

Finsbury Tower

Independent Viability Review

Prepared on behalf of the London Borough of Islington

August 2016



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1.0 INTRODUCTION

- 1.1 We have been instructed by the London Borough of Islington ('the Council') to review a viability assessment that has been prepared by Montagu Evans, in relation to the proposed redevelopment of Finsbury Tower by Hermes Investment Management.
- 1.2 Estates Gazette Interactive records state that the building was built in the 1960s and was last refurbished in 1995. We have been informed that it was sold for £107m in November 2015 to CIT Group. We have checked Land Registry records, which cite a purchase price of £106m, and states that the freeholder is Finsbury Tower Estates Ltd, which we assume is a company that is affiliated to Hermes.
- 1.3 The previous planning application, P2015/2222/FUL, was for a, "*Partial refurbishment comprising external alterations to the existing office building including re-cladding of the podium (ground floor) , creation of a new portico main entrance on Bunhill Row, creation of a secondary entrance to the rear and conversion of the existing rear services yard to a landscaped garden*". This application was withdrawn.
- 1.4 A Planning application was also submitted for the change of use of the basement and ground floor of the existing building and the refurbishment and alteration to the building resulting in a loss of 1,214 sq m (gross) of office space. This application was by Hermes Real Estate Investment Fund, under P2015/1049/FUL.
- 1.5 The applicant has explored five different options, of which Option 1 (the proposed development) is the preferred option and is the only one that is shown to generate a surplus in Montagu Evans' appraisals - thus is the only one that is considered to be viable. The proposed development entails:
- 12-storey extension to the existing tower
 - 2-storey extension to the existing podium
 - The erection of a 4-storey extension on the corner of Bunhill Row and Dufferin Street
 - A new 5-6 storey building to the rear of the tower, with a frontage onto Lambs Buildings, to accommodate 21 units of affordable housing (100% social rent) and affordable workspace
 - Various public realm improvements, including a new pedestrian route through the site, connecting Bunhill Row with Errol Street.
- 1.6 This proposed scheme is shown below as option 5:
- Option 1) Refurbishment of existing 15 storey building
 - Option 2) 8 storey extension
 - Option 3) 10 storey extension
 - Option 4) 11 storey extension
 - Option 5) 12 storey extension
- 1.7 The refurbishment scheme generates a residual value of £76,767,535, which has been adopted as a Benchmark Land Value. The results of the appraisals are:

Development Option	Residual land value	Surplus generated (compared against £76.8m benchmark)
8 storey extension	£66,070,147	-£10,697,388
10 storey extension	£69,234,737	-£7,532,798
11 storey extension	£72,931,953	-£3,835,582
12 storey extension	£76,631,333	-£136,202

- 1.8 In the above table, the only viable options are the refurbishment option and the 12-storey option - the latter being effectively at a break even position.
- 1.9 The Montagu Evans development options all assume the provision of Affordable Workspace equivalent to 5% of the total Gross Internal Area (GIA), part at a rent of a peppercorn in perpetuity, and part at a rent of a peppercorn for the first 10 years. We understand that the overall provision of 5% of total GIA is in line with Islington planning policy, and that the rental assumptions are more generous than Islington's policy which requires only that Affordable Workspace be let at no more than 80% of Open Market levels.
- 1.10 The proposed scheme will provide up to 25 Social Rented apartments within a standalone building. The applicant's advisers state that, *"Whilst affordable housing is not required under Islington policy covering office floorspace provision, we understand that this is a local priority that our Client intends to satisfy. We understand that the Social Rented tenure is in particular demand in Islington."*
- 1.11 The Council has instructed us to consider whether it is necessary for the extension of the building to be as high as 12 storeys. It is argued that this height of extension is required in order to ensure that the scheme remains viable.
- 1.12 This Viability Review does not constitute a 'Red Book' valuation, meaning that Valuation Practice Statements 1-4 of the Red Book (RICS Valuation - Professional Standards, January 2014) are not of mandatory application. The Valuation Date for this Viability Review is the date of this report, as stated on the title page. This Viability Review has been undertaken in accordance with the Terms & Conditions provided to the Council and with any associated Letters of Engagement, and should only be viewed by those parties that have been authorised to do so by the Council.

2.0 CONCLUSIONS & RECOMMENDATIONS

- 2.1 Following our review of the viability assessment by Montagu Evans, we note that it is generally very detailed and based on good market evidence in respect of the adopted costs and values. We have, however, suggested some relatively minor changes to office yields (for the refurbishment scheme) and profit levels (for the development and refurbishment schemes).
- 2.2 The scheme's delivery of an affordable housing block is effectively resulting in the tower extension having to be as high as 12 storeys - in order for sufficient revenues from new office space to be generated, to ensure the scheme is viable. There is therefore a trade-off between affordable housing delivery and the restriction on the height of the building. There is also a trade-off between height restriction and the rent discounts granted to the affordable workspace, which will require further consideration by planning officers.
- 2.3 In the remainder of this Section, we discuss the different Options in turn, and finally discuss the affordable workspace valuation.

12-storey extension scheme

- 2.4 We agree with the rents and yields that have been applied to value the completed office floorspace, and agree with all the other cost inputs.
- 2.5 Regarding the affordable housing values, these total £2.5m and are based on an offer received from a leading Registered Provider. This constitutes good market evidence thus we accept these values, although it would be useful to be provided with a copy of this offer.
- 2.6 Regarding the profit targets, these are arguably higher than is typical. We suggest 17.5% on Cost for the proposed development (rather than the 17.5% on GDV). This increases the residual value from £76.63m to £81.91m.
- 2.7 Given that the site was purchased for £106m according to Land Registry, this suggests that the purchaser formulated its final bid on the basis of considerably more optimistic appraisal assumptions than have been adopted by Montagu Evans; we suggest that this may in part reflect a lower profit requirement, and also that future improvements in viability were factored in. We have, however, reviewed viability entirely on the basis of present-day costs and values - as is required by the National Planning Policy Guidance in its guidelines on how to assess viability for planning purposes.

