

Final Report

Earl's Court Opportunity
Area Development Proposal

Site Wide (Comprehensive)
Applications 1 & 2

On Behalf of:

Greater London Authority (GLA),
Royal Borough of Kensington &
Chelsea (RBKC),

London Borough of Hammersmith
and Fulham (LBHF)

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1. Introduction

- 1.1. Instructions were received 17th May 2011 from GLA, RBKC and LBHF in respect of the outline planning proposals for Earl's Court & West Kensington Opportunity Area to assess the financial viability of the related outline planning application schemes to determine the maximum reasonable amount of affordable housing.
- 1.2. The planning application which has been submitted to both RBKC and LBHF is in respect of the site wide comprehensive scheme (Applications 1 and 2).
- 1.3. We commenced our review of the applicants Viability Assessment in Summer 2011 and have been working together with the applicant over the past year to resolve queries in respect of the revenue, costs and assumptions that inform the applicants Viability Assessment and where possible reach an agreed position.
- 1.4. This report considers the 'Site Wide Development Option' (applications 1 & 2) which envisages the comprehensive redevelopment of the Earl's Court Opportunity Area. This report does not consider the metrics of applications 1 & 2 in isolation of one another.

Viability

- 1.5. Financial viability has become an increasingly important material consideration in the planning system. While the fundamental purpose of good planning extends well beyond financial viability, the capacity to deliver essential development and associated infrastructure is inextricably linked to the delivery of land and viable development.
- 1.6. The National Planning Policy Framework (NPPF) emphasises deliverability and the provision of competitive returns to willing land owners and developers to enable sustainable development to come forward.
- 1.7. The RICS is at an advanced stage of preparing a "best practice" guidance note for RICS members in respect of Viability in Planning. An exposure draft was publicised on the RICS web site earlier this year in May and publication of the document is anticipated soon.

1.8. In undertaking our review we have had regard to the GLA, RBKC's and LBHF's written instructions May 2011 and we set out a bullet summary of these below:

- Review the credibility of the assumptions adopted in the applicant's development appraisal, in particular the level of financial contribution made towards planning obligations including the provision of affordable housing and works in kind.
- Review and consider the following information:
 - Scheme drawings
 - Full schedule of accommodation
 - Net and gross floor areas
 - Residential sales revenues
 - Retail turnover/disposal strategy incentives and investment disposal
 - Development cost (retail, commercial, residential and relevant planning obligations)
 - Site specific costs (demolition, site remediation, railway protection, decking and highway works)
 - Build programme
 - Disposals programme for future land sale
- The consultants will be required to undertake an audit of the applicant's development cost plan.
- Evaluate the development costs and site specific costs, professional fees, existing use value, sales values and other related financial constraints including planning obligations proposed or that are required for the site wide regeneration
- Evaluate whether the costs and values used are reasonable and whether the arguments used to justify the scheme design and affordable housing offer are also reasonable.
- The consultants will be required to consider the package of planning obligations being offered by the applicants, including the level of financial contribution or provision and/or of works in kind.

- Evaluate the financial arguments underpinning the applicants approach to the provision of affordable housing with regard to level, tenure and mix.
- The assessment should be made on the assumption of the availability of nil housing grant unless advised by the awarding public body. The consultant should advise, on the basis of discussions with the relevant public bodies, as to the future availability of housing grant or other housing subsidy and advise on the appropriateness and robustness of a review mechanism (see below) to account for this in the development viability.
- Advise as to the appropriateness, robustness and form of any review mechanism considered necessary to ensure the maximum reasonable amount of affordable housing is provided over the lifetime of the development by taking account of future changes in the viability of the development.
- With particular regard to the policy requirements of CH2 of RBKC Core Strategy, the assessment should be made on the basis of Net present Value (NPV) in relation to 'target rents' (social rented tenure) and the affordability thresholds for affordable housing set out in the London Plan.

1.9. Our instructions are to review and evaluate the applicant's assertion the scheme can only provide approximately 10.6% affordable housing units in addition to the Section 106 package calculated at c. £11.65 cash contribution and works in kind c. £101.11m and CIL contributions of c. £34.39m

1.10. We set out our comments under the numbered sections of this report below.

2. Property Description and Location

Site Wide – Application 1 & 2

2.1 The Site Wide Development Option includes the comprehensive redevelopment and regeneration of the West Kensington and Gibbs Green housing estates. The majority of homes will be reprovided within the Earl's Court Site. However, the Development Option includes a portion of replacement homes being delivered off-site as part of the Applicant's planning application for the redevelopment of the Seagrave Road Car Park which was granted planning permission in March 2012.

Location

2.2 The Earl's Court Site referred to as Applications 1 & 2 occupies an area of approximately 32.22 hectares and is located in both the London Borough of Hammersmith and Fulham (LBHF) and the Royal Borough of Kensington and Chelsea (RBKC), in west London. The Site area situated within RBKC boundary is 9.06 hectares and the Site area within LBHF is 23.16 hectares.

2.3 The Earl's Court Site is bound to the north by West Cromwell Road; to the east by Philbeach Gardens, Eardley Crescent and Warwick Road; to the south east by Lillie Road; to the north west by West Cromwell Road and to the south west by North End Road.

2.4 The LBHF and RBKC administrative boundary bisects the Site along a north west / south east axis from Lillie Road to West Cromwell Road.

Site Description

2.5 The Site is dominated by railway infrastructure and large footprint buildings. It comprises the following:

Earl's Court Exhibition Centre Buildings

2.6 The Earl's Court Exhibition Centre Building (EC1) and Earl's Court Exhibition Hall 2 Building (EC2) occupies a triangular area of land of approximately 10.5 hectares. The EC1 and EC2 Buildings comprise approximately 3.6 hectares of exhibition space.

- 2.7 Both buildings are constructed on a steel and concrete slab podium over a network of railway infrastructure on a series of concrete pillars (including District Lines, the Piccadilly Line, the West London Line and London Underground Limited stabling).

Northern Access Road

- 2.8 To the north west of EC1 lies an area of land, identified as the 'Northern Access Road'; between the rear of Philbeach Gardens, and the West London Railway Line. This component of the Site covers an area of approximately 0.94 hectares and is currently unused and covered in scrub. It was previously occupied by railway sidings.

Empress State Building

- 2.9 The Empress State Building is a 33 storey office building located to the west of EC2, currently occupied by the Metropolitan Police Service. The Empress State Building is the highest building within the immediate area and occupies an area of land approximately 0.88 hectares in size.

West Kensington and Gibbs Green Estates

- 2.10 The West Kensington and Gibbs Green Estates form the western portion of the Site and are both located in LBHF. The larger West Kensington Estate, containing 634 homes, was built between 1972 and 1974 and includes a mix of residential accommodation: flats, maisonettes and terraced housing. The smaller Gibbs Green Estate comprises 126 homes and was built in 1961. The Gibbs Green Estate also includes Gibbs Green School, a former primary school, which is temporarily occupied by Queensmill School.

