37-47 Wharf Road, London, N1 7RJ

Independent Review of Assessment of Viability

1.0 INTRODUCTION

1.1 BPS Chartered Surveyors has been instructed by the London Borough of Islington to review a development appraisal that has been provided by the Doug Birt Consulting (DBC) on behalf of the applicant, Family Mosaic, in respect of a proposed residential development on land at 37-47 Wharf Road, N1 JRJ. This development appraisal has been supported by a detailed Valuation Report from GL Hearn which estimates key cost and value inputs.

1.2 The Council owns one-third of the site while the Canal & River Trust owns the remainder. The agreed purchase price for the site is [redacted]m, and is subject to an overage agreement whereby 50% of any private sales revenues over £[redacted] per sqft (£[redacted] per sqm) are to be paid to the vendors. We have not been provided with details concerning how the proceeds will be divided between the two owners, the Council and the Canal & River Trust.

1.3 The site is located in close proximity to City Road and the City Road Basin canal. It is bounded by Wharf Road to the east, City Road Basin to the west, existing residential properties to the north and a 3-5 storey electricity substation to the south. It is designated for residential-led development in the Finsbury Local Plan.

1.4 The site is roughly rectangular and has an area of 0.255 Ha. It is partially cleared but still includes some 1-2 storey disused industrial sheds which are thought to date from the 1950s and to have originally been used as packing factories. The most recent use was as warehousing.

1.5 The residential land to the north comprises a low- to -mid-rise social housing estate that is owned by the Council, which was constructed in the 1990s. Opposite the subject site, on the east side of Wharf Road, is a residential scheme known as the Wenlock Building which has replaced the previous warehousing. Family Mosaic recently completed Papyrus House which is in close proximity and like the subject site is adjacent to the City Road Basin.

1.6 The proposed scheme will provide 99 residential units of which 81% will be affordable housing by unit number and the remainder private housing. The affordable housing will be comprised of 80% Social Rented and 20% Shared Ownership units. The scheme will consist of 5 houses, 38 maisonettes and duplexes and 56 flats, which are all in line with the London Housing Design Guide in respect of dwelling sizes.

1.7 The proposed scheme will exceed the Council's affordable housing target of 50% by unit as required by Core Strategy Policy CS12. It is also providing a higher proportion of Social Rented units than the 70% target set by policy CS12. This level of provision is in part being supported by Recycled Capital Grant Funding of £800,000, which has been included within the appraisal.

1.8 DBC's viability assessment concludes that the current level of 81% affordable housing provision, together with planning contributions of £107,250 towards Mayoral CIL and £1.3m of Section 106 contributions, is the maximum level of contributions towards planning obligations the scheme can provide. Whilst the scheme exceeds the affordable housing target of 50%, we have nevertheless sought to establish whether the current level of provision is the maximum that Family Mosaic can viably provide.

2.0 CONCLUSIONS & RECOMMENDATIONS

2.1 Following our review of the viability assessment including its costs and value inputs, we are now satisfied that the applicant cannot viably deliver any additional affordable housing or payments towards planning obligations. The profit generated by the scheme is below typical levels required by developers, who typically require a profit level of 18-20% on private sales revenue (GDV), in contrast to the 7.2% profit shown in the development appraisal.

2.2 The development appraisal for the proposed scheme generates a residual site value of £[redacted]m once all costs have been deducted including a developer's profit of 7.2% on GDV for the private market housing. This residual value is in line with the agreed purchase price of £[redacted]m.

2.3 If a 20% profit on private market GDV were to be adopted instead, the residual site value would fall to £[redacted] which would render the scheme unviable with a substantial deficit of -£[redacted]m when the scheme is benchmarked against the £[redacted]m purchase price.

2.4 The appraisal does not include the overage payment as a scheme cost. Based on the current appraisal which includes average sales values of £[redacted] per sqft, the required overage payment would be £[redacted]. Therefore this payment (together with associated finance costs) if accounted for in the appraisal would further reduce the profit generated.

2.5 It is likely that sales growth in the near future will improve viability and result in a higher profit being generated. This eventuality has been addressed by the Council as vendor in its overage agreement with Family Mosaic.

2.6 From the vendors' perspective, the current appraisal indicates that £[redacted]m plus the current level of overage payment (£[redacted]) indicated by the scheme values – thus an effective land receipt of £[redacted]. A payment of £[redacted]m is somewhat higher than can be justified based on present-day build costs and sales values (and based on typical profit requirements of 18-20% on private GDV) although with predicted sales value growth this discrepancy would likely be overcome.

2.7 We summarise below our conclusions regarding some of the key appraisal inputs:

<u>Private Sales Values</u>

2.8 Sales values for the private units are based on a December 2013 valuation by GL Hearn thus could in our view be increased marginally to reflect recent sales growth and recently achieved values at nearby new-build schemes that we have reviewed.