Refurbishment (benchmark) scheme

- 2.8 The refurbishment scheme generates a residual value of £76,767,535, which has been adopted as a Benchmark Land Value.
- 2.9 In considering the investment market and comparable sales transactions, we suggest that the office yield differential is not great enough between the refurbishment option (5.0%) and development options (4.5%). The rents and yields applied to the development options are consistent with recent market evidence that we have analysed. However, with respect to the refurbishment scheme (i.e. benchmark scheme), we do suggest that a higher yield should be applied in order

to show a greater difference between this and the development options - in terms of their relative appeal to investors. This reflects the limited level of refurbishment undertaken and the constraints posed by retaining the existing façade.

- 2.10 We calculate that by increasing the yield from 5.0% to 5.25%, this reduces the office capital values by £7.49m, and increasing this to 5.5% would change it by £14.29m. Making this £7.49m reduction in the refurbishment appraisal, reduces the residual from £76.8m to £72.0m. We also suggest a lower profit target is appropriate, in part because we view the profit differential shown by Montagu Evans (15% vs. 17.5%) to be insufficient to fully reflect the large differences between the refurbishment and development options - especially their difference development periods and levels of risk. We have therefore reduced the profit to 12.5% on Cost, which increases the residual from £72.0m to £75.8m.
- 2.11 The aforementioned revised benchmark land value of £75.8m can be compared to the £81.9m revised residual land value for the proposed scheme (12 storeys), and suggests a surplus of just over £6m.

8-, 10- and 11-storey extension options

- 2.12 Our revisions to the 12-storey extension increased the surplus from -£0.14m to £6.1m. Applying these changes to the other options would lead to the 11-storey option showing a surplus, while the 8- and 10- storey options would remain unviable.
- 2.13 We suggest that further discussion is required with the applicant's advisers regarding profit levels, refurbishment costs, the specification of the refurbishment option and affordable workspace values (see following paragraph)."

Affordable workspace

- 2.14 Part of the affordable workspace will be let at a peppercorn rent for 10 years, after which it will revert to full market rent. The capital value is £5,964,000 (after deduction of purchaser's costs) in the appraisals of the development options. After being provided with the detailed valuation for this space, we can confirm that it has been calculated correctly.
- 2.15 Regarding the affordable workspace that is at a peppercorn rent in perpetuity, we note that this is lower than the typical requirement that affordable workspace should be at c80% of Market Rent, therefore the Council may wish to consider allowing a higher rent in order to increase values and thereby improve viability - which could allow the scheme to proceed with a lower number of extension floors. For example, at 80% of Market Rent in perpetuity, this space would have a capital value (after deducting purchaser's costs) of £6.74m - which could enable the height of the extension to be lowered.

3.0 OFFICE VALUES

- 3.1 The office rents for all the Options have been estimated by Strutt & Parker, who provide a floor-by-floor rent schedule for each Option. On request, comparable lettings evidence has been provided. We analyse this evidence below, and in particular we focus on comparing the rents that have been applied in the different Options.
- 3.2 For Option 5 - the proposed scheme - the rents range from £60.50 (ground floor) up to £80 psf (27th floor), with a steady gradient as one moves up the building. By comparison to the refurbishment option, the 10th floor (as one example) has a £59 per sqft rent, compared to the £66 per sqft rent shown in the proposed scheme.
- 3.3 We have considered whether this differential suitably reflects the higher appeal of upper floor buildings. We would expect there to be a gradient, which we have seen in many high rise office buildings, including Centre Point and the Heron Tower.
- 3.4 Strutt & Parker assume that a very high specification will be provided for the proposed scheme's offices. It is referred to as "extremely high". Their valuation was undertaken in May 2016. This is prior to the 'Brexit' vote, therefore they may wish to revise this valuation to reflect the current market uncertainty, which has had an impact on the capital values of London offices. It is, however, likely that any changes (such as, for example, a 'softening' of yields) would apply both to the benchmark scheme (i.e. the refurbishment scheme) and the extension schemes, therefore would counteract each other, thus limiting the impact on overall scheme viability.

Proposed scheme's office rents

- 3.5 The site is in the City Fringe market and close to the Silicon Roundabout area surrounding the Old Street Roundabout. It is therefore an up and coming office area, which we would expect to generate substantial levels of occupier demand. The new-build letting evidence provided by Strutt & Parker includes the following, which we have commented upon:
- [10 Finsbury Square](#) - lettings on the 3rd, 4th and 5th floors, all at £63.50 psf. This is a new-build. Deals agreed in January 2016. In very close proximity, just to the south east of Finsbury Tower. Grade A offices. Comparing this to the proposed scheme, which has £61.50 psf to £62.50 psf for the 3rd-5th floors, this suggests that Strutt & Parker's estimate is reasonable. This new-build 10 Finsbury Square office may be marginally superior to the proposed scheme which is constrained by the existing building structure - for example the floor to ceiling heights. This comparable has an excellent outlook, being adjacent to attractive playing fields. It has an excellent double-height reception. Floor to ceiling heights are 2.75m with a 150mm raised floor void.
 - [Cordy House, Curtain Road](#) - this new-build is in close proximity, to the east of Finsbury Tower. It achieved £50 per sqft in Q3 2015. Improvements in rents since then may justify higher rents at the proposed scheme. This rent was for the 1st-3rd floors, and compares to £60.50-£61.50 per sqft applied to the proposed scheme's 1st-3rd floors.