- 2.11 The existing residential accommodation across the two estates comprises: 531 social rent homes; 58 Registered Social Landlord owned properties; and 171 privately owned market homes (acquired through Right to Buy).

Lillie Bridge Depot

- 2.12 The Lillie Bridge Depot comprises the Lillie Bridge Depot maintenance/marshalling yard and rail tracks which are located in the central and northern portion of the Site. The Depot is currently used as a maintenance facility by London Underground Ltd (LUL) and comprises a series of sheds and industrial buildings. Ashfield House, an office building of 9

storeys is located on the northern edge of the Site and is used as a Transport for London training facility. The Depot component of the Site comprises an area of approximately 7.2 hectares.

Bus Facility

- 2.13 Immediately adjacent to the Empress State Building and the Exhibition Centre (EC2) is a bus layover facility accessed from Lillie Road. It comprises of a bus layover area with capacity for up to four buses to stand simultaneously and a small stand alone unit that includes welfare facilities dedicated for the use of drivers.

Earl's Court Station

- 2.14 Earl's Court Station (Listed Grade II) is located to the East of the Site and connected to the existing Earl's Court Exhibition Centre by a disused tunnel, escalator shaft and ticket hall which are located within the curtilage of the application scheme site. The tunnel, escalator shaft and ticket hall originally provided public access from Earl's Court Station westwards under Warwick Road, rising within the Exhibition Centre (EC1). It was closed to public use around 2003.

West Kensington Station

- 2.15 West Kensington Station is located within the north-west corner of the Site. It is locally listed as a Building of Merit and falls within the Barons Court Conservation Area.

Clear Channel Building

- 2.16 The Clear Channel Building is a four storey commercial building located on the corner of Warwick Road and West Cromwell Road.

Rootstein Mannequin Factory

- 2.17 Located to the North-West of the Site is a two storey commercial property which provides the headquarters and factory for the production of display mannequins by Adel Rootstein.

175-177 North End Road

- 2.18 175-177 North End Road comprises a small parade of inter-connected two storey terraced properties with retail use at ground floor and residential

accommodation above. The properties fall within the Barons Court Conservation Area.

1-8 Gibbs Green

- 2.19 1-8 Gibbs Green comprises a four storey residential building. The building is accessed from within the Gibbs Green housing estate, but its South-West elevation addresses Beaumont Crescent and falls within the Barons Court Conservation Area.

3. Development Planning Proposal

3.1 In June 2011, the applicant submitted an outline planning application which reserved detailed design of the scheme for a later stage.

3.2 In December 2011, the applicant submitted detailed designs for three plots that fall within RBKC with the remaining development plots to remain in an outline form (only providing details of maximum and minimum parameters for the height and layout of the development plots).

3.3 We understand that detailed design proposals for these plots will be the subject of further detailed discussion with the LPA's and will come forward in due course.

3.4 The scale of the development plots is to be controlled through changes to the Development specification and parameter plans at reserved matters stage. These documents currently outline the scope of the planning applications, the development options and the proposed uses for each development plot within the masterplan area.

3.5 The development specification for each application envisage the following land use floor areas:

Application 1

Land Use	Class	GIA (sq.m)	GEA (sq.m)
Residential	C3	131,422	138,339
Business	B1	12,672	13,132
Retail	A1 – A5	3,295	3,414
Hotel & serviced Apartments	C1	7,123	7,381
Education / Health / Community / Culture / Leisure	D1/D2	5,854	6,067
Sub – Total		160,366	168,333
Ancillary *		26,639	27,463
Total		187,055	195,796

* The total maximum area proposed for ancillary uses is 27,463 sqm (GEA). This comprises floorspace for incidental purposes linked to the land uses in Table above. Including, inter alia, parking, servicing, plant, storage, maintenance, machinery and circulation mainly at below ground and basement levels.

Application 2

Land Use	Class	GIA (Sq M)	GEA (Sq M)
Residential	C3	587,043	617,940
Business	B1	81,736	84,701
Retail	A1 – A5	22,502	23,318
Hotel & serviced Apartments	C1	8,625	8,938
Education / Health / Community / Culture / Leisure	D1/D2	24,858	25,760
Private Hospital	C2	10,208	10,578
Sub – Total		734,972	771,235
Ancillary *		145,156	150,421
Stabling Sui Generis		10,840	11,175
Total		890,968	932,831

* The total maximum area proposed for ancillary uses is 150,421 sq m (GEA). This comprises floorspace for incidental purposes linked to the land uses in Table 6.1. Including, inter alia, parking, servicing, plant, storage, maintenance, machinery and circulation mainly at below ground and basement levels.

Application 1 & 2

Land Use	Class	Maximum floorspace GEA (Sq M)
Residential	C3	756,279
Business	B1	97,833
Retail	A1 – A5	26,732
Hotel & serviced Apartments	C1	16,319
Education / Health / Community / Culture / Leisure	D1/D2	31,827
Private Hospital	C2	10,578
Sub – Total		939,568
Ancillary *		177,884
Stabling Sui Generis		11,175
Total		1,128,627

* The total maximum area proposed for ancillary uses is 150,421 sq m (GEA). This comprises floorspace for incidental purposes linked to the land uses in Table 6.1. Including, inter alia, parking, servicing, plant, storage, maintenance, machinery and circulation mainly at below ground and basement levels.

4. Information Relied Upon

4.1 In preparing this report we have had regard to a comprehensive amount of information and correspondence. The key documents relied upon are:

- Residential Pricing commentary together with supporting appendices prepared by Savills dated 5/4/12
- Full Site Viability appraisal model and sensitivities prepared by CBRE dated 28/6/12
- Earls Court Redevelopment Viability Assessment: Commercial Uses and Land Value Report prepared by CBRE dated December 2011
- Earls Court Viability Assessment – Further Information on Land Values & Commercial Values prepared by CBRE dated 29th March 2012 and 3rd April 2012
- Argus AUV appraisals prepared by CBRE dated February 2012
- Student Accommodation Land Sales prepared by CBRE undated
- LBHF Gibbs Green Private Residential Comparables prepared by CBRE undated
- LBHF Earls Court Existing Use Valuation of the Social Housing prepared by CBRE undated
- EC1 and EC2 Trading Information supplied by CBRE various dates
- Advertising Boards Comparable Evidence prepared by Tim Thomas Partnership undated
- Earls Court Regeneration Illustrative Report prepared by EC Harris Built Asset Consultancy dated 8th July 2011
- Cost Models supplied by EC Harris dated July 2011