2.9 We do however accept that the private market units' situation within a predominantly affordable housing scheme is likely to constrain values, but there is uncertainty over the extent to which this will constrain values and we consider that there is a potential for higher values to be achieved, especially for the upper floor apartments. The impact on viability of an increase in values would in any case be suitably addressed by the overage agreement.

2.10 By increasing the market values by, for example, 5%, this results in an increase in the residual value by £825,000, which is equivalent to an increase in profits from 7.2% to 11% on GDV, although this is clearly considerably lower than the typical target profit level of 18-20%.

Build Costs

2.11 We have not been provided with a detailed cost plan, so have only undertaken a summary comparison of the scheme costs against BCIS rates. This comparison suggests that the costs are broadly reasonable.

Affordable Housing Values

2.12 The affordable housing has been valued by Family Mosaic. We have undertaken our own modelling which uses assumptions typically used affordable housing valuations, including in respect of capitalisation rates (yield) and management costs, and the results suggest that Family Mosaic's values are somewhat high relative to the market as a whole. Thus we are satisfied that the affordable housing is not undervalued.

Planning contributions

2.13 The £1.3m contribution included in DBC's appraisal is inclusive of Islington CIL and S106 Contributions. This figure was arrived at as part of the land deal, such that Mosaic will also be required to pay 50% of any 'planning shortfall sum' to the vendors, this shortfall being defined as the amount by which the contribution toward planning obligations (i.e. S106 and CIL) falls below £1.3m.

2.14 The appraisal also includes Mayoral CIL of £107,000. Planning officers have calculated the required Mayoral CIL payment as £107,681 and Islington CIL payment as £536,000, which assumes that the buildings on site have been not been continuously occupied for a six month period over the last 3 years. Details of the occupancy history of the buildings have been requested from the applicant. The S106 Contribution is calculated by planning officers at £54,900, and in addition there will be a carbon offset payment of either £135,240 or £157,320 (depending on whether the preferred or secondary energy strategy is adopted). Therefore the total contribution based on these calculations will be a maximum of £855,901. This calculation is provisional and may be subject to amendment once other planning matters have been considered further as these matters may have implications for the level of S106 contributions that will be required.

2.15 The total payment of £855,901 contrasts with the £1,407,681 towards planning contributions in DBC's appraisal. From a viability point of view, however, if these contributions are in actuality £855,901, this would trigger a £222,049 payment (50% of the shortfall) to the vendor to make up for the 'planning shortfall sum' (see para 2.13); therefore the total payments by the applicant would only be £222,049 lower than is shown in DBC's appraisal which does not materially impact on our above conclusions concerning scheme viability.

3.0 SALES VALUES

3.1 The scheme has a number of advantages including its proximity to the City Road Basin which may be an attractive feature for buyers, and that it is sufficiently set back from City Road to limit traffic noise. Moreover, nearby developments including the Wenlock Building (18-42 Wharf Road) to the east and the Canaletto tower to the west (on opposite side of the Basin) indicates marked improvement and regeneration of this area especially as a residential location.

3.2 The units will either have the benefit of private balconies, terraces or gardens. The development will be car free, with the exception of provision of disabled spaces if required. The lack of parking may constrain private sales especially for the 3-bed, family units which make up the majority of the market units as shown in the table below:

Unit mix for proposed scheme

	Market Sale		Intermediate		Social Rent		Totals	
	Units	Hab Room	Units	Hab Room	Units	Hab Room	Units	Hab Room
1 bed	5	10	10	20	4	8	19	38
2 bed	4	12	6	18	40	120	50	150
3 bed	10	50	-	-	14	70	24	120
4 bed	-		-	-	6	36	6	36
Totals	19	72	16	38	64	234	99	344
%	19%	21%	16%	11%	65%	68%		

3.3 The private housing will be in the block facing the road, which will be shared with social rented apartments. The private units are on the fourth (i.e. level 5), fifth and sixth floors of Block A. They will take up part of the fourth floor (with the remainder of this floor to be social housing) and the entire fifth and sixth floor. Whilst the scheme will be tenure blind externally, there is nevertheless the likelihood that the close proximity to social housing will influence buyer perceptions and thus constrain private sales values. This suggests that the values will not compete with those of comparable all-private schemes.

3.4 Block A's plans show three separate cores thus we assume that the private units will not share a core with the affordable units, which will minimise the impact of having a mixed tenure building including in respect of achievable private sales values and property management issues such as service charges.