- [White Collar Factory, 100 City Road](#) - this Derwent London building is very close to Finsbury Tower. It is a high quality office building, and has achieved high-£50s/low-£60s for many of its floors. The latest letting cited is £63.50 for the 7th & 8th floors. By comparison, the proposed scheme has £64.00 and £64.50 psf for the 7th and 8th respectively. We would not expect the proposed scheme's (on a floor to floor comparison) to significantly exceed values at 100 City Road, *unless* it is the case that there has been substantial growth in rents since this date.
- 3.6 According to CBRE, for Q1 2016, *“Prime Central London offices again showed significant growth of 2.6% across both rents and capital values. The capital also contained most of the nation’s hotspots. Prime offices in the City saw its highest rental growth in six years at 4.6%, while London Docklands saw increases of 5.4%.”* It is unclear what the impact of Brexit will be; CBRE’s figures indicate that City offices have thus far been the hardest hit, with a 6.1% decrease in capital values in July. We would therefore be hesitant to apply any inflation to the comparable lettings (such as at 100 City Road) to reach a present estimate of rents and overall capital values.
- 3.7 The quality of the reception area is an important consideration and a key driver of values. The current reception area is somewhat dated. We have sought to establish what works will be undertaken to the reception for the proposed scheme, and how it will alter. We have also made a comparison between this and the reception that the ‘refurbishment option’ will deliver. We have not, however, yet been provided with sufficient information regarding the reception areas, thus are unable to form a final opinion.
- 3.8 The standard of internal fit-out is a key driver of values. These will, we understand, be Grade A, air-conditioned offices. Whilst Strutt & Parker say they will be “extremely high” specification this is not fully apparent from the cost plan, and insufficient levels of detail are provided for us to identify the level of fit out. We have requested further details from Montagu Evans, but have not yet received detailed information regarding specification.
- 3.9 The proposed scheme will provide a new façade and will effectively provide accommodation on a par with new-build. The extension floors will have the same floor to ceiling heights as the existing floors, therefore they will be very similar to the floors below. We therefore agree with the approach taken by Strutt & Parker, whereby similar rents are provided for the new-build and refurbished floors of the proposed scheme (after factoring out the impact of height on rents). For example, there is only a £1 psf difference between the 15th and 16th floors (the latter being the first new-build floor).
- 3.10 The top floor is £80 per sqft. This is difficult to support as there are no comparable lettings cited at rents this high, and none cited at this high above ground level. This is therefore a somewhat untested rent level. We do, however, agree with the rents applied, which show a progression with height and are consistent with the general trend for higher rents on upper floors, where there are better views. There is, however, likely to be a ceiling upon how much occupiers are willing to pay in this location, which is City Fringe thus is outside the core London office markets.

Refurbishment option

- 3.11 As stated above, we consider the proposed scheme's rents to be reasonable. The rents are higher for the extension option than for the refurbishment option. For example, the 5th floor is £56.00 psf for the refurbishment, and 62.50 psf for the extension options. We have considered whether this differential is sufficient to account for the difference in quality; this is just over 10% lower rents.
- 3.12 The refurbishment scenario has rents ranging from £52 psf (tower) up to £64 psf (15th floor), with a steady gradient of increasing rents as one moves up the building. This is assumed to be a 'light touch' refurbishment, therefore our Cost Consultant has sought to establish that this level of refurbishment is reflected in the Cost Plan.
- 3.13 As the building will not be provided with a new façade in the refurbishment scenario, this will impact on values, as the current façade is somewhat dated. The refurbishment would need to take into account the age of the façade and the windows which may need replacing in order to provide modern standards of energy efficiency etc. This may therefore impact on rents.
- 3.14 Based on our experience of other London schemes, including refurbishment schemes, we agree with Strutt & Parker's assertion that the differential in rents between new-build and refurbished space has recently narrowed - driven in large part by the shortage of 'cheap' offices and the loss such offices via residential conversion (under Permitted Development Rights).
- 3.15 We discuss below some of the comparable lettings cited by Strutt & Parker, which are of relevance to refurbished offices:

[The Bower Warehouse, Old Street](#) - comprehensive refurbishment. These let for £50.25-£67.50 per sqft. These were pre-lets in Jan-Nov 15.

[C-Space, 37-45 City Road, EC1](#) - £55.00 to £63.50 per sqft achieved. Comprehensive refurbishment. For example, £63.50 on part 3rd compares to the estimate of £55 per sqft for Finsbury Tower. We have checked the EGi building report for C-Space; it is effectively a new building, as it has a new façade and some extension works. It is therefore arguably more similar to the *proposed* scheme than the refurbishment option, and this is reflected in the rents being closer to the proposed scheme's.

[Alpha Beta, 14 Finsbury Square](#) - historic façade, arguably a more attractive building than the existing Finsbury Tower. These were let in Jan-Apr 15 at £52.00-£60.00 psf, on the 4th-6th floors. By comparison, the refurbishment scheme is estimated at £55.50-56.50 per sqft - which strengthens the view that these estimates are reasonable.

- 3.16 We have, in addition, referred to lettings records on Estates Gazette Interactive, including the following lettings:

[140 Old Street, London, EC1V 9BJ](#) - High quality refurbishment, including a new, plate-glass façade. Let for £60 per sqft in April 2016. Was refurbished in 2003 (to Grade A specification), thus a new refurbishment could achieve higher lettings, although the refurbishment scheme at Finsbury Tower does not include a new façade thus is arguably inferior. This suggests that £54 estimated for the 1st floor of the refurbishment Option is reasonable.

[104-110 Goswell Road, London, EC1V 7DH](#) - Let for £61.50 per sqft in July 2016. This has a dated façade. Specification is short of grade A. Does not have suspended ceilings. Oak floors. 2nd floor letting. This does suggest that the refurbishment Option's estimated values are broadly reasonable, based on the most recent lettings evidence, and may even be somewhat cautious.

[Scrutton Street](#) - let in June 2016 at £54.50 per sqft on 1st floor. This has a dated facade, which has been refurbished but not replaced. Has comfort cooling. Overall, we would expect marginally higher rents for the Finsbury Tower refurbishment, thus £54.00 per sqft for the refurbishment Option is realistic by comparison.

- 3.17 In conclusion, we agree with the rents that have been applied in the refurbishment scenario.

Yields - for all Options

- 3.18 The gross yield for the proposed scheme's offices is 4.5%. For the refurbishment scheme, the gross yield is 5.0%. Arguably this is not sufficiently higher than the application scheme's yield to reflect the difference in quality. We would expect the investment market to look considerably more favourably on the proposed scheme than the refurbishment scheme, given that the latter will retain a dated façade which may result in further works being required in the future to replace parts of this façade. Montagu Evans confirm that the refurbishment option would be an internal-only refurbishment and would not require any planning permission.
- 3.19 No yield evidence has been provided by Montagu Evans in support of their yield estimates. Consequently, we have researched the local market and considered the following investment deals:
- [1 Tudor Street, EC4Y 0AH](#) - Close to Farringdon Crossrail. Second-hand Grade A, a modern building, constructed 2009. Multi-let to high quality tenants, large modern reception. Sold at **4.16%** yield, in July 2015. This is a 70,591 sq ft office.
 - [16-17 Bowling Green Lane](#) - located to the west of Finsbury Tower. Sold at a **3.76%** net initial yield, in August 2015. Multi-let property. Grade-II listed building, Grade A specification. This suggests that a higher yield should be applied to the John Street property.
 - [2 Pear Tree Court, EC1R 0DS](#) - property refurbished in 2000. Close to Farringdon Road tube station. This is a growth area due to the construction of Farringdon Crossrail Station. **3.74%** net initial yield. Single let to Euromonitor International. Sold in August 2015.
 - [20 Red Lion Street, Sandland Street, WC1R 4QN](#). Achieved a net initial yield of 5.0%. Sold Feb 2015. Recently fully refurbished. Modern building. Located in a superior location, to the south of the Site. Refurbished in 1998. Single occupancy, by a Patent Office. High quality office building.

