Finsbury Tower

Independent Viability Review - ADDENDUM REPORT

Prepared on behalf of the London Borough of Islington

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Introduction

1.1 This addendum report is supplemental to our August 2016 Viability Review in respect of a proposal by Hermes Investment Management to redevelop Finsbury Tower. This addendum is in response to a Note by Montagu Evans, dated 28th September 2016, which comments upon our Viability Review and makes some changes to their viability assessment in response to our review's findings. Their Note also makes adjustments to reflect the changes to the scheme that have occurred since our August report. These have an impact on viability, thus we have reviewed these changes to determine whether they impact upon our August conclusions. The changes to the scheme are:

- Architectural amendments due to the response from the Design Review Panel. There has been a triangular wedge cut off the South East corner of the new part of the tower, over 12 floors. There has also been further articulation at the top of the building which loses additional floorspace on the top two levels.

- Affordable workspace previously located in the basement of the affordable housing block has been removed (replaced with full market rented floorspace).

- The affordable workspace to be provided in the Podium will be provided at a peppercorn rent in perpetuity. This was previously only at a peppercorn for 10 years, after which it would revert to full market rents.

1.2 We discuss below how these changes have impacted on viability, and provide an update to our conclusions.

Updated appraisal results & conclusions

1.3 The refurbishment scheme generated a residual value of £76,767,535, which was adopted as the Benchmark Land Value. The results of the appraisals were:

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

1.4 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.

1.5 The residual land value generated by the 12 storey appraisal was £76.63m. Following the recent changes to the scheme, this has reduced substantially, to £61.87m.

1.6 With respect to the benchmark land value of £76,767,535, this has been reduced by Montagu Evans to £67.66m, which is the revised residual value of the benchmark (refurbishment) scheme. This change is due to the increase in the yield from 5.0% to 5.5%, which brings it into line with the yield we suggested in our July 2016 report.

1.7 The latest £61.87m residual value of the 12 storey scheme, when compared to the latest benchmark of £67.66m, shows this scenario to be in deficit by £5.79m.

1.8 Montagu Evans has not made our suggested change to the developer's profit applied to the refurbishment appraisal. This change from 15.0% to 12.5% profit on Net Development Value obviously has the effect of increasing the benchmark scheme's residual value and thereby worsening the proposed scheme's viability, therefore if Montagu Evans were to adopt 12.5% it would only serve to further increase the £5.79m deficit shown by the 12 storey scheme.

1.9 The reduction in office floorspace has impacted on scheme viability and altered our conclusions. We now concur that the 12 storey scenario generates a viability deficit, based on present day costs and values, therefore our suggested reduction to the height of the extension to 11 storeys can no longer be justified on viability grounds.

1.10 In line with the Islington Development Viability SPD, applicants will be required to demonstrate the deliverability of the benefits of the scheme, in particular affordable workspace and affordable housing. As such, further testing will be required such as considering the scheme on a growth basis, and other measures such as providing a declaration that the scheme is capable of being delivered; and evidence of any contractual arrangements for the delivery of affordable housing and/ or affordable workspace. When considering the use of a growth model, we have had regard to RICS Guidance Note *Financial Viability in Planning* which states *in para 3.6.5.1-2*:

"An alternative approach to the reappraisal approach (and current day appraisals) is the use of projection models. In more volatile market conditions, many planning applications may not be viable for the schemes proposed using present-day values and costs. This reflects a variety of factors that would include the relationship of likely end values to the costs of building the scheme. Inevitably, when such schemes go forward for discussion with the LPA, applicants may look at growth models (see Appendix D) and the likelihood of the proposed development becoming viable over the short to medium term, with the acceptance that it may not be currently viable. This is normally more relevant to large schemes to be built over the medium to longer term than for short term projects."

"Current day methodologies, for large schemes of a medium to longer term build out duration, may at times give the LPA cause for concern as the case is made that the site is not currently viable. As a result they may not achieve the desired outturn in terms of planning obligations, etc. The principle and application of projection models is for sites that are non-viable today but where the likelihood is that development would occur at some future date in the life of a planning permission, or where the development is likely to be over a sufficiently long period of time during which the market conditions may vary."

1.11 The duration of the 12 storey scheme is 55 months (just over 4.5 years), therefore there is strong potential for growth in office rents over this period, which may serve to eliminate the scheme's viability deficit. There is therefore a good argument for adopting a growth-model approach in this case, especially given the strong rental growth achieved in the City Fringe market in recent years. Moreover, the development period is longer for the proposed scheme than for the refurbishment (benchmark) scheme, allowing a longer period over which rents can grow.

1.12 The application of growth to the appraisal would likely be more consistent with the approach of the purchaser, CIT group, which paid £106m for the site – considerably over the residual land value that is generated by Montagu Evans' 'present day' appraisals.

Office values

1.13 The changes in office floorspace have led to changes to the overall GDV of the offices. These changes have been reflected in the appraisal, and we can confirm that these adjustments have been correctly made by Montagu Evans.

Affordable workspace

1.14 The current affordable workspace has a nil value in the latest appraisal, which is a correct approach as it has a nil (peppercorn) rent in perpetuity. We are therefore satisfied with this element of the valuation, and understand that Planning Officers consider this affordable workspace offer to be policy compliant.

1.15 There were, in the previous appraisal, 7,481 sq ft (NIA) of affordable workspace at a peppercorn rent in perpetuity, and 7,750 sq ft (NIA) at a peppercorn rent for 10 years, reverting to open market rent thereafter. The space that was at a peppercorn in perpetuity was located in the basement of the affordable housing block, which has since been removed as the Council deem this basement to be unsuited to office use; this basement will now, we understand, accommodate plant and other facilities, thus will not generate any value.

1.16 For the new appraisal, there is 8,590 sq ft (NIA) of affordable workspace, which is entirely on the 1st floor. This is a substantial loss in value to the developer, as there was previously £6.0m of Gross Development Value generated by the affordable workspace.

Build costs

1.17 Build costs have altered slightly as a result of the area changes. However, the overall rate per sq ft – which was agreed by our Cost Consulant, Neil Powling, has remained unchanged, and we remain of the view that the costs are reasonable.

Sensitivity testing – adjustments to affordable workspace

1.18 Montagu Evans have suggested two ways in which the viability deficit could be eliminated:

One way for this deficit to be eroded would be for the workspace to be rentalised (albeit at a reduction to the agreed market rent for this 1st floor space of £60.50 per sq ft). Adopting the agreed 4.50% capitalisation yield, our calculations show that a capital receipt from this space of £10,150,000 would be sufficient for the 12-storey scheme to break even. This capital value could be achieved were a rent *of £53.17 per sq ft applied across the affordable workspace, representing 88% of the agreed market rental value.*

Another way to erode the £6.0m deficit would be to maintain the affordable workspace at a peppercorn in perpetuity, but to add additional market floorspace. We have calculated that an additional 6,633 sq ft NIA at the highest agreed rental bracket of £80.00 per sq ft would be sufficient for the scheme to breakeven.

1.19 The above adjustments have been demonstrated by Montagu Evans in the appendices of their Note of 28th September, and we can confirm that these adjustments have been correctly applied. It is, however, not clear whether the applicant intends to make one of these changes, or whether instead it intends to provide the 8,590 sqft of affordable workspace (all at a peppercorn in perpetuity) that is included in Montagu Evans' latest development appraisal.

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