3.5 The units on the upper two floors of Block A will be duplexes with the benefit of large outdoor terraces. The top floor is set back from the main facade to give a penthouse style design, thus there is the potential for these units to attract premium values. We note, for example, values at a nearby proposed scheme we have recently reviewed where penthouse values were £2.35m and £2.45m equivalent to £11,808 sq m(£1,097 Sq ft) and £11,560 sqm (£1,074 per sq ft). Penthouse values are highly sensitive to location, the prestige of the scheme they are within and the level of services provided including whether concierge services are offered. Taking these factors into account we do not consider that values higher than those estimated by GL Hearn for the upper floor flats (£[redacted]) can be justified based on current evidence.

3.6 The private units are valued at £[redacted]m by GL Hearn. The values applied to the individual units in DBC's appraisal are as follows:

• 4 x 1 bed flats @ 51 sqm [redacted]
• 1 x 1 bed flat @ 53 sqm [redacted]
• 1 x 2 bed flat @ 71 sqm [redacted]
• 1 x 2 bed flat @ 76 sqm [redacted]
• 1 x 2 bed flat @ 77 sqm [redacted]
• 1 x 2 bed flat @ 78 sqm [redacted]
• 1 x 3 bed flat @ 120 sqm [redacted]
• 1 x 3 bed flat @ 130 sqm [redacted]
• 1 x 3 bed flat @ 142 sqm [redacted]
• 1 x 3 bed flat @ 152 sqm [redacted]
• 1 x 3 bed flat @ 155 sqm [redacted]
• 1 x 3 bed flat @ 156 sqm [redacted]
• 1 x 3 bed flat @ 160 sqm [redacted]
• 1 x 3 bed flat @ 161 sqm [redacted]
• 1 x 3 bed flat @ 193 sqm [redacted]
• 1 x 3 bed flat @ 217 sqm [redacted]

3.7 We have analysed these values by unit type as below:

- 3-beds £[redacted]m to £[redacted]m
- 2-beds £[redacted] to £[redacted]
- 1-beds £[redacted]

3.8 The values per sqft are detailed in the following table:

[Table redacted]

3.9 We have compared the average value of £[redacted] per sqft (£[redacted] per sqm) to values at other schemes nearby, which are summarised below. These comparable schemes suggest that marginally higher values could potentially be achieved at the subject site even allowing for the negative impact of affordable housing, especially once recent sales growth is taken into account. The date of GL Hearn's sales valuation is December 2013 and the comparable evidence cited is from Q4 2013 and earlier, and is predominantly sales of secondhand units.

Table 3: Summary of average values

	Average values per sq ft (March 2014)	Average values per sq ft (pre-March 2013)
Art House	**£1,356**	**£930**
Canaletto	**£1,170**	**£1,000**
Central Square	**£1,420**	**£800**
Eagle House	**£1,121**	**£900**

3.10 Canaletto is in very close proximity to the proposed scheme. Whilst this is a high rise scheme that is likely on average to achieve higher values per sqft than the subject site, it is nevertheless useful for comparison.

3.11 Central Square is located to south-east, on City Road. This is a highly comparable location. The proposed units arguably are in a superior location as have the benefit of proximity to the canal.

3.12 Whilst the schemes in the table above are all arguably superior in terms of the private housing provided, it is nevertheless questionable whether such a large differential in values is suitable between these and the proposed scheme.

3.13 The comparable evidence provided by GL Hearn, including sales at the nearby Banyan Wharf and Wenlock Building, show that values significantly exceeding £1,000 per sqft can be achieved in this locality. However, many of the units in the proposed scheme are very large with the largest ones being 160-217 sqm, thus these are unlikely to achieve high levels in terms of capital values per sqft.

3.14 GL Hearn cites values of £1,107 per sqft for the nearby Lexicon scheme at 261 City Road, and Banyan Wharf at 17-21 Wenlock Road is £1,115 per sqft. The values at the subject site are considered to be likely to achieve lower values due to the proximity to social housing as the scheme is 81% affordable, although the extent of the impact of proximity to social housing depends on how separated the private units are and whether the design is tenure blind. Moreover, it is typical in Central London to have high valued housing in relatively close proximity to affordable housing.

3.15 The values average £[redacted] per sqft in the appraisal but £[redacted] per sqft in GL Hearn's valuation report, the reason for this difference being that the unit mix has changed since the date of GL Hearn's report such that the 1-beds and 2-beds have been replaced by 3-bed, resulting in a reduction in values per sqft.

3.16 Sales values have increased by 8.8% since December for the borough of Islington according to the Land Registry House Price Index. We therefore suggest that this is a minimum increase required to bring the values into line with the present day market and to reflect the markedly higher value that are being achieved locally in recent months.

4.0 AFFORDABLE HOUSING VALUES

4.1 Family Mosaic has valued the 16 shared ownership units at £[redacted], or an average of £[redacted] each, which assumes a 25% initial equity share and then an additional 30% of the equity purchased after 10 years with a 2% rent on the unsold equity. We have applied these assumptions in our own appraisal model which and the results suggest that Family Mosaic's values are the higher end of the range we would expect, probably due to it adopting low yields in its financial appraisal.