- Construction Growth Forecasts supplied by EC Harris dated December 2010
- Construction Risk Schedules prepared by EC Harris dated March 2012
- Exceptional Cost Reports and Information including Over sailing and Tracking Schedules prepared by EC Harris various dates.
- Rights of Light Report prepared by GIA dated 10th May 2011
- Planning Documents available via:

RBKC application 1 (ref PP/11/1937)

LBHF application 2 (ref: 2011/02001/OUT)

5. Methodology

- 5.1 The methodology adopted by CBRE reflects the nature of the proposed development. The development period is envisaged to be c. 22 years, therefore a growth model approach (revenue growth and cost inflation) having regard to an Internal Rate of Return (IRR) as a measurement of risk reward has been adopted.
- 5.2 The approach is not a common method of considering viability assessments but it is an appropriate measurement of return for multi-phased schemes over the anticipated project programme.
- 5.3 The application scheme has been assessed on both a current cost and revenue basis, which is the usual approach for considering viability, and an outturn approach which adopts growth and inflation into the development appraisal.
- 5.4 The scheme is not viable on a present day cost and revenue basis and it is therefore necessary to consider on an outturn approach which adopts revenue growth and cost inflation over the duration of the assumed project programme.
- 5.5 The merit of using an out-turn approach is that it can secure a known amount of affordable housing and S106 planning obligations when the scheme on a current cost and revenue approach is not viable.
- 5.6 The downside, however, is that growth and cost inflation is difficult to predict and the amount of affordable housing and S106 contributions secured could look insufficient if the market grows at a faster rate and the scheme outperforms current forecast revenue and cost inflation projections.

Financial Model

- 5.7 CBRE have prepared a bespoke excel based financial model to appraise the applicant's project viability. We attach a summary of the model structure and methodology and attach this as Appendix 1.
- 5.8 We have not considered every single cell reference and formulae which informs the model. We have however been provided with a verbal assurance

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from CBRE as to the accuracy of the formulae and cell references contained within the model.

- 5.9 We have met with CBRE to discuss the model methodology and have been provided with an overview of the model together with an audit of which considered a random selection of cells and we are satisfied.

Appraisal Land Use Area Assumptions

- 5.10 Details of the proposed floor space for each land use that inform the financial model are set out below:

Land Use	Application 1 (RBKC) Maximum Floorspace GIA (sq m)	Application 2 (LBHF) Maximum Floorspace GIA (sq m)	Site Wide 1 & 2 Maximum Floorspace GIA (sq m)
Residential	131,422	587,043	718,465
Offices	12,672	81,737	94,409
Retail	3,294	22,502	25,796
Leisure	2,667	11,326	13,993
Hotel/Serviced Apartments	7,123	8,625	15,748
Education	-	4,662	4,662
Medical	-	10,208	10,208
Cultural / Community Hub	3,187	4,144	7,331
Day Care Facility	-	1,351	1,351
Health Care	-	3,378	3,378
LUL Stabling	-	11,175	11,175
Total	160,365	746,151	906,516
Total Residential units	930	5,845	6,775

- 5.11 The residential unit numbers are based upon average unit sizes and are calculated having regard to the applicant's proposed mix of units within each building envelope.

5.12 We have considered the maximum floor areas set out in Para 3.5 & 3.6 above and have sought to reconcile with the model and on the assuming the ancillary land use areas are accepted by the LPA's the financial model would appear to understate the GIA floor area by c. 950 sq ft which may be due to a rounding and represents a difference of 0.10%.

Efficiency

5.13 We have considered the gross to net floor areas assumptions (tabulated below) that inform the financial model and these appear to fall within an acceptable range, given the stage of design of the scheme. But as the scheme evolves these should be reviewed as +/- changes to individual efficiencies will impact upon revenue.

Application 1 & 2		
Land Use	GEA to GIA	GIA - NIA
Residential	95%	82.5%
Residential Town Houses	96.5%	100%
Business	96.5%	80%
Retail	96.5%	90%
Hotel & serviced Apartments	96.5%	100%
Education / Health / Community / Culture	96.5%	100%
Leisure	96.5%	100%

Internal Rate of Return

5.14 The IRR is calculated using a discounted cashflow appraisal at a discount rate which equates the total costs and total revenue over the cashflow programme period. An IRR measurement takes full account of the time value of money and is used as the measure of profitability having regard to the time the project takes to complete.

5.15 An IRR has been applied to the growth models where as an annualised percentage this provides a measure of the rate at which the scheme generates a return.

5.16 The applicant's IRR hurdle benchmark adopted in the scheme assessment is considered reasonable given the stage of project design at 20% for this

complex large scale residential led scheme; and at this level it falls at the upper end order of range as at the date of this report.

5.17 The financial model assumes the applicant adopts the role of a master developer in which the necessary parcels of land are acquired and all necessary site wide heavy infrastructures are implemented to create serviced plots. The master developer realises revenue receipts following the sale of the serviced plots to individual plot developers and the plot developers develop the sites and sell completed schemes to investors and occupiers.

5.18 We acknowledge the applicant's exit strategy to realise the value from the individual plot sales however we do not accept the method by which they determine individual plot values in so far as growth has been applied. We comment more fully under Para 15.1 – 15.24 below.

6. Assessment of Benchmark Land Values

- 6.1 The land ownership of the site is fragmented and it is subject to different leasehold and freehold interests.
- 6.2 CBRE have considered alternative development schemes to inform their opinion of value derived by reference to the permissible land uses subject to all material local plan policies as well as corresponding S106 contributions which could reasonably be sought by the local planning authority.
- 6.3 Through our own analysis we have arrived at a different benchmark land value and we have adopted this in our assessment of the applicant's proposal which falls below the value adopted by the applicant.
- 6.4 Benchmark land values have been assessed as at June 2011 for a range of different sites in different ownerships which are summarised below. Much of the detail and descriptions for these sites are provided within the CBRE viability report. We have therefore concentrated our main focus on value assumptions where there are points of disagreement or queries that remain unanswered.

EC1 & EC2

- 6.5 The exhibition centres have been valued by CBRE at £110.7m on the basis that the existing operational business continues for the foreseeable future, assuming that re-development does not take place.
- 6.6 We referred the valuation of the exhibition centres to our specialist property valuers and their opinion of value on an existing use basis was £82.5m.
- 6.7 A series of discussions ensued and neither party was able to reach agreement on value for the exhibition centres leading to the decision to pursue third party valuer (GVA) to determine. The third party opinion of value was £97m and we have adopted this value in our appraisals.

Northern Access Land

- 6.8 The Northern Access Land (NAL) is assessed on an exiting use value basis at a total of £10.1m by capitalising the existing income by a gross equivalent

yield of 8.5% which is supported by yield evidence for advertising comparables. We accept the valuation of £10.1m for the NAL as reasonable.