- [2 Bedford Row](#). Listed, prestigious Georgian building. Achieved a 4.4% yield (not mentioned whether this is a gross or net yield). Entire building let to a law firm.
 - [Saffron Court, St Cross Street, EC1N 8XA](#). This sold at a 5.25% net initial yield, in August 2015. 1960s building. Six storeys. In close proximity to John Street, and near Farringdon station.
 - [Isis House, 74 New Oxford Street, WC1A 1EU](#) (grade A - 4.1% yield), achieved in January 2015. Refurbished effectively to a new-build standard in 2013, including a glass façade. Excellent location. Grade A specification, including air conditioning. Would expect considerably higher yield for application scheme's offices, given their inferior location.
- 3.20 With respect to an office in Tavistock Place, in a recent assessment by Crossland Otter Hunt (who were instructed by BPS) of achievable net yields for a fully refurbished (high-quality, Grade B) office, they advised that 4.75%-5.0% is realistic. This is to west of Finsbury Tower, and in the Midtown market. It is similar in being outside the Core office market.
- 3.21 We question the 0.5 percentage point differential between the proposed scheme and refurbishment scheme offices, given the low yields that have been achieved for new-build offices and the benefits of including new floors on the building. The yield achieved for refurbished offices appear dependent on the extent of refurbishment and the quality of the original building.
- 3.22 In light of the Leave vote in the EUV referendum, there has been a fall in capital values of London offices, thus we would not suggest lower yields than Montagu Evans have adopted. Prior to the referendum, sub 4.5% could be expected for a refurbishment that was as good as a new-build (such as provided a new façade etc) - as Alpha Beta demonstrates:
- [Alphabeta \(Former Neptune House, Triton Court\), 14 Finsbury Square, London, EC2A 1BR](#), achieved 3.89% yield in August 2015. This has an historic façade and was comprehensively refurbished. Close proximity to subject site.
- 3.23 For a new-build scheme at 150 Holborn, Crossland Otter Hunt recently advised a net initial yield of 4.25% was appropriate, which is circa 4.00% gross initial yield. This was based on Telephone Exchange on High Holborn (3.4% NIY) and 124 Theobalds Road (4.0% NIY).
- 3.24 In conclusion, have left the proposed scheme's yield unchanged in light of the EU Referendum, and suggest a marginal increase to the refurbishment scheme's yield. We calculate that by increasing the yield from 5.0% to 5.25%, this reduces the office capital values by £7.49m, and increasing this to 5.5% would change it by £14.29m.
- Rent Free Periods**
- 3.25 The rent free period is 12 months for both the refurbishment Option and the four extension Options. This is a realistic allowance.

Void Periods

- 3.26 It is unclear from the appraisal how long the void periods are for each options' office floorspace. This will need to be discussed further with Montagu Evans.

Rent Receivable Letting Period

- 3.27 The appraisal of the refurbishment scheme shows a total of £5,309,575 of income received prior to investment sale, and £655,623 received prior to refurbishment - the latter being documented in Appendix Three of the Viability Report, based on the passing rents in the building. The rents prior to development of the development Option is less (£154,306) which we understand reflects the fact that works will be able to commence on the refurbishment while some of the tenants remain in place, whereas the development scenarios will require full vacant possession immediately.
- 3.28 We agree that the rents prior to investment sale have been correctly applied in the Argus appraisals, and reflect the estimated rents applied by Montagu Evans.

Affordable office values

- 3.29 Montagu Evans describe the affordable workspace that is being offered:

A provision of Affordable Workspace equivalent to 5% of the total GIA, part at a rent of a peppercorn in perpetuity, and part at a rent of a peppercorn for the first 10 years. We understand that the overall provision of 5% of total GIA is in line with Islington policy, and that the rental assumptions are more generous than Islington's policy which requires only that Affordable Workspace be let at no more than 80% of Open Market levels

- 3.30 Regarding affordable workspace, the Guidance on Affordable Workspace (2014) requires the combined rent and service charge to be less than 80% of the average for comparable market rates.
- 3.31 Planning policy CS13 requires the proposed scheme to provide:

"...either a proportion of small, micro and/or affordable workspace or affordable retail space, or contributions towards these, from major non-residential developments where the majority of floorspace is not in public education, community or social infrastructure uses."

- 3.32 Also relevant is policy DM5.4 as it has regard to the size and affordability of workspace. It states that developments,

"...must incorporate an appropriate amount of affordable workspace and/or workspace suitable for occupation by micro and small enterprises."

- 3.33 Planning Officers have previously informed us that the required level of provision is 5% (100 sqm) of the total business floorspace, and that the Council's Business and Employment Support Team will therefore negotiate rents with Affordable Workspace Providers on a case by case basis. The precise level of rents that apply in the case of the application scheme would be a matter for further discussion.

- 3.34 The value of the 11,410 sq ft of space that is at peppercorn for 10 years, then reverting to full market rates, is £5,964,000. We do not have the detailed calculation for this. The affordable workspace is on the 1st-4th floors. We calculate, assuming this workspace is on the 1st floor (at £60.50 per sq ft), a capital value of £6.9m, which is based on a capitalisation of the full market rent then discounting this by ten years - as shown in the following table:

GIA	NIA	Rent	Capitalisation
8,934	6,689	404,663	8,992,509
11,410	8,542	516,813	11,484,724
20,344	15,231		1
			7,395,332
			6,924,468

- 3.35 We have since received a copy of Montagu Evans' investment valuation which shows that the £5,964,000 figure is net of purchaser's costs and letting fees, and that it discounts the capital value by 11 years - this being suitable as it includes the 10 year period plus 1 year of rent free for the future incoming tenant.
- 3.36 Regarding the affordable workspace that is at a peppercorn rent in perpetuity, it is correct that this should have nil capital value in the appraisal. We note that this is lower than the typical requirement that affordable workspace should be c80% of Market Rent, therefore the Council may wish to consider allowing a higher rent in order to increase values and thereby improve viability - which could allow the scheme to proceed with a lower number of extension floors.

