sales values when compared to the subject site

- Flat 83 The Cooper Building sold for an adjusted price of £1,499,983 (£1,680 sq.ft / £18,080 sq.m). This is a ninth floor property with underfloor heating and concierge facilities.

We have maintained the proposed three bed unit values. We have also maintained the ground rent assumptions for the purpose of the current analysis.

3.19 The applicant's consultants have included affordable rent units within the scenarios which are 35% of open market sales rates. The applicant's consultants note *"generally shared ownership is not appropriate where unrestricted market values of a unit exceed £600,000"* and that shared ownership units would not be viable within a high value area such as Margery Street. Therefore, shared ownership units have not been included within the financial appraisal.

3.20 Our scenario includes 2x one bed and 1x two bed intermediate units and have applied an average value rate of £500 sq.ft / £5,382 sq.m which we deem to be reasonable in the current market. We have also included 3x two bed and 3x three bed social rent units. We have applied a sales rate of £190 sq.ft / £2,045 sq.m.

3.21 Our Cost Consultant, Neil Powling FRICS has provided an approximate cost rate estimate for the benchmark scheme using BCIS data. The applicant's consultants have selected upper quartile BCIS costs for the hypothetical residential schemes in order to reflect the high-quality development which would be required at this location. Our Cost Consultant has also calculated build costs on this basis, however, notes that an 80% efficiency is more likely rather than 85%. Neil has added 10% external works, £200,000 for demolition and site clearance and a 5% contingency. On this basis, we calculate a construction cost of £3,365,252.

3.22 We have allowed for 5.5% purchasers costs on the land value which comprises stamp duty and legal & agent fees. Professional fees have been set at 10% which we deem reasonable in line with the development characteristics as well as market norms.

3.23 Disposal sales agent and legal fees have been included at 1.50%. Finance costs have been calculated on the basis of a 7% debit rate. We have applied a developer profit target of 20% on GDV which reflects the characteristics of the development.

3.24 The applicant's consultants have included s106 contributions for carbon dioxide off setting at £1,000 per flat. Following advice provided by the Council, we have altered the appraisal to allow for a figure of £7,500 per unit which equates to £135,000 in total. This calculation is carried out on a case by case basis.

3.25 On the basis of our residual calculation we calculate a total net land value of say £3.4 million.

4.0 COMMERCIAL UNIT VALUATION

4.1 In order to ascertain the value of the property as a hostel, the applicant's consultants have considered actual current revenues and costs which show a yearly surplus of approximately £33,400 and when capitalised at a yield of 5.25%, generates a Market Value of approximately £640,000.

4.2 The applicants consultants have also considered the market value of the property as a Hostel assuming it was run on a commercial basis.

4.3 We are of the view that the applicant's approach is conceptually incorrect in simply deriving an investment value of the hostel. The simple grant of consent for hostel use would not of itself generate an investment value of a fully completed and operating hostel. There are buildings on site which we consider to represent an investment which should reflected in the valuation of the property to differentiate site value from completed and operating investment value.

4.4 The submitted Planning Statement includes a summary of the existing accommodation. The provided analysis includes 43 bedrooms, 2 bedrooms with bathrooms and 6 self-contained studio flats. This provides a total of 51 room opposed to 49 as represented within the table below. We have removed the additional two units from the spreadsheet.

T2: Accommodation summary

Floor	Bedrooms		Apartments / studios		Total floor GIA (sq. m.)
	Number	Size range (sq. m.)	Number	Size range (sq. m.)	
Ground	18	11.0 – 17.9	2	17.0 – 17.9	580
First	13	9.9 – 12.4	2	31.6 – 35.6	480
Second	12	10.6 – 15.7	2	30.7 – 35.6	441
Total	43	-	6	-	1,501

Sources: IPA architects

4.5 The house keeper has a room which is assumed to attract no income. The proposed value rates are:

- One bed studios flats: £500 per week
- Beds with bath: £375 per week
- Bedsit: £300 per week.