EC1 EC2 & Northern Access Land Marriage Value

- 6.9 The applicant has set out that without the development of EC1, EC2 and Northern Access Land (NAL) there will be no transfer of value from east to west across the regeneration area and CBRE are doubtful whether indeed regeneration of the entire opportunity area would take place.
- 6.10 In seeking to understand the contribution that EC1 & EC2 offer CBRE have considered two scenarios that seek to isolate the contribution of uplift and diminution in value that could reasonably be anticipated having regard to the financial model assumptions both with and without the development of EC1, EC2 and NAL.
- 6.11 If EC1 & EC2 remain and development takes place around them to address these hypothetical circumstances Savills assert this would result in reduction in the achievable residential sales revenues and specification resulting in reduced construction costs of the residential dwellings and in line with this CBRE have reduced retail & office rents together with a resultant shift in yields.
- 6.12 This indicates the scheme would generate a NPV loss of c. £252m if EC1, EC2 remain as exhibition centres. If they were redeveloped as envisaged in the June 2011 scheme the analysis prepared by the applicant indicates a NPV profit of £70m and demonstrates a spread between the profit and loss outcomes of c. £322m.
- 6.13 After making allowance for sharing between the east and west sites that fall within RBKC & LBHF (as values are drawn across from RBKC). The developer indicates that c. £80.5m is the maximum marriage value sum that could be paid to TFL who is the Freehold owner of the land.
- 6.14 Whilst theoretically it is possible to demonstrate a negative land value but practically we question whether this would indeed occur in the open market. However it does isolate the additional value released with the inclusion of EC1/2 and NAL.

6.15 Notwithstanding the comments above best practice guides us to have regard to Market Value (MV) of the land and in this respect we are unsure whether the current use value (CUV) plus marriage value as relied upon by the applicant will exceed a policy compliant alternative use value (AUV) of the site. If exceeded the benchmark land value would be overstated and this would artificially reduce any surplus that may be available for planning obligations.

6.16 To consider the negative land value further; if the exhibition centres were to remain in situ it would drive a developer to explore a different scheme proposal to mitigate the constraints and impact of not developing the EC1, EC2 and NAL land. Furthermore, in considering the redevelopment of the land that falls within RBKC which is ostensibly phase 1 of the site wide scheme there is some concern in our minds that this may not be "Deliverable" i.e. given the low level IRR return as a first phase.

Cluny Mews

6.17 We are in agreement with the majority of the valuations for the Cluny Mews site. Following discussions with CBRE regarding the appropriate floor areas for the R&D building we have agreed the values for this building at £1.18m. The remainder of the values proposed by the applicant have been previously accepted. Consequently the agreed total value for the Cluny Mews site is £18.38m.

TFL Depot Land

6.18 This site covers a large proportion of the total site area for the scheme at 15.68 acres and is understood to be held freehold by TFL. The site has been considered as 3 separately assessed components including Lillie Bridge (which includes Ashfield House), 175-177 North End Road and the 8 Advertising Boards which front onto the Southern side of the A4.

Lillie Bridge Depot

6.19 The site has been investigated in terms of a cost of replacement as opposed to a land value. The costs of this replacement will be funded by a land payment to TfL. TfL have provided cost plans in relation to these costs. These

costs are treated as development costs and are dealt with separately in the financial viability model. We also comment at Para 14.1 – 14.5.

175-177 North End Road

- 6.20 The property comprises 5 separate retail units which are held by way of four occupational leases on the ground floor with a total passing rent of £50,900 per annum. There is a self contained maisonette on the first floor for which the applicant has estimated a rent in the region of £15,000 per annum.
- 6.21 The total estimated income of £65,900 has been capitalised adopting a 6.5% yield in perpetuity which produces a value for the property in its current use of £0.95m net of purchaser's costs.
- 6.22 Whilst the rental values do not appear unreasonable, the yield appears optimistic for this location considering the likely covenant strength on the retail. We would expect a higher yield of c. 8% for this property which is in line with the yield evidence for North End Road provided by the applicant. Adopting an 8% yield produces a value of c. £0.775m net of purchaser's costs.

Advertising Hoardings

- 6.23 Whilst it has not been possible to verify the existing income, the valuation approach adopted by the applicant is logical. The rental values are in reasonable proportion to those of the other boards in the area as is the calculation of capital value at £9.4m.

LBHF Land

- 6.24 The land currently owned by Hammersmith and Fulham Council has been divided into several different sites and assessed on both an existing and alternative use value basis. The private and social housing has been assessed based on their current use values. The other two sites under Council ownership are Gibbs Green School and 70 & 80 Lillie Road which have been assessed based on alternative use values and are assessed under a separate section of our report.

Private and Social Housing

- 6.25 The social housing at Gibbs Green and West Kensington comprises a total of 589 units (531 social rented and 58 RSL units). Privately owned housing comprises a mix of freehold and long leasehold interests totalling 170 units (39 houses and 131 flats).

Social Housing

- 6.26 The social rented units have been valued at total of £30.5m by adopting Discounted Cash Flow (DCF) methodology. Having reviewed the applicants cash flow and assumptions, we are satisfied the values proposed in respect of social housing are reasonable.

RSL Units

- 6.27 The RSL units have been valued at £3.3m. In doing so it is assumed the units would be let on FRI terms with the landlord not incurring any management, maintenance or insurance costs. Whilst we would usually expect these costs to be deducted, we note the yield has been increased from 6% to 7.5% to reflect these costs. Accordingly we advise the values for the RSL units are reasonable.

Private Housing

- 6.28 The private units are valued at a total of £45.35m. Having reviewed the comparable evidence provided in addition to making our own investigations, we are satisfied the overall values for the private housing are reasonable.

Alternative Use Assessment

- 6.29 A total of four sites have been assessed based on a hypothetical alternative use value approach and LBHF Officers have provided a view on the policy compliance of the AUV schemes to inform the credibility of these schemes. These include Land around Empress State, Rootstein, Gibbs Green School and 70 & 80 Lillie Road.
- 6.30 The main use assumed is student accommodation which is proposed on every site. Two of the sites include Serviced Apartments (SA) and one includes Assisted Living (AL). The table overleaf summarises the use type mixes proposed for each site.

Site	Student Units	SA Units	AL Units
Land Around Empress State	614	220	116
Roostein	513	-	-
Gibbs Green School	539	218	-
70&80 Lillie Road	289	-	-
TOTAL	1,955	438	116

6.31 To supplement these proposals we have been provided with an OS extract which detail the building footprints and proposed storey heights for each scheme. In order to provide commentary on all schemes we have made general comments on the values and cost headings which will provide an overview of the inputs informing the appraisals for these schemes. We have concluded by making site specific comments.

AUV Scheme Revenues

Student Accommodation Revenues

6.32 We are informed all schemes will be direct let with all units designed as cluster rooms. In total there is 1,955 student units proposed. Key assumptions include an all inclusive rent of £240 per week, facilities management (FM) costs of £1,850 per unit per annum and a NIY of 7%. The applicants rent and yield combination produces a capital value of c. £130,000 per unit.

