Independent Viability Review

Application to redevelop Ravensbourne Wharf, Norman Road, Greenwich, SE10 9QF

Prepared on behalf of the Royal Borough of Greenwich

30th September 2019

Planning reference: 18/4530/F

BPS
Chartered Surveyors

1.0 INTRODUCTION

1.1 We have been instructed by the Royal Borough of Greenwich ('the Council') to undertake a viability review in respect of the proposed redevelopment Ravensbourne Wharf under application number 18/4530/F:

"Demolition of existing buildings and construction of a 26 storey building (plus basement) comprising 111 self-contained residential units (Use Class C3), 791sqm of co-working office floorspace (Use Class B1a) and 64sqm of café floorspace (Use Class A3), public realm improvements, hard and soft landscaping, communal amenity space (including child play space), secure cycle storage, car parking spaces and car lift, provision of access for a permanent mooring for public use on Deptford Creek, and other associated works."

1.2 The site is 0.109 Hectares and currently accommodates a mix of uses: workshops, office space, storage space and residential. The site is bounded by Deptford Creek to the west, Brewery Wharf to the north, and Hilton's Wharf to the south, and by Norman Road to the east.

1.3 The applicant, The Edition Group, instructed consultancy ULL to prepare a viability assessment (dated January 2019). This assessment concludes that the applicant's offer of 26% affordable housing (to be delivered as Build to Rent units let at London Living Rents) is the maximum that can reasonably be delivered. This is to be secured for 15 years as affordable housing, following which it will revert to full open market (i.e. 'private') rented housing.

1.4 We have scrutinised the cost and value assumptions that have been used in ULL's development appraisal, in order to determine the level of affordable housing provision that the scheme can viably support – based on present-day costs and values.

1.5 The advice set out in this report is provided in the context of negotiating planning obligations and therefore in accordance with PS1 of the RICS Valuation - Professional Standards (January 2014) (Red Book), the provisions of VPS1 – 4 are not of mandatory application and accordingly this report should not be relied upon as a Red Book Valuation.

1.6 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

Viability results

2.1 In ULL's January 2019 viability assessment, the residual land value generated by the proposed scheme is £1.2m, and the benchmark land value estimated by ULL is £1.77m, which indicates a viability deficit of £0.57m. This appraisal assumes that 26% of the Build to Rent units are affordable housing – capped at London Living Rent levels, for a period of 15 years.

2.2 Following our April 2019 review of ULL's viability assessment, the affordable housing offer has been changed. This now has the affordable housing as affordable in perpetuity (rather than only for 15 years). This is in response to comments made by the Council's planning officers, and the GLA's offers. The latest offer is for 20% affordable housing, as London Living Rent in perpetuity, and this has been accompanied by minor scheme design changes to accommodate the revisions to the unit mix and tenure mix. This offer compares to the 26% London Living Rent that was being offered previously (which was predicated on this only being restricted rents for 15 years). This reduction in overall affordable is necessary to compensate the applicant for the worsening of viability resulting from switching to *in perpetuity* affordable housing – and this is a relatively minor fall in overall affordable housing percentage.

2.3 The latest offer is modelled in ULL's updated viability report (July 2019), which calculates a residual land value of £1.142m which is very similar to the £1.2m in the previous (26% London Living Rent for 15 years) appraisal, and generates a deficit when compared against the benchmark land value of £1.77m. Following our review of the costs and values assumptions within this appraisal we conclude that these are realistic, and are in agreement with the overall conclusion that the applicant's offer maximises affordable housing delivery (based on present-day cost and values). In accordance with the GLA's Affordable Housing SPG, we would recommend that the Council considers putting in place a post-construction viability review in order to capture any improvements in viability. In addition to this, the GLA advises that a clawback should be put in place which would be triggered if the units are sold as conventional private sale at any point with the first 15 years.

2.4 As detailed below, changed the affordable to being *in perpetuity* has a substantial effect on the viability result. In ULL's January 2019 appraisal, the rent on the London Living Rent units jumps from £483,874 to £793,652 due to these units switching to full market tenure. By switching to an arrangement where these units remain as affordable housing in perpetuity, this decreases the *present*-day GDV by £4.76m.