4.0 DEVELOPMENT COSTS

Build costs

- 4.1 Our Cost Consultant, Neil Powling, has undertaken a review of the Cost Plan and have benchmarked these costs against BCIS average tender prices. The main conclusion of the review is that the cost estimate for the development Options appear to be reasonable. Neil's estimated closely matches that which has been adopted in the appraisal.
- 4.2 With respect to the refurbishment option, this is stated by Strutt & Parker as being a 'light refurbishment. Neil Powling has looked at the cost estimate and believes that this is indeed a relatively low level of expenditure and is consistent with a light touch refurbishment - as he discusses below:

Option 5 (scenario 1) is the refurbishment of the existing building. The GIA is 235,051ft² (21,837m²). The scenario testing allows for a light refurbishment cost of £26,400,000 (£1,209/m²). The refurbishment states an allowance for repair and re-use of existing cladding. There is no detailed costing and therefore no detail of specification that might be included in the estimated costs. We query how practical a light refurbishment will be in providing a building to satisfy market requirements; the services will need upgrading or more likely replacement to satisfy modern expectations; existing glazing will not provide the modern glazing specifications that may be designed to support the climate control of the building environment. We have determined an estimated cost from a BCIS location adjusted refurbishment rate for an air conditioned office building with a 10% allowance for contingencies of £31,700,000 (£1,452/m²). We consider this a realistic estimate of cost for refurbishment of the building to a reasonable but nevertheless moderate or mid-range specification.

- 4.3 Based on the market evidence we have considered in respect of our rent and yield analysis, we consider the overall capital value applied to the refurbished space to be too high for a scheme that has this level of refurbishment. This discrepancy can be addressed by way of a yield shift - or alternatively by an increase in refurbishment costs so as to deliver a quality of space commensurate with the rents and yields that Montagu Evans have used. Neil has suggested an increase to the costs (inclusive of contingency) of £5.3m.
- 4.4 We calculate that by increasing the yield from 5.0% to 5.25%, this reduces the office capital values by £7.49m, and increasing this to 5.5% would change it by £14.29m. We therefore suggest that applying a yield shift (to 5.25%) is appropriate and removes the need to revise the refurbishment costs, as the 'light touch' refurbishment is reflected in the costs and then factored in to our yield estimate.

Professional Fees

- 4.5 The professional fees allowance is 10% for the development options, which is a reasonable rate. We note that for the refurbishment option, these fees are 8%. Our Cost Consultant states that professional fees are typically *higher* for refurbishment schemes, thus we have requested further justification for this lower rate.

Developer's Profit

- 4.6 A developer's profit of 17.5% on GDV is adopted for the development options. This compares to the 15% on GDV applied to the refurbishment scheme. This 17.5% profit is in line with typical rates for commercial developments. Given the lower cost of the refurbishment option, and the lesser risk it entails (including lower 'planning risk') it is logical to have a differential in profit - indeed, it is common to see lower profit requirements for refurbishment/extension schemes.
- 4.7 The overall profit on Cost is shown as 16.83% in the refurbishment scheme (and 13.98% on GDV). It is not clear how this estimate has been reached, as it does not match the 15% on GDV cited by Montagu Evans.
- 4.8 We have considered comparable evidence of profit targets that have been applied by developers in respect of recent schemes we have been involved in:
- 31-32 Alfred Place - experienced office agent undertook a conventional residual valuation to determine the value of an office refurbishment scheme, and used a developer's profit of 15% on Cost. Extensive works were required. The works to the adjoining building were less extensive, so no profit added to these costs.
 - Oliver's House, 51-53 City Road - extensive office refurbishment. Savills undertook a residual valuation and included a 15% profit on Cost.
 - Merchant's Hall, 46 Essex Road - extensive office refurbishment. Agent applied a 15% profit on GDV in the office refurbishment appraisal. The agents' client would have 'benefitted' from a higher profit target as this would have made this office scheme less viable and would therefore reduce the surplus available for contributions towards affordable workspace. Therefore they had no interest in *under*-estimating the profit target.
 - Diorama, Park Square East - extensive office refurbishment and reconfiguration. CBRE's target profit of 15% on Cost. The applicant in this case was seeking to prove that office use is 'obsolete', thus had no incentive to under-estimate the profit target.
- 4.9 The above are all Central London properties and these valuations were all within the last few years, thus comprise highly relevant evidence. These profit levels are in line with the advice of Crossland that, "*Traditionally, a developer would look for a 15-20% return on costs, including making an allowance for financing on a traditional residual valuation*". Thus the 16.8% on Cost in Montagu Evans' appraisal is at the upper end of this range suggested by Crossland, and as higher than many other developers' have required, as shown by our comparable schemes.
- 4.10 For the refurbishment scheme, the £21,561,202 profit requirement does appear to be very high for a refurbishment scheme. Reducing this would impact on viability by increasing the benchmark land value.
- 4.11 Moving on to the development option's profit, cited at 17.5% on GDV in the Viability Report, this is 16.34% on GDV (20.41% on Cost) in the appraisal. We have requested an explanation for this discrepancy. Taking into account the comparable evidence above, we view this as being at the upper end of the range; 17.5% is in line with profit rates applied to residential, and it is common for lower rates to be

applied to commercial space. Given the excellent location of this building within the office market, and that the majority of the space will be refurbishment space

- 4.12 These development options include £2.5m of affordable housing, which would typically be assigned a lower profit requirement of c6% on Cost.
- 4.13 For example, Farringdon Road scheme applied 17.5% on *Cost* to a predominantly office scheme. Thus perhaps the profit is excessive on Finsbury scheme, especially given that most of the space will only need to be refurbished.
- 4.14 We have considered the relationship between IRR and profit on Cost for each option:
- The IRR is 15.68% for the refurbishment option, compared to its 16.83% profit on Cost;
 - and for the development option (12-storey) the IRR is 13.32%, compared to its 20.41% profit on Cost.
- 4.15 This shows that the refurbishment option is gaining a better return (IRR) once the 'time value of money' is taken into account. This is a function of the shorter development period. It indicates that the refurbishment option's profit on Cost may be somewhat high, and that the *difference* between the profit on Costs for the refurbishment and development options may be insufficient, especially given how much long the latter's development period is. Moreover, the refurbishment scheme receives income while part of refurbishment is underway, which improves scheme cashflow; the lettings commence 17 months in to the refurbishment project, but 30 month in to the development project. Clearly if the *difference* in profit were to be *increased*, this would tend to worsen viability (by making the development option less valuable relative to the refurbishment option).
- 4.16 In conclusion, we have applied a lower profit of 17.5% on Cost to the development options, and likewise a lower profit of 12.5% on Cost to the refurbishment option - which increase the difference between these two profit levels.