6.33 As a secondary check, the applicant has provided land sales evidence for student accommodation sites which supports plot values in zones 1 and 2 in the range c. £0.03m - £0.045m. The applicants plot values are relatively conservative at c. £0.026m - £0.031m.

6.34 In our initial review, we had concerns regarding the rental values adopted which appear optimistic in relation to the evidence. Additionally, we questioned potential oversupply and the fact that we would expect a greater differentiation in rental values to reflect the heterogeneity of the individual sites.

6.35 Whilst we still consider the rental values optimistic, we note the yield adopted is relatively conservative. Furthermore, the demand in London is so great for

student accommodation that the impact of these schemes would be unlikely to have a significant material impact on the supply and demand dynamics.

- 6.36 Having reviewed the applicants DCF spreadsheets provided we appreciate that whilst there may be slight differences of opinion regarding some of the inputs, we are of the opinion that the overall values proposed in respect of student accommodation are not unreasonable.

Serviced Apartments Revenues

- 6.37 A total of 438 serviced apartment units have been assumed and are divided between the Land around Empress State scheme (220 units) and the Gibbs Green School scheme (218 units). The units proposed comprise a mix of studios (15%), one bed (55%) and two bed (30%) apartments.
- 6.38 We have been provided with a range of data for serviced apartments in the area to help support the average nightly room rates adopted by the applicant of £95 for studios, £105 for 1 beds and £150 for 2 beds. Ideally we would require the accounts and trading information for Think Earl's Court which is the most pertinent comparable. This would account for discounts that occur between the advertised room rates and the average achieved room rates. We have requested this information and were informed it was commercially sensitive and unattainable.
- 6.39 Whilst the average room rates adopted have not been fully evidenced, a review of market research for serviced apartments indicates that the adopted rates do not appear unreasonable.
- 6.40 The occupancy rates assumed by the applicant are 85%. We are informed that Think Earl's Court is currently trading at 87.5% occupancy and further information provided for five local serviced apartments demonstrates average occupancy rates of c.85%. We would expect initial occupancy rates to be much lower than those assumed by the applicant but would expect these to stabilise after the first two years. Accordingly we comment the occupancy rates appear slightly optimistic.
- 6.41 Running costs have been assumed at 40% of the projected turnover. These seem reasonable for the number of units proposed in the schemes.

6.42 The assumptions made by the applicant produce weighted net rental value per apartment of £21,780 per annum. We are of the opinion this is at a generous but acceptable level.

6.43 The applicant has adopted a 6.5% yield which appears reasonable for a standing investment in a well located central London location. We would expect a slightly higher yield to reflect the uncertain locations and the fact we are not valuing standing investments. However, we are willing to accept the applicants yield as reasonable albeit at the lowest point of an acceptable range.

Assisted Elderly Living Revenue

6.44 A total of 116 assisted living units have been proposed for the Land Surrounding Empress State scheme. The applicant has not provided a unit mix or a plot by plot breakdown of values. They assert the value adopted of £935 per sq ft is 4% above average private residential values. However, it is unclear how average private residential values have been derived and no comparables have been provided. We have accepted the applicants proposed values for the purposes of our appraisals as we have been able to benchmark against values for other schemes. However, we add a note of caution that we would normally require evidence in support of the values proposed.

AUV Scheme Costs

Build Costs

6.45 We have not been provided with cost plans to support the base build costs for the AUV schemes. However, the applicant has adopted the same construction costs as used previously for the Seagrave Road viability assessment.

Contingency

6.46 Provided base build costs are taken from the Seagrave Road project it is our understanding that these costs included a contingency allowance of 5%. We have excluded the additional 3% developer contingency in the appraisals to avoid double counting and the fact we consider an overall contingency of 5% contained within the cost plan to be sufficient.

Abnormal Costs

- 6.47 We have not been provided with full cost plans to support these site specific costs. Many of the cost headings are similar to those assumed for the Seagrave Road project. The costs relate to items of expenditure that could be considered acceptable however there is limited information to support the quantification of these costs.

Section 106 Costs

- 6.48 Section 106 costs have been assumed at £15.46 per sq ft (GEA) per site. We were advised by the applicant this was verbally confirmed by LBHF as acceptable.

Project Programme and Sales Rates Assumptions

- 6.49 A 6 month pre-construction period and construction period of 21 months has been assumed for all schemes. Sales are assumed at practical completion for both the student accommodation and serviced apartments. These timings are reasonable.
- 6.50 A 12 month sales period with 60% off plan sales followed by a linear sales distribution for the remainder has been assumed for the assisted living. We would expect a stepped sales rates profile with more units selling in the opening months of the scheme and fewer toward the end.

Professional Fees

- 6.51 Professional fees are assumed at 12% for all of the AUV schemes. This falls within an acceptable range albeit at the upper end of the range we would expect to see. Although it is probable the applicant would in practice agree fixed fee arrangements with the professional team.

Project Insurance

- 6.52 These are included at 1% which is the same level adopted on the Seagrave Road project. We have not been provided with evidence or quotations to support these costs.

Marketing and Sales costs

- 6.53 We are satisfied the marketing and sales costs adopted in the applicants appraisals fall within an acceptable range.

Finance

- 6.54 The applicant has assumed a finance rate of 7%. We accept this assumption as reasonable and have reflected the same rate in our appraisals.

Profit on cost

- 6.55 The applicant has adopted 15% profit on cost for the student accommodation and serviced apartments. In respect of the assisted living a 20% profit on cost margin is assumed. We accept the developer's profit margins adopted as reasonable for both the student accommodation and assisted living.

- 6.56 We consider a lower margin would be acceptable for the serviced apartments which would be highly unlikely to be built speculatively, typically with an operator signed up in advance thus reducing the risk element and risk reward required.

Hope Value Discount

- 6.57 There remains a strong argument to suggest that the residual valuations for the AUV schemes should be discounted to reflect the fact that the hypothetical schemes do not have a planning consent. Any prudent purchaser for the sites would make an allowance for the risk of obtaining planning permission. This is not currently reflected and any values identified will reflect the maximum realistic position.

Site Specific Land Value Assessment

- 6.58 We are of the opinion that generally, one would expect more differentiation between the individual sites than has been reflected by the applicant to reflect the various advantages and disadvantages of the individual locations.

- 6.59 The student land values proposed are reasonable. There is a slight difference of opinion regarding the appropriate occupancy rates and profit levels in respect of serviced apartments. However, when considering overall land values adopted, we are currently in a position to accept the land values for 3

out of the 4 AUV schemes namely Roostein, Gibbs Green School and the Lillie Road sites.