Development Costs

2.5 Our Cost Consultant, Geoffrey Barnett Associates, has undertaken a review of the Stace cost plan and has concluded that its cost estimate is reasonable, based on comparison with BCIS average tender price – adjusted for site specific and scheme specific factors. Their full report is in **appendix one**. The high costs per sqm of delivery high-rise blocks is the primary reason for the scheme's restricted viability performance.

2.6 Other costs inputs into the appraisal, including professional fees, finance costs and sales fees, are all in line with typical benchmark rates.

Development Values

2.7 The estimated capital value for the PRS units, and the affordable units, are realistic and supported by suitable market evidence, including nearby new-build apartments. In addition, the non-residential elements of the proposed scheme have been attributed suitable capital values.

Affordable housing – policy considerations

2.8 As stated above, the affordable housing offer is for London Living Rent units, which was initially proposed by the applicant to be affordable for a period of 15 years, after which they would transition to full open market 'private' rents. This 15 year period matches the minimum period for Build to Rent to remain in this tenure, as required by the Mayor's SPG. After this the units may be disposed of individually for private *sale*, but the Mayor requires such a sale to trigger a clawback:

"Individual homes cannot be sold or the covenant would be broken. This would trigger a 'clawback' review that may result in a payment owed to relevant LPA. While the appropriate covenant length will differ, the minimum covenant length should be 15 years. Given that the market is now maturing, the Mayor expects to see all schemes having a covenant of at least 15 years."

2.9 With respect specifically to affordable housing, the SPG states:

"The clawback does not relate to any affordable units provided as part of the scheme. Affordable units are not subject to a minimum covenant period and must always be secured in perpetuity. Additionally, overall ownership of the building(s) in which the units are located may change during the covenanted period without triggering 'clawback' if the units remain in single ownership and management as Build to Rent."

2.10 This suggests that the applicant should not limit the period of affordable housing to only 15 years. And the delivery of the affordable housing as Discounted Market Rent tenure (at London Living Rents), is endorsed by the SPG:

"*Discounted market rent is also better suited to Build to Rent than other affordable products because units can more easily be tenure blind and "pepper potted" through the development. In addition, some discounted market rented products not let by local authorities/Registered Providers can also qualify for mandatory CIL relief."*

"*Affordable housing tenure: the pathway recognises the need for all homes on the Build to Rent development to stay under single management and as such will encourage affordable homes on the development to be delivered as **discounted***

***market rent (preferably at London Living Rent levels)**, managed by the Build to Rent provider (or possibly via another designated manager)".*

2.11 With respect to the affordable housing *target*, the SPG does not set a specific target for PRS schemes, and states that a fixed target is not suitable owing to the 'distinct economics' of PRS: "*The 'threshold approach' for affordable housing, set out in Part two of this SPG for 'build for sale' developments, would not be applied to Build to Rent developments".*

2.12 And the NPPF does suggest that when affordable housing is provided in PRS schemes, it is acceptable to have Discounted Market Rent as the form of affordable.

2.13 The 'distinct economics' of BTR is highlighted by the SPG, specifically its typical lower value than build for sale. However, recent performance of BTR in London is strong, and in some cases have performed as well as – or even better than – equivalent Build for Sale schemes. And the SPG advises that applicants should "*undertake viability assessments that are specifically designed to deal with this model*" which has been done by ULL thus it can be considered compliant with the GLA's requirements. For example, the SPG states that *"a different approach to profit (Build to Rent schemes often require a lower level of profit compared to 'for sale' schemes)…",* and ULL have adopted a suitable profit level specifically suited to this type of PRS scheme.