Other costs - development options

- 4.17 The appraisal includes Carbon Credits of £547,000 for all the development Options. We have requested confirmation from Planning Officers that this is a required contribution.
- 4.18 There is a £77,083 payment for early termination of the 4th floor lease. This is a realistic allowance.
- 4.19 Letting Agent Fees of 10% and Letting Legal Fees of 5% are in line with typical rates.
- 4.20 Disposal Fees (0.60% sales agent and 0.30% sales legals on offices; 1.00% sales agent and 0.50% sales legals on retail and affordable workspace). These are reasonable.
- 4.21 The interest rate of 7% is a standard rate, which is the default shown in the GLA Toolkit. The duration of the 12 storey scheme is 55 months. By contrast, the refurbishment scheme is 33 months. This further shows that a lower profit

requirement is suitable due to the shorter period in which capital is tied up in the scheme. Our Cost Consultant has analysed these and considers them to be realistic.

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Appendix One:

Independent Cost Review by Neil Powling

1 SUMMARY

- 1.1 The estimate includes for the provision of 4 twin lifts, we understand this is a design solution for vertical transport constrained by limited floor space, but as there is only one supplier for this product the cost of £960,000 per twin lift equivalent to £480,000 per single lift is a high cost that cannot be tested by competitive tender. We have allowed for this higher cost in our adjusted benchmarking.
- 1.2 An adjustment of £3,450,000 has been made for inflation to 2Q2016 calculated at 2.72%. The base date of the estimate before the inflation adjustment has not been stated. The current forecast all-in BCIS TPI for 4Q15, 1Q16 and 2Q16 is unchanged at 274. The TPI for the current quarter 3Q16 is 273. The forecast TPIs earlier this year were above this level but the market changes leading to the EU referendum and the result have caused significant reductions in the forecast levels. We therefore believe the market changes mean that no adjustment is required to the base estimate.
- 1.3 Our benchmarking of the commercial element yields an adjusted rate of £3,450/m² compared to the Applicant's £3,420/m² (before the inflation adjustment). We are therefore satisfied that the Applicant's commercial costs are reasonable.
- 1.4 Our benchmarking of the residential element yields an adjusted rate of £2,612/m² compared to the Applicant's £2,601/m² (before the inflation adjustment). We are therefore satisfied that the Applicant's commercial costs are reasonable.
- 1.5 Option 5 (scenario 1) is the refurbishment of the existing building. The GIA is 235,051ft² (21,837m²). The scenario testing allows for a light refurbishment cost of £26,400,000 (£1,209/m²). The refurbishment states an allowance for repair and re-use of existing cladding. There is no detailed costing and therefore no detail of specification that might be included in the estimated costs. We query how practical a light refurbishment will be in providing a building to satisfy market requirements; the services will need upgrading or more likely replacement to satisfy modern expectations; existing glazing will not provide the modern glazing specifications that may be designed to support the climate control of the building environment. We have determined an estimated cost from a BCIS location adjusted refurbishment rate for an air conditioned office building with a 10% allowance for contingencies of £31,700,000 (£1,452/m²). We consider this a realistic estimate of cost for refurbishment of the building to a reasonable but nevertheless moderate or mid-range specification.

2 METHODOLOGY

- 2.1 The objective of the review of the construction cost element of the assessment of economic viability is to benchmark the Applicant's costs against RICS Building Cost Information Service (BCIS) average costs. We use BCIS costs for benchmarking because it is a national and independent database. Many companies prefer to

benchmark against their own data which they often treat as confidential. Whilst this is understandable as an internal exercise, in our view it is insufficiently robust as a tool for assessing viability compared to benchmarking against BCIS.

- 2.2 BCIS average costs are provided at mean, median and upper quartile rates (as well as lowest, lower quartile and highest rates). We generally use mean or occasionally upper quartile for benchmarking. The outcome of the benchmarking is little affected, as BCIS levels are used as a starting point to assess the level of cost and specification enhancement in the scheme on an element by element basis. BCIS also provide a location factor compared to a UK mean of 100; our benchmarking exercise adjusts for the location of the scheme. BCIS Average cost information is available on a default basis which includes all historic data with a weighting for the most recent, or for a selected maximum period ranging from 5 to 40 years. We generally consider both default and maximum 5 year average prices; the latter are more likely to reflect current regulations, specification, technology and market requirements.
- 2.3 BCIS average prices are available on an overall £ per sqm and for new build work on an elemental £ per sqm basis. Rehabilitation/conversion data is available on an overall £ per sqm and on a group element basis ie. substructure, superstructure, finishings, fittings and services - but is not available on an elemental basis. A comparison of the applicants elemental costing compared to BCIS elemental benchmark costs provides a useful insight into any differences in cost. For example: planning and site location requirements may result in a higher than normal cost of external wall and window elements.
- 2.4 If the application scheme is for the conversion, rehabilitation or refurbishment of an existing building, greater difficulty results in checking that the costs are reasonable, and the benchmarking exercise must be undertaken with caution. The elemental split is not available from the BCIS database for rehabilitation work; the new build split may be used instead as a check for some, but certainly not all, elements. Works to existing buildings vary greatly from one building project to the next. Verification of costs is helped greatly if the cost plan is itemised in reasonable detail thus describing the content and extent of works proposed.
- 2.5 BCIS costs are available on a quarterly basis - the most recent quarters use forecast figures, the older quarters are firm. If any estimates require adjustment on a time basis we use the BCIS all-in Tender Price Index (TPI).
- 2.6 BCIS average costs are available for different categories of buildings such as flats, houses, offices, shops, hotels, schools etc. The Applicant's cost plan should ideally keep the estimates for different categories separate to assist more accurate benchmarking. However if the Applicant's cost plan does not distinguish different categories we may calculate a blended BCIS average rate for benchmarking based on the different constituent areas of the overall GIA.
- 2.7 To undertake the benchmarking we require a cost plan prepared by the applicant; for preference in reasonable detail. Ideally the cost plan should be prepared in BCIS elements. We usually have to undertake some degree of analysis and rearrangement before the applicant's elemental costs can be compared to BCIS elemental benchmark figures. If a further level of detail is available showing the build-up to the elemental totals it facilitates the review of specification and cost allowances in determining adjustments to benchmark levels. An example might be

fittings that show an allowance for kitchen fittings, bedroom wardrobes etc that is in excess of a normal BCIS benchmark allowance.