Land Around Empress State

- 6.60 It is our opinion that the methodology for assessing this site is flawed as the applicant has relied upon Vacant Possession value for the site. We understand the Empress State building is subject to a lease with an unexpired term of circa 8 years as at the date of valuation. The building footprints are situated on the Empress State buildings car park which we understand is also an element included in the lease.
- 6.61 We **assume** the applicant would require a cleared site in order to develop the proposed scheme at the current date. If not, we would expect significant compensation payments in relation to developing on the existing tenant's car park, the diminution in value to the tenant's interest and rights to light compensation.
- 6.62 Consequently we would expect to see a term and reversion approach for the Land around the Empress State. This values the site in its exiting use for the unexpired term at the present date and defers the alternative use value by the unexpired term on the lease for the Empress State. We have applied a present value discount factor of 8 years at 7% to the vacant possession AUV provided by the applicant in deriving our land value. We have requested the applicant to provide any income for the term for which we could reflect but this has not been forthcoming.
- 6.63 We highlight that we would expect this value to be lowered further to reflect compensation payments in respect of rights to light and diminution in value to the Empress State building as a result of the enveloping AUV scheme. The applicant has not provided any assessment of compensation for us to review and as a result these have not been reflected.

Summary of Land Values

Site	Applicant Benchmark	DVS Benchmark	Comments
EC1, EC2 & NAL			
EC1 & EC2	£110,700,000	£97,000,000	Land value determined by 3rd party.
Northern Access Land	£10,100,000	£10,100,000	
Marriage Value (Eastern sites)	£80,500,000	£80,500,000	Question marriage value – no AUV to check the value relied upon does not exceed the AUV benchmark.
Sub-total	£196,300,000	£187,600,000	
CLUNY MEWS			
Buildings 1 & 2 Cluny Mews	£7,200,000	£7,200,000	
R & D Building	£1,480,000	£1,180,000	DVS based on agreed floor areas
X6 Advertising Boards	£10,000,000	£10,000,000	
Sub-total	£18,680,000	£18,380,000	
LAND AROUND EMPRESS STATE			
Land Around Empress State	£46,385,000	£27,000,000	Term and reversion methodology adopted by DVS.
TFL DEPOT			
175-177 North End Road	£950,000	£775,000	Different yields
Advertising hoardings	£9,400,000	£9,400,000	
Sub-total	£10,350,000	£10,175,000	
LBHF LAND			
Social Rented Units	£30,500,000	£30,500,000	
RSL units	£3,300,000	£3,300,000	
Private Units	£45,350,000	£45,350,000	
Gibbs Green School	£27,400,000	£27,400,000	
70&80 Lillie Road	£9,000,000	£9,000,000	
Sub-total	£115,500,000	£115,500,000	
ROOSTEIN			
Roostein	£15,500,000	£15,500,000	
TOTAL	£402,715,000	£374,155,000	

7. Residential Revenue

Affordable Housing

- 7.1 The scheme will involve the re-provision of 560 units across the LBHF part of the opportunity area together with a payment of c. £33.57m to secure 200 homes at Seagrave Road (a total of 760). The remaining rented units will be relocated across the Earl's Court Opportunity Area and the freehold of these properties will be passed to LBHF at nil cost.
- 7.2 In support of the adopted affordable housing values, the applicant has provided a Supplemental Affordable Housing Note prepared by Quod dated February 2012.
- 7.3 The affordable housing note states the preference for 740 intermediate housing units in LBHF is for shared equity or discount market tenure (DMS). On that basis, Quod have valued the intermediate units on Proval Software at a rate per sq ft of £210 based upon an industry benchmarked set of assumptions.
- 7.4 We have been provided with the Proval summary sheets that inform how the rate of £210 per sq ft has been arrived at, however, we have not been provided with any further information to support which "performance indicator" has been used as a benchmark in order to inform the £210 per sq ft relied upon is appropriate.
- 7.5 Quod have also run a scenario whereby the intermediate housing product is substituted with a shared ownership product as opposed to shared equity/DMS. The affordable housing note states that values on the basis of shared ownership are between £240 - £250 per sq ft.
- 7.6 Quod have assumed that a registered provider will purchase shared equity/discount market sale units. However, we are of the view that the plot developer could also sell these units and we are aware of 2 current schemes in LBHF where the developer is selling discount market sales units directly to purchasers.

7.7 These schemes operate on the basis that there is no rent to pay on the equity share held by LBHF, therefore a purchasers housing costs will consist of mortgage payments, service charges, ground rent, and normal taxes & utility bills.

7.8 Ground rent income has not been taken into consideration for the intermediate units and we would expect these units to attract a ground rent.

Market Housing

Overview of Applicant's Residential Revenue Methodology

7.9 In support of the adopted residential revenue, the applicant has provided a Savills residential market report dated April 2012 together with supporting appendices.

7.10 In summary, Appendix 3 of the Savills report provides a single rate per sq ft for each building in the master plan. The rates per sq ft populate the CBRE appraisal model for each building, use and specification type.

7.11 The model generates the revenue for the residential uses by multiplying the assumed Net Internal Area (NIA) for the building reference by the appropriate rate per sq ft as outlined in Appendix 3 of the Savills report.

7.12 Consequently the revenue for each building is expressed as a single capital value dependent upon the specification type.

7.13 Whilst the above commentary provides a short summary of how the revenue is generated in the appraisal model. The Savills report provides an overview of the methodology of how the rates per sq ft for each building in the master plan have been arrived at.

Pricing Methodology

7.14 In arriving at the rates per sq ft for each building outlined in Appendix 3 of their report Savills have compiled mix matrices for each phase which show the range of anticipated unit sizes within each phase and the spread of capital values they would expect for each phase.

7.15 Savills have undertaken a detailed analysis of 1 building from each phase providing a "high level" overview of how capital values could be typically apportioned across a building dependent upon specification type and floor level.

7.16 Savills have stated that the application scheme is at an "outline permission" stage and the provision of more detail is not possible given its necessarily high level nature, consequently they have used phase wide unit and area mixes consistently across all of the pricing exercises according to the phase.

Comparable evidence

7.17 In support of the values, the appendices to Savills report contains new build comparable evidence from Bramah, Chelsea Apartments and Chelsea Creek and second hand comparables from both Hammersmith & Fulham and Kensington and Chelsea.

7.18 Although there no comparable evidence from the immediate locality of the site to support the values relied upon by the applicant, Savills are of the view that the demolition of the exhibition centres will together with the right product and phasing strategy increase values in the locality through pulling value in from the higher value locations of Kensington and Chelsea.

Unit Sizes

7.19 Savills have adopted average unit sizes across the phases. A more detailed scheme design may result in a change to the spread of unit sizes across the scheme and this may impact upon revenue receipts and construction costs.