2.14 And the SPG states: *"A Late Stage Review will be required for Build to Rent schemes following occupation of at least 75 per cent of the market units within the development or at a date agreed by the LPA at a point when market rents have stabilised. It is expected that in most cases any uplift in affordable accommodation will be accommodated on-site."*

2.15 The Council's own policies set a target of 35% for affordable housing in general. This is detailed in the Council's Planning Obligations SPD, in Policy H3:

"Developments of 10 or more homes or residential sites of 0.5 hectare or more will be required to provide at least 35% affordable housing. The precise percentage, distribution and type of affordable housing will be determined by the particular circumstances and characteristics of the site and of the development, including financial viability."

3.0 BUILD TO RENT CAPITAL VALUES

Private housing - estimate rents

3.1 The rents per week adopted for the full market units are: £358-£404 for one-beds, £427-493 for two-beds, and £600-683 for three-beds. A good selection of comparable evidence has been provided.

3.2 It is common for PRS rents to be higher than conventional rented housing, due to the advantages of Build for Rent, including the longer tenancies being offered, the commonly good quality specification of PRS units, the added value provided for tenants in terms of shared amenity space and facilities/

These are the gross rents. A 25% deduction has been made for operating costs, which we note is a figure put forward by CBRE in their research into the PRS sector, thus this is a an accepted figure.

3.3 We have looked at the local market, including the very nearby development at Faircharm Dock on Creek Road, where availabilities include a two-bed at £392 per week, which is a duplex. This is a new-build development. The Ravensbourne scheme's two beds are substantially higher than this, which can be explained by the higher level of on-site.

3.4 We have been provided with the specification for the apartments, which indicates a relatively high specification (but not completely 'top end') as confirmed by our Cost Consultant. The units will be provided part-furnished. It will have riverside views, especially on the upper floors.

3.5 Other comparables includes a block on Tarves Way where 3 two-beds are available at £381 per week. One of these has a floor area of 625 sq ft (58 sqm) which is much smaller than the proposed scheme's two-beds (80-82 sqm).

3.6 Another is in the Merryweather block on Greenwich High Road, available at £387 per week, which is 781 sq ft. Thus the weekly rent is £0.51 per sq ft. This is very close to the £0.51 per sq ft for a typical mid-level (i.e. 12th floor) 2-bed in the proposed scheme.

3.7 And on the Millennium Quay at Glaisher Street, the modern block (although no brand new) has a two-bed available at £427 per week. The floor area is not provided but we would not expect from the plans for it to be much different from the proposed 2-beds. This unit has river views.

3.8 The Clipper Apartments modern development nearby has a two-bed at £415 per week. This is just to the east of the proposed scheme – in close proximity. It is 729 sq ft. The proposed units' higher rents per week are therefore justified on the basis of their larger size and the superior on-site amenities.

3.9 Looking at the one-beds, these are 54 sq m (581 sq ft) each, and the range of rents per week corresponds with the height of the units – i.e. the upper floors have a premium rent.

3.10 Looking at the Beacon Point availabilities, these include a 2-bed duplex at £380 per week, (which is lower than the unit ULL cites: a 2-bed at £485 per week). It has a balcony as is a reasonable size at 895 sq ft, and good amenities including a 24 hour concierge. It is close to the subject site and close to the Thames, with river views. Another 2-bed is available in Beacon Point at £415 per week. In this context, the pricing adopted by ULL suitably reflects the advantages of the proposed units, including their good specification and views.

3.11 Adagio Point Laban Walk SE83FG has a 3-bed available at £531 per week. This is a 10th floor unit. This is very close to the subject site – on the opposite side of Deptford Creek. The proposed scheme's 3-beds at £600-683 per week are clearly substantially higher than this, which full reflects the proposed scheme's superiority (especially in terms of available amenities.

Affordable housing rents

3.12 As per the guidance of the GLA's SPG, London Living Rents have been applied – which for this Ward (Greenwich West) are:

Beds	Weekly Rent
1	£1,070
2	£1,189
3	£1,308
4	£1,427
5	£1,546

3.13 They have assumed that after 15 years these units will revert to full open market rent levels.

3.14 The PPG (July 2018) states:

"The National Planning Policy Framework states that affordable housing on build to rent schemes should be provided by default in the form of affordable private rent, a class of affordable housing specifically designed for build to rent. Affordable private rent and private market rent units within a development should be managed collectively by a single build to rent landlord.