4.2 Family Mosaic has valued the social rented unit at £[redacted]m for 64 units, averaging £[redacted]. These are set at target levels. These are stated as £147-£155 per week for 2-beds and £164 per week for 3-beds. On request a summary of the appraisals of the affordable housing has been provided but this provides little detail concerning the appraisal assumptions including yield and management costs assumptions.

4.3 The social rent units' values are higher than typical values. For example, using a rental assumption of £164 pw and adopting typical appraisal assumptions in respect of management costs and investment yield, we calculate a value of £144,000. Similarly, for the one-beds at £147 pw we estimate £127,000. This includes cost and rental growth (2.5% per annum) and other assumptions that are based on those used by the Council and which are typical within the market. We are therefore satisfied that the values attributed to the Social Rented units in the viability assessment are not understated.

5.0 BENCHMARK LAND VALUE

5.1 The site has an area of 0.255 Ha, and is partially cleared but still includes some 1-2 storey industrial buildings which are thought to date from 1950s and to have originally been used as packing factories. The most recent use was as warehousing. No existing use valuation has been provided in relation to this extant lawful use.

5.2 GL Hearn's Valuation Report gives an opinion of Market Value for the proposed scheme of £[redacted]m based on a residual valuation of the site assuming the scheme is granted consent. This figure is in line with the price agreed of £6m between the landowners and the applicant. It assumes a 10% profit on GDV for the private units.

5.3 Mosaic will also be required to pay 50% of any 'planning shortfall sum' to the landowner, this shortfall being defined as the amount by which the contribution toward planning obligations (i.e. S106 and CIL) falls below £1.3m. This figure of £1.3m is included in the appraisal so we assume no planning shortfall sum will arise.

5.4 The Contract of Sale states as a condition that the purchaser must provide at least 80% affordable housing of which 80% will be social rent and the remainder shared ownership. This requirement clearly has a major impact on site value relative to a scheme that did not exceed the Council's policy target of 50% affordable housing.

5.5 There is a sales overage such that applicant must pay 50% of proceeds over £[redacted] per sqft. Based on the sales values of £[redacted] per sqft in the appraisal, the overage payment would be £[redacted]m, bring the total land receipt to £[redacted].

6.0 DEVELOPMENT COSTS

6.1 A base build cost of £[redacted]m (£[redacted] per sqm or £[redacted] per sqft) is included the appraisal, based on a cost plan produced by EC Harris based on Q2 2014 prices. We have undertaken a headline comparison of this build cost against BCIS average tender prices.

6.2 To reach a comparable cost rate we have stripped out the Contingency, Externals and Design Fees from EC Harris's build cost estimate. We have based our estimate on the BCIS rate for 6-storey-plus flatted scheme, of £1,408 per sqm to which we have added an additional allowance of £50 per sqm for attaining Code for Sustainable Homes Level 4, based on comparable levels of costs at other schemes. This makes allowance for the renewable energy facilities that will be provided including solar panels.

6.3 After adjusting for an Islington location factor of 1.18 this gives a cost rate of £1,720 sqm. This would be lower however once the rate is adjusted to allow for some of the floorspace being in lower-rise blocks. A higher allowance could be justified for reaching Level 4 bearing in mind the renewable energy facilities that will be provided.

6.4 We have not been provided with a detailed breakdown of the floor areas by block and of the building heights of each block which makes it difficult create a precise BCIS cost estimate given that BCIS costs vary markedly according to the height of buildings.

6.5 Our BCIS estimate give a build cost of £18.9m compared to EC Harris's £[redacted]m – a difference of £[redacted]m which is within an acceptable range. We cannot, however, give further assurance regarding cost levels without further information being provided, specifically a detailed cost plan and a breakdown of the floor areas. But given the scale of the deficit in viability and that the scheme is currently exceeding the affordable housing target, it may be considered to be unnecessary to require additional information.

6.6 Overheads & Profit (OHP) of 5% is included within the build cost which operates as a Contractor's Return thus is any acceptable item to including.

6.7 Professional Fees of 12% and Marketing Fees of 3% are at typical benchmark levels thus we accept these are reasonable.

6.8 The build cost includes Design Fees of 3% which are in addition to the 12% Professional Fees. The Design Fees were included in the base build cost on the assumption of a design & build contract. We consider that the 3% Design Fees of c£630,000 could be removed from the appraisal although in the context of the overall viability position this would be of limited significance. These Fees could however been categorised as a form of contingency which would bring the total contingency to 6%, which is a not unreasonable figure.

BPS Chartered Surveyors
31st July 2014