Specification

7.20 Whilst the apartments have been graded in terms of a specification level, we are aware that the specification benchmark developments also provide additional on-site facilities such as a concierge, swimming pools, gym and additional facilities. For example we have been informed it is likely that all apartments would benefit from an estate wide residents facility that would provide facilities such as those listed above.

7.21 Savills have highlighted that the scheme is at an outline planning stage and consequently buildings have yet to be designed. There remains the possibility

that individual buildings in the future may be designed to have these facilities internally which would be intended for residents of that building only.

- 7.22 This is a pertinent point, as the scheme design evolves the location of these facilities could have a material impact on the value of the residential units.

Specification – Cost versus Value added

- 7.23 We have undertaken an exercise that compares the cost of providing an upgraded specification from Standard + to Premium against the value added to the units. We have taken blocks BW07a and BW01a as examples of the value added to the scheme by allocating proportions of these buildings to different specification levels.

- 7.24 In the example below of BW07a, we have calculated the cost of providing a Premium specification and the value this specification generates. We have also calculated the cost and value of substituting the Premium specification to Standard + as a comparison.

	Revenue = Rate per sq ft x Net Internal Area	Cost x Internal Area	Gross Revenue less Cost
Premium	c. £61.5m	c. £26.69m	c. £34.81
Std +	c. £57.47m	c. £20.65m	c. £36.82m
		Difference	c. £2m

- 7.25 This example shows that by substituting Premium specification to Standard + specification, Standard + generates a higher value to the master developer of c. £2m as the Standard + generates a higher surplus after deducting cost from revenue. Consequently, for this example alone, adopting Premium specification generates a loss to the building of c. £2m in comparison to adopting Standard +.

- 7.26 We have also run the same scenario with building BW01a and the Premium specification generates a loss of c. £1.5m in comparison adopting Standard + specification.

	Revenue = Rate per sq ft x Net Internal Area	Cost x Internal Area	Gross Revenue less Cost
Premium	c. £34.74m	c. £17.09m	c. £17.65
Std +	c. £32.46m	c. £13.22m	c. £19.23
		Difference	c. £1.58m

7.27 We understand a Premium specification may be required in order to diversify the product to meet target sales rate assumptions; however, it is unlikely that any developer would bring to the market a premium specification product that does not deliver optimum value.

7.28 Consequently, as the design process evolves a developer would value engineer the scheme by reducing costs through material substitutions in order to optimise revenue.

Service Charges

7.29 We have not been provided with any information that indicates estimated service charges across the scheme. Service Charges will be influenced by the level of facilities available within a building and maintenance costs. Typical facilities include gardens/outside communal space, car park, gym, swimming pool/spa, business space, concierge, Porter etc.

7.30 Service charges are typically calculated on a rate per sq ft and we are aware of a number of schemes where service charges can range from c. £2 per sq ft to £17 per sq ft with the upper end of this range reflecting service charges on “super prime” Central London developments.

7.31 Residential values will be influenced to a certain extent by service charges as they can impact upon affordability in terms of target market price sensitivity and we would expect service charges to be considered in tandem with a unit by unit pricing exercise.

7.32 The applicant has not considered service charge liability in conjunction with the pricing of the scheme and they are of the opinion that this will be self financing insofar that the cost will be met by purchasers of the residential units.

7.33 However, we are of the view that service charges will have a significant impact on the scheme pricing as the level of service charges will impact upon the capital values that can be achieved.

Ground rents

7.34 The applicant has adopted a blended ground rent across the scheme of £400 per annum with no growth assumed.

7.35 Ground rents are typically influenced by the unit type and we would expect to see a spread of ground rents across each building which would be dependent upon the unit type (i.e. 1 bed, 2 beds, 3 beds etc). For example, we are aware of current developments within a close proximity to the application scheme being marketed with ground rents up to and in excess of £1,000 per annum with the larger units such as Penthouse apartments attracting the highest ground rents.

7.36 In addition, we have noted that several new build developments allow for review of ground rents after 5 - 10 years and these reviews will have regard to the retail price index (RPI). Consequently, the opportunity to review the ground rents in cycles could be feasible across the application scheme development programme.

7.37 Consequently, a defined unit mix per building will inform whether the ground rent assumptions adopted by the applicant are appropriate. However, there remains the opportunity to add value to the scheme as the design of the scheme evolves and there is greater certainty regarding unit mixes across the buildings.

Car Parking

7.38 The applicant has valued all residential car parking spaces across the scheme at £0.050m each. We understand that the scheme will offer a blend of basement parking spaces and under-croft car parking spaces. It is likely the value of the car spaces reflect whether located in a basement or under-croft and size of the space.

7.39 In addition, the appraisal model does not capture growth in the value of the car spaces.

Sales rate assumptions and Phasing

7.40 Savills have assumed that 60% of the residential units in each building will be sold by practical completion. With each building starting sales after a 24 month marketing period prior to practical completion with the remaining units in each building to sell within a 12 month period after practical completion.

7.41 Sales rates would be influenced by the product available and pricing. In addition, it is unclear whether the residential buildings would include their own additional facilities such as a reception/concierge, gym and swimming pool etc as the addition of these facilities could serve to increase sales values and sales rates.

7.42 In terms of achieving the applicants sales rates assumptions it should be borne in mind the release of new units would be competing with other new build developments that provide additional leisure facilities and are branded and designed in a way which provide a degree of exclusivity, comfort and security.

7.43 From a "high level" perspective, the applicant's sales rates in relation to off-plan sales do not appear to be unreasonable. However, the sales programme outlined in Para. 6.38 may not be appropriate for every building.

7.44 There remains the opportunity that 100% of units within some buildings could be sold by practical completion especially when considering marketing will start 24 months prior to practical completion. However, this would need to be carefully monitored as high demand could be an opportunity to increase pricing.

7.45 For example, building BW10d has 217 residential units and on the basis of 60% off-plan sales, 133 units are assumed to sell at practical completion. Whilst off-plan sales of 60% may be appropriate for this building due to the large number of apartments, by contrast, NE06c has 57 units and due to the lower number of units a sales rate in excess of 60% could possibly be achievable.

7.46 In terms of achieving significant off-plan sales, units within a scheme would usually be released in phases across a pre-practical completion marketing period with purchaser interest driven by launches of limited numbers of units providing a diverse range of unit types, sizes and specifications.

7.47 Consequently, as a detailed scheme design evolves there could be greater certainty of sales rates as each building will respond to the needs of the target market in terms of branding, specification and marketing to both overseas and domestic occupiers and investors.

Summary of Residential Revenue

Overview

7.48 We set out below an extract from the applicant's financial model which shows the revenue contribution for the residential elements of the scheme which broadly account for c. 90% of the total scheme revenue of c. £12.05 bn.