- 2.8 To assist in reviewing the estimate we require drawings and (if available) specifications. Also any other reports that may have a bearing on the costs. These are often listed as having being used in the preparation of the estimate. If not provided we frequently download additional material from the documents made available from the planning website.
- 2.9 BCIS average prices per sqm include overheads and profit (OHP) and preliminaries costs. BCIS elemental costs include OHP but not preliminaries. Nor do average prices per sqm or elemental costs include for external services and external works costs. Demolitions and site preparation are excluded from all BCIS costs. We consider the Applicants detailed cost plan to determine what, if any, abnormal and other costs can properly be considered as reasonable. We prepare an adjusted benchmark figure allowing for any costs which we consider can reasonably be taken into account before reaching a conclusion on the applicant's cost estimate.
- 2.10 We undertake this adjusted benchmarking by determining the appropriate location adjusted BCIS average rate as a starting point for the adjustment of abnormal and enhanced costs. We review the elemental analysis of the cost plan on an element by element basis and compare the Applicants total to the BCIS element total. If there is a difference, and the information is available, we review the more detailed build-up of information considering the specification and rates to determine if the additional cost appears justified. If it is, then the calculation may be the difference between the cost plan elemental £/m² and the equivalent BCIS rate. We may also make a partial adjustment if in our opinion this is appropriate. The BCIS elemental rates are inclusive of OHP but exclude preliminaries. If the Applicant's costings add preliminaries and OHP at the end of the estimate (as most typically do) we add these to the adjustment amounts to provide a comparable figure to the Applicant's cost estimate. The results of the elemental analysis and BCIS benchmarking are generally issued as a PDF but upon request can be provided as an Excel spreadsheet.

3 GENERAL REVIEW

- 3.1 We have been provided with and relied upon the Viability Submission dated 21.6.16 issued by Montagu Evans, the Strutt & Parker letter dated 23.5.16, summary tables of the five development options, comparison costs of Finsbury Tower with South Bank Tower dated 27.7.16 issued by Arcadis and a further cost breakdown/elemental cost plan dated 5.8.16 issued by Arcadis.
- 3.2 The building for option 1 is a 12 storey vertical extension of the existing 17 storey office building - 29 storeys in total. The Affordable residential block comprises 6 stories of residential above a basement and lower ground of affordable B1 - 8 storeys in total.
- 3.3 The Arcadis costs from Appendix 4 of the Viability Submission are given for options 1 to 5. We have considered option 5 in paragraph 3.15 below. This report otherwise considers option 1 - the vertical extension of +12 storeys commercial cost £130,373,000 and residential cost £6,777,000. The residential costs for options 1 to 4 are the same and our comments relating to residential costs below are applicable to all these options. We have not considered separately the

- commercial costs for options 2, 3 and 4 but as the estimates have a common derivation we would expect our conclusions to remain unchanged from those for option 1.
- 3.4 The estimate includes for the provision of 4 twin lifts, we understand this is a design solution for vertical transport constrained by limited floor space, but as there is only one supplier for this product the cost of £960,000 per twin lift equivalent to £480,000 per single lift is a high cost that cannot be tested by competitive tender. We have allowed for this higher cost in our adjusted benchmarking.
- 3.5 The cost plan is on a current day basis with an inflation update to 2Q2016. Our benchmarking uses current BCIS data which is on a current tender firm price basis.
- 3.6 The cost plan includes an allowance of 12.5% for preliminaries. The allowance for overheads and profit (OHP) is 5%; we consider both of these allowances reasonable. The allowance for contingencies is 5% which we consider reasonable.
- 3.7 An adjustment of £3,450,000 has been made for inflation to 2Q2016 calculated at 2.72%. The base date of the estimate before the inflation adjustment has not been stated. The current forecast all-in BCIS TPI for 4Q15, 1Q16 and 2Q16 is unchanged at 274. The TPI for the current quarter 3Q16 is 273. The forecast TPIs earlier this year were above this level but the market changes leading to the EU referendum and the result have caused significant reductions in the forecast levels. We therefore believe the market changes mean that no adjustment is required to the base estimate.
- 3.8 The residential units all intended as affordable with no market sale. Specifications of the cost plan are intended on this basis.
- 3.9 We have downloaded current BCIS data for benchmarking purposes including a Location Factor for Islington of 125 that has been applied in our benchmarking calculations.
- 3.10 Refer to our “Elemental analysis and BCIS benchmarking”, below.
- 3.11 The proposed development comprising vertical extension of the building and refurbishment of the existing space plus a new build 8 storey block for affordable residential with some affordable B1 is an uncommon form. Arcadis have used a similar project (South Bank Tower) that has been procured and is under construction to inform their estimate and we have been provided with details of the costs used.
- 3.12 We consider the BCIS average rate for 6+ storey flats to be the most appropriate for benchmarking the residential element; and the average rate for offices generally vertical extension as an appropriate base rate for benchmarking the commercial element.
- 3.13 Our benchmarking of the commercial element yields an adjusted rate of £3,450/m² compared to the Applicant’s £3,420/m² (before the inflation adjustment). We are therefore satisfied that the Applicant’s commercial costs are reasonable.