We have seen a private room in Clink78 hostel at King's Cross Road with shared facilities currently advertised for a similar weekly rate as the proposed bedsit rate. We note that under the Council's Planning Policy, the hostel use would be subject to restrictions in relation to occupation. This may restrict the achieveable value rates and impact other assumptions.[1]

4.6 The assumed average occupancy rate is 85%. A JLL (2016) report analysing hotels and hostels in London notes average occupancy rate of 82.2%. Furthermore, a PWC (2015) report on the hospitality industry in London notes an occupancy forecast of 84% for 2015 and an actual 2014 occupancy rate of 83% for hotels. We appreciate that the current analysis is based on hostel use, however, hotel occupancy information is still

[1] For the purposes of the current assessemement we have not made any deductions to account for the restricted use. A decrease in rates would not change the conclusions of our report.

useful for reference purposes. We consider the proposed occupancy rate to be optimistic but largely reasonable.

4.7 The proposed overall costs to run the hostel are 21% of the gross income per annum. We consider this to be a reasonable assumption.

4.8 The applicants consider that the annual balance will be equally split between the operator and the landlord. Hostels can be run based on many different agreements which have an impact on the appropriate yield. We have considered the 50% model and allowed for a yield of 5.16%. We have also considered a model which assumes that the land owner is also the operator of the hostel which in our view would attract a yield of 7%.

4.9 The level of risk attached to hostel ownership relates to the strength of the hostel operator, if this is not the land owner, and the strength of the brand they offer. This is represented within the table below compiled by Savills (2015) which compares hotel yields depending on the operational structure. We accept that the current analysis is for hostel yields, however, this represents the structures which may be applicable.

Typical yields by operational structure

Structure	2014 yield	2015 yield
Franchise	6.5% to 10.0%	5.5% to 8.5%
Turnover leases	7.0% to 8.0%	6.5% to 7.5%
Fixed lease (strong covenant)	4.75% to 5.25% (50 basis point discount on similar product outside London)	4.25% to 5.0% (25-50 basis point discount on similar product outside London)
Fixed lease (unproven covenant)	6.0% to 8.0% depending on rent cover	5.75% to 7.5% depending on rent cover

Table source: Savills

4.10 We can see that a fixed lease agreement can attract a low yield if the operator has strong covenant. We have considered two scenarios as follows:

- Scenario a: there is a higher level of risk to the gross earnings as they directly reflect the risks of operating such a business but value is calculated by reference to the total EBITDA
- Scenario b: we have considered a model where the EBITDA is split equally between rent and a return to the hostel operator. The valuation is based on the land owner's right to receive the rent. This is a lower risk investment as it reflects the covenant strength of the operator and a contractual commitment to pay a fixed rent.

We consider that the applicant's approach is conceptually incorrect in only deriving an investment value of the hostel. The simple grant of consent for hostel use would not of itself generate an investment value of a fully completed and operating hostel, it would simply confer rights to develop the site for hostel use. However there are buildings on site and we are firmly of the view that this should be reflected in the valuation of the property to differentiate site value from completed and operating investment value. As such, we have provided a headline construction cost rate based on BCIS data and included this within our appraisal.

4.11 For the scenario assuming that the land owner is also the operator we calculate a residual land value of £2.55 million. For the scenario with a 50:50 split between the land owner and the operator, we calculate a residual land value of £520,871.

Appendix 1: BCIS Cost Information

65 Margery Street WC1X 0JH
BCIS downloaded 12th Jan 2017

Islington
Taken as 3 storey flats

Applicant 26.11.16 - 4Q2016		
Location Islington	122	
TPI 4Q2016	286	forecast
TPI 1Q2017	288	forecast

Avg prices default new build	**LF100**	**LF122**	**sample**	% inc on mean
Flats generally mean	1,300	1,586	897	
Flats generally UQ	1,464	1,786	897	12.6%
Flats 3-5 storey mean	1,277	1,558	603	
Flats 3-5 storey UQ	1,453	1,773	603	13.8%
Avg prices max age 5yrs new build				
Flats generally mean	1,356	1,654	259	
Flats generally UQ	1,538	1,876	259	13.4%
Flats 3-5 storey mean	1,319	1,609	178	
Flats 3-5 storey UQ	1,492	1,820	178	13.1%