Residential Revenue Contribution	£m
Resi Town Houses	£316.77
Resi Premium	£3,549.00
Resi StandardPlus	£3,862.00
Resi Standard	£2,945.00
Resi Affordable	nil
Resi Intermediate Affordable	£141.89
Resi Decant Affordable	nil
Resi Decant Intermediate Affordable	nil
Total	£10,814.66

7.49 The residential values assessed by Savills for the outline application scheme do not appear to be unreasonable at this stage of design. Whilst Savills appear to have created a hierarchy of values across the scheme that differentiate values between the character areas. It should be noted that no comparable evidence exists that can support the values relied upon.

7.50 The application scheme will generate its own market with values that may outperform the immediate local market and this will be dependent upon the branding and place-making the scheme generates.

- 7.51 As the scheme straddles the border of LBHF and RBKC, the scheme is situated away from the higher value locations within RBKC. The scheme will attempt to replicate and draw some of the values that are achieved in the more aspirational and higher value areas of RBKC.
- 7.52 However, due to the limited level of detail available (in terms of the product available, indicative buildings and general site vision) it is unclear how this would be achieved.
- 7.53 Savills have highlighted in their report the application scheme is at an outline planning application and consequently a detailed design and layout of each building has not yet been undertaken. Therefore a unit by unit pricing exercise has not been undertaken.
- 7.54 However, we would expect a unit by unit pricing to be undertaken as the detailed design of the scheme evolves to provide greater certainty of the potential revenue streams that could be anticipated together with targeted marketing.

Pricing Methodology

- 7.55 In terms of pricing methodology, the approach undertaken by Savills does not appear to be unreasonable given the stage of design the scheme is currently at. Whilst we have not been provided with a building by building breakdown of values, Savills have provided us with an illustrative building mix for a building from each phase as examples of how the pricing exercise has been approached.
- 7.56 The unit pricing in Appendix 2 of the Savills pricing commentary shows building reference WV06a in phase 1 of the scheme and a spread of capital values reflecting unit types, sizes, specification and floor level.
- 7.57 The spread of values follows the logic that apartments located on the upper floors which benefit from desirable views have the ability to generate higher capital values than similar units on the lower floors.
- 7.58 However, the values provided for the apartments are based upon average unit sizes and we would expect greater certainty in respect of the values once a

detailed design of this building has been undertaken as the current pricing for the building has been based upon broad assumptions in terms of unit mix and average unit sizes.

Comparable Evidence

7.59 There is no direct comparable evidence to fully support the values adopted for the scheme due to the location of the subject site and that capital values for residential units in the immediate locality are lower than the values adopted for the proposed scheme.

7.60 Ultimately, the values the application scheme will achieve within each of the phases will be dependent upon the achieved values from the first initial phases. Savills have indicated that the aim for the scheme in terms of achieving optimised value is to draw value across from Phase 1 situated within RBKC.

Plot Sales

7.61 The CBRE appraisal model assumes that the applicant adopts the role of “master developer” and will sell individual building plots to market developers to build units.

7.62 Whilst the pricing exercise undertaken by Savills should reflect current day values, the applicant’s appraisal models assumes individual building plots will be sold to other developers to construct and sell.

7.63 Consequently, in the future this could result in a broad range of product types not yet envisaged which could impact upon the residential revenue and sales rates assumptions which will impact upon the overall viability of the scheme.

Marketing

7.64 For example, a building developed by a high end developer is likely to offer a more luxurious product than that offered by a volume house builder and consequently it would follow that there would be a significant price differential between the respective developers product.

7.65 As the scheme evolves, the pricing of residential units will be influenced by the developer, the product on offer, demand and the price points at which

previous sub-phases have sold. With this approach it will be critical to manage the release of building plots to avoid over supply and the dilution of values.

- 7.66 The scheme will generate its "own" market and a developer's aspiration for generating sales revenue will be influenced by providing a product type which is different to that of previous buildings, phases and one that meets the needs of the purchasers at a specific point in time as tastes and trends will evolve over time.

Product Differentiation

- 7.67 This will require careful management to avoid the potential competition of "second hand" stock from previous phases competing with the release of "new" buildings coming forward as this could have a detrimental impact on achieving optimum scheme revenue.

Unit by Unit Pricing

- 7.68 As the level of design for the residential buildings evolves it is likely the pricing for the apartments will be assessed on a unit by unit basis. This would take account of each apartment's specific attributes such as floor level, outside space (balcony/terrace), layout and aspect. Thus providing a greater level of certainty of capital values that could be achieved.

- 7.69 However, given the stage of design and our comments set out above we are broadly satisfied with the values that have been adopted by the applicant.

Residential Unit Mix

- 7.70 The applicant's appraisal model assumes a development scheme of 6,775 units (comprising private residential 5,475 units, intermediate residential 740 units, and 560 units decant and relocation).

- 7.71 The RBKC application scheme and LBHF application scheme proposes a unit mix range set out in the table below.

Restricted: Earl's Court Opportunity Area – Site Wide

	Scheme Total	RBKC					LBHF		
		Phase 1	Phase 6	Total	%	Range	Total	%	Range
Studio	226	0	0	0	0%	0%	226	4%	2-5%
1 Bed	1870	134	0	134	14%	10-15%	1736	30%	29-35%
2 Bed	2479	320	4	324	35%	20-40%	2155	37%	30-40%
3 Bed	1450	229	8	237	25%	25-40%	1213	21%	20-25%
4 Bed	750	235	0	235	25%	25-35%	515	9%	5-10%
Total	6775			930			5845		

7.72 The site wide mix will be informed by each individual buildings unit mix and it is pertinent to this review that as more detailed unit mixes are developed for each building this will inform the proportion ranges proposed by the applicant. Given the stage of design the applicant has adopted average unit sizes and mixes across the entire scheme.

7.73 However, as the design progress and floor layouts are worked up the units within an individual building will be priced on a unit by unit basis and at this time the substitution and mix of units contained within a block could impact upon the scheme metrics in terms of cost and revenue.

8. Commercial Uses (December 2011 scheme)

8.1 The application scheme comprises a mix of commercial uses including offices, retail, leisure, hotels, medical and various other community uses. The master plan proposes the following approximate floor areas for each of these uses:

Use	Total approx GIA (sq m)	Total approx GIA (sq ft)
Offices	94,409	1,016,217
Retail	25,796	277,673
Leisure	13,993	150,615
Hotels	15,748	169,510
Education	4,662	50,177
Private Hospital	10,208	109,876
Cultural / Community Hub	7,331	78,906
Day Care Facility	1,351	14,543
Health Care	3,378	36,355

Source: Areas extracted from the applicants site-wide appraisal model

8.2 We have analysed the floor areas set out above and we are satisfied the floor areas reconcile with the floor areas which inform the financial model.

8.3 Much of the detail and commentary is provided in the CBRE report. For the purposes of the commercial values review, we have focussed our attention on the assumptions where there is a degree of uncertainty or disagreement.

Office Revenue

8.4 The yield and rental values