"20% is generally a suitable benchmark for the level of affordable private rent homes to be provided (<u>and maintained in perpetuity</u>) in any build to rent scheme."

3.15 The PPG makes clear reference to affordable housing within Build for Rent schemes should be affordable in perpetuity. Thus it is not clear where the approach of maintaining these for only 15 years has come from.

Discounted cashflow

3.16 In the January 2019 ULL appraisal, the Discounted Cashflow is initially for only for a period of 15 years. This appears to due to a misreading of the policy which is that the developer must covenant keep the units as PRS for *at least 15 years*, but it does not in our view follow that it should be assumed (for valuation purposes) that PRS use ceases at 15 years or that affordable units revert to full market rents after 15 years.

3.17 The discount rate applied is 3.75% which appears to be a reasonable optimistic rate thus we would not dispute this, especially as it is combined with the addition of 1.25% per annum rental growth (given that the Knight Frank yields factor in growth implicitly. We have referred to the Knight Frank *Private Rented Sector Update 2017* which gives a gross yield of 3.75-4.00% for the Zone 1 Prime, which would be applicable to Greenwich – and which is an 'all risks' figure thus any growth assumptions are implicit. In addition, CBRE's residential property investment yield guide (December 2017) for Zone 2 gives a net yield of 4%.

3.18 We have a preference to an 'all risks yield' approach as this allows for the use of readily available yield evidence and hence pegs the valuation to the market. By contrast, it is unclear how the discount rate compares to the market. In this case however, it is clear that the discount rate adopted is realistic.

3.19 The level of management & maintenance costs is 25% of gross rents, which is reasonable in our experience. We have had reference to Knight Frank's Private Rented Sector Update (January 2016), which assumes a typical discount of 25% to gross rents to reach net rents, which allows for typical levels of costs for maintenance, lettings management, repairs, void periods, insurance, utilities and replacement of fixtures and fittings. In addition, advice we have recently received from the CBRE Residential Capital Markets team regarding operating costs, suggest this same level of deduction.

3.20 If the affordable housing were to remain so in perpetuity, this would, we calculate, reduce the total GDV by £3.50m, thus ULL would likely argue that this would necessitate a reduction to the affordable housing quantum to redress this fall in viability.

3.21 In the January 2019 ULL appraisal, the GDV of the scheme is £22.38m for the first 15 years alone, and £59.41m in perpetuity. It is the latter figure that has been adopted. Post-year 15, the rent on the London Living Rent units jumps from £483,874 to £793,652 due to these units switching to full market tenure. By switching to an arrangement where these units remain as affordable housing in perpetuity, this £0.31m jump gives decrease of *present*-day GDV of £4.76m. We have then estimate the level of reduction in affordable housing that would be required in order to counteract this reduction in GDV. The rents per sq ft for the LLR units are on average 58.3% of the average for the private units.

ITEM NO: 5 (Appendix 6)

4.0 COMMERCIAL USES

4.1 The ground level has two distinct entrances: a triple-height glazed entrance for Ravens Works (co-work users and members of the public) facing Norman Road, and a more private entrance for Ravens Wharf (residents) to the side.

4.2 The triple height foyer in the commercial zone acts an extension of public realm during the day, with a cafe and flexible breakout spaces which can host pop-up events, exhibitions and social events. The café is open for use by co-work users, residents and members of the community, and creates an active frontage along Norman Road. Users will be able to walk through the foyer to access the Creekside where additional seating is provided in the public realm.

4.3 Co-work users can register at the reception to access the day-pass spaces on ground level or the private studios on the floor above, which have security-controlled access. The co-work spaces and cafe will be managed by the workspace operator.

4.4 The rents and yield adopted are as advised by Savills. These are £22-25 per sq ft for the office space, and £15 per sq ft for the retail space. And both have been given a yield of 7.0%. This gives a total capital value of £2.78m for the commercial space, which is a small portion of the overall scheme.