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- 3.14 Our benchmarking of the residential element yields an adjusted rate of £2,612/m² compared to the Applicant's £2,601/m² (before the inflation adjustment). We are therefore satisfied that the Applicant's commercial costs are reasonable.
- 3.15 Option 5 (scenario 1) is the refurbishment of the existing building. The GIA is 235,051ft² (21,837m²). The scenario testing allows for a light refurbishment cost of £26,400,000 (£1,209/m²). The refurbishment states an allowance for repair and re-use of existing cladding. There is no detailed costing and therefore no detail of specification that might be included in the estimated costs. We query how practical a light refurbishment will be in providing a building to satisfy market requirements; the services will need upgrading or more likely replacement to satisfy modern expectations; existing glazing will not provide the modern glazing specifications that may be designed to support the climate control of the building environment. We have determined an estimated cost from a BCIS location adjusted refurbishment rate for an air conditioned office building with a 10% allowance for contingencies of £31,700,000 (£1,452/m²). We consider this a realistic estimate of cost for refurbishment of the building to a reasonable but nevertheless moderate or mid-range specification.

Finsbury Tower, Bunhill Row ECLY 8TG
Elemental analysis & BCIS benchmarking

	Commercial						Residential				Total		BCIS new build mean rates			
	Commercial		Residential		Total		Commercial		Residential		Total		Commercial	Residential	Commercial	Residential
	£	£/m ²	£	£/m ²	£	£/m ²	£/m ²	£/m ²	£/m ²	£/m ²	£/m ²	£/m ²	£/m ²	£/m ²	£/m ²	£/m ²
	37,109		2,536		39,645		LF100	LF125	LF100	LF125						
	5,144,275		5,144,275		5,144,275											
Demolitions		139				130										
1 Substructure	3,574,275	96	659,000	260	4,233,275	107	119	149	117	146						
2A Frame, upper floors & roof	19,304,275	520	546,000	215	19,850,275	501	105	131	98	123						
2B Upper Floors	inc		inc		inc		52	65	68	85						
2C Roof	1,374,275	37	136,000	54	1,510,275	38	94	118	77	96						
2D Stairs	inc		inc		inc		32	40	26	33						
2E External Walls	18,804,275	507	990,000	390	19,794,275	499	158	198	150	188						
2F Windows & External Doors	inc		inc		inc		90	113	75	94						
2G Internal Walls & Partitions	1,744,275	47	246,000	97	1,990,275	50	48	60	53	66						
2H Internal Doors	979,275	26	136,000	54	1,115,275	28	29	36	44	55						
2 Superstructure	42,206,375	1,137	2,054,000	810	44,260,375	1,116	608	760	591	739						
3A Wall Finishes	2,147,275	58	136,000	54	2,283,275	58	33	41	63	79						
3B Floor Finishes	2,286,275	62	191,000	75	2,477,275	62	60	75	51	64						
3C Ceiling Finishes	1,517,275	41	82,000	32	1,599,275	40	29	36	31	39						
3 Internal Finishes	5,950,825	160	409,000	161	6,359,825	160	122	153	145	181						
4 Fittings	1,986,275	54	355,000	140	2,341,275	59	25	31	48	60						
5A Sanitary Appliances							12	15	24	30						
5B Services Equipment (kitchen, laundry)							12	15	17	21						
5C Disposal Installations	1,196,000	32			1,196,000	30	10	13	11	14						
5D Water Installations	1,195,000	32	1,365,000	538	2,560,000	65	20	25	26	33						
5E Heat Source	443,000	12			443,000	11	35	44	46	58						
5F Space Heating & Air Treatment	8,442,000	227			8,442,000	213	137	171	88	110						
5G Ventilating Systems	5,629,000	152			5,629,000	142	44	55	16	20						
5H Electrical Installations (power, lighting, emergency lighting, stand by generator, UPS)	9,189,000	248			9,189,000	232	133	166	73	91						
5I Gas Installations	217,000	6			217,000	5	3	4	6	8						
5J Lift Installations & escalators	6,144,000	166	100,000	39	6,244,000	157	29	36	31	39						
5K Protective Installations (fire fighting, dry & wet risers, sprinklers, lightning protection)	1,757,000	47			1,757,000	44	14	18	8	10						
5L Communication Installations (burglar, panic alarm, fire alarm, CCTV, door entry, public address, data cabling, tv/satellite, telecommunication systems, leak detection, induction loop)	2,646,000	71			2,646,000	67	25	31	20	25						
5M Special Installations - (window cleaning, BMS, medical gas)	2,891,000	78			2,891,000	73	20	25	31	39						
5N BWIC with Services	664,300	18	50,000	20	714,300	18	14	18	11	14						
5O Design Development/risk/BREEAM/ carbon reduction	500,125	13			500,125	13	8	10	7	9						
5 Services	40,913,425	1,103	1,515,000	597	42,428,425	1,070	516	645	415	519						
6A Site Works	1,294,275	35	191,000	75	1,485,275	37										
6B Drainage																
6C External Services	684,275	18	136,000	54	820,275	21										
6D Minor Building Works																
6 External Works	1,978,550	53	327,000	129	2,305,550	58										
SUB TOTAL	101,754,000	2,742	5,319,000	2,097	107,073,000	2,701	1,390	1,738	1,316	1,645						
7 Preliminaries 12.5%	12,719,000	343	665,000	262	13,384,000	338		217		206						
Overheads & Profit 5.03%	5,756,000	155	299,000	118	6,055,000	153										
Pre-Construction Services Agreement (PCSA) 0.54%	650,000	18			650,000	16										
SUB TOTAL	120,879,000	3,257	6,283,000	2,478	127,162,000	3,208		1,955		1,851						
Design Development risks																
Construction risks 5%	6,044,000	163	314,000	124	6,358,000	160										
Employer change risks																
Employer other risks																
SUB TOTAL	126,923,000	3,420	6,597,000	2,601	133,520,000	3,368										
Inflation to 2Q2016 2.72%	3,450,000	93	180,000	71	3,630,000	92										
TOTAL	130,373,000	3,513	6,777,000	2,672	137,150,000	3,459										
check	3,513															
Bench marking		2,109		1,978												
Add demolitions	139															
Add external works	53		129													
Add additional cost of substructure			114													
Add additional cost of frame, upper floors, stairs	284															
Add additional cost of ext walls & windows	197		109													
Add additional cost of fittings	22		80													
Add additional cost of space heating and air treatment	90															
Add additional cost of electrical installations	81															
Add additional cost of lift installations	129															
	996		432													
Add prelims @ 12.5%	125		54													
Add OHP @ 5.03%	56	1,177	24	510												
		3,286		2,488												
Add contingency @ 5%		164		124												
Total adjusted benchmark		3,450		2,612												

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Date: 17th August 2016

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