4.5 Comparable evidence includes the Mitre Building at £28 per sq ft for offices. The subject site has good access to the amenities of Greenwich town centre and to the mainline rail and DLR stations. A unit in Deptford Foundry development, to the west of the subject site; it is available at £20,000 per annum (£26 per sq ft) rent, and alternatively for a sale price of £200,000, thus a 10% yield is implied here.

4.6 An office is available at £20.40 per sq ft at Unit 10 Greenwich Quay, which is in very close proximity to the subject site. We have limited detailed regarding this property, but would expect higher rents for the proposed offices given the on-site amenities available.

4.7 Adagio Building, Creek Road, London, SE8 3FJ – offices available at £25 per sq ft. These are in a recently construction building, and have modern facilities including air conditioning. We would expect very similar rents for the subject site, thus ULL's adoption of £25 per sq ft is reasonable – albeit perhaps a marginally higher rent could be secured given the excellent on-site facilities. The Savills economic report outlines the excess demand for office space in the Borough. It is difficult to value this office space given the nearby evidence is convention offices rather than 'co-work' space.

4.8 The offices will clearly be aimed at very small business, start-ups and similar occupiers, thus the covenant strength is likely to be relatively low. This means the yield of 7.0% is arguably justifiable. The lack of co-working space in Greenwich creates an opportunity, but also represents risk and uncertainty in terms of how this space will be received.

4.9 With respect to the retail space, this is £15 per sq ft in ULL's appraisal. The retail space is an A3 café which is located on the ground floor and is in the break-out space thus it is closely linked to the office/co-working area. It will also be open to the public, thus the combination of public use and office occupant use will ensure popularity. We would not expect it to compete in terms of rents/yields with prime cafes such as those in central Greenwich. No comparable lettings evidence has been provided by ULL or Savills.

4.10 The yield for the café is 7.0%. This is a reasonable yield for this type of space, which is not in a prime retail location. It will depend on the success/occupancy levels of the office space, but will also have to compete with the amenities on offer in the centre of Greenwich thus does not fully have the benefit of a 'captive market'. We have had reference to Knight Frank's Yield Guide (May 2017) which gives a yield of 6% for retail in 'Good Secondary' locations. In view of this being a small unit which is within a co-working set-up, it is not conventional space and therefore some additional yield allowance for risk is justified. Comparable units on the market include:

- Sangley Road, Catford, London, SE6 2JT (A3 & A5 Uses) – Café available at £19.80 per sq ft.
- 4 Deptford Broadway, LONDON, SE8 4PA - Café in close proximity to the subject site, and in a similar type of location, just to the south of the subject site. Available at £23 per sq ft.
- Deptford Station Arch 2, Deptford High Street, London, SE8 4NS – Café/restaurant within the arches near Deptford Station.

4.11 The above comparables do suggest that ULL's adopted A3 rents are reasonable.

5.0 BENCHMARK LAND VALUE

5.1 The site is currently occupied by a two to three story brick building, which contains warehouse and office floorspace, accessible from Norman Road. These buildings "*stand in a state of disrepair and are considered to be unattractive elements in the street-scene*". This is a two-/three-storey late 19th century building with later additions, mid-to-late 20th century extensions and modern outbuildings. The building is part-vacant, and contains 668 m^2 of commercial space *"with employment use by two people, as well as 2 residential units"*. ULL have created an Existing Use Valuation (EUV) for the current buildings on site. The current occupational arrangements are temporary due to the impending redevelopment of the site, thus if the existing use were to continue long-term we would expect different arrangements and full occupancy.

5.2 The benchmark land value adopted is £1.77m, which is comprised of a £1.475m Existing Use Value to which a 20% landowner premium has been applied. The EUV is based on the capitalisation of an estimated rent, but with no void period, rent free period, letting fees or refurbishment costs. The building is part-vacant at the moment but the details of how much is vacant and what parts of the buildings, has not yet been divulged. However, in view of the very cautious yield of 7.0% adopted by ULL, it could be argued that these factors (i.e. voids, rents frees etc) have been factored into the yield. With respect to refurbishment costs, this is basis, low-specification facility thus it is not to be expected that substantial refurbishment would be required in order to secure tenants.

5.3 The residential units are two studio flats which have been assumed to have a weekly rent of £175 per week. This is a realistic rent, based on current availabilities, for example a £185 per week availability at the Old Fire Station which is a reasonably good quality unit. We do not have any details regarding the subject site's studios, such as their condition and size, thus are unable to give a precise valuation. But it is clear that the vast majority of the studios available locally are at above £175 per week thus the rent adopted by ULL appears reasonable and not overstated.

5.4 With respect to the commercial uses on-site, these are a workshop & storage space (both B1c), offices (B1a), both of which are at £12.50 per sq ft. Commercial lettings are provided in support of this rent, including recent lettings on Norman Road at £11.47-£12.05 per sq ft. These do suggest that the adopted rents are realistic for this type of secondary/tertiary quality commercial space.

5.5 A planning history search of the site reveals only a brief history, returning four results, three of which are from the 1990s. The earliest of the three was an application submitted for the erection of a new bagging plant, which was approved in 1990. The second, refused in 1994, sought to change the use to a place of worship, while the third was for a change of use to a car repairs, tyres, exhaust and MOT testing centre, which was withdrawn.

5.6 The yield adopted for this is 7.0% which reflects the limited quality of this facility, but on the other hand commercial space is scarce in this area, especially given the strong pressure on commercial land due to residential redevelopment. Knight

Frank's *Yield Guide* gives 5.75% for 'Secondary Estates', and in view of the condition of this building a higher yield than this is suitable. ULL cite a Knight Frank yield of 7.0% for 'Tertiary Estates'.

5.7 Regarding the 20% landowner premium that has been adopted, this reflects the NPPF requirement to make allowance for a 'competitive return' to the landowner. The latest version of the Government's Planning Practice Guidance (updated July 2018) states that, "*The premium should provide a reasonable incentive for a land owner to bring forward land for development while allowing a sufficient contribution to comply with policy requirements*." And the Mayor's SPG (August 2017) states that premiums should be 10-30%, and premiums within this range have been accepted in planning appeals thus are of national relevance. In this context, a 20% premium is realistic in this case, where the site has considerable residential development potential.

6.0 DEVELOPMENT COSTS

6.1 Our Cost Consultant, Geoffrey Barnett Associates, has undertaken a review of the Stace cost plan and has concluded that its cost estimate is reasonable, based on comparison with BCIS average tender price – adjusted for site specific and scheme specific factors. Their full report is in **appendix one**.

6.2 The assumptions made in respect of the purchaser's costs, professional fees (8%), sales fees, and letting/marketing fees, are all in line with typical benchmark rates thus can be considered reasonable.

6.3 Finance costs are calculated using an industry-standard interest rate of 7.0%, and based on cashflow assumptions with the Argus appraisal. As a proportion of the total development costs (exluding finance itself), the finance costs are 6.9% which is broadly realistic for a scheme of this size and complexity which involves substantial upfront, 'front-loaded' costs.

6.4 The appraisal includes allowances for Mayoral and Greenwich CIL. The estimates will need to be confirmed by Planning Officers.

6.5 The profit allowance made by the applicant is 12.5% on GDV as per ULL's appraisal. This is stated as being lower than the typical requirement of a developer. ULL state that this rate is the suggested rate of the GLA. The GLA's SPG states that *"a different approach to profit (Build to Rent schemes often require a lower level of profit compared to 'for sale' schemes)…"* We have had regard to the Planning Practice Guidance (as updated July 2018) which refers to a 15-20% on GDV as the range of acceptable profit allowances in viability assessments – but in view of the GLA's comments above, a lower rate can be adopted for PRS schemes. With respect to other PRS schemes in London we have been involved with, profits as low as 10% on Cost have been adopted, including for a scheme in Reading – which is an areas of exceptionally high growth (due to the impending opening of Crossrail). This 10% on Cost (circa 8.5% on GDV) was based on advice provided by PRS specialists at CBRE. This is at the lower end of adopted profits.

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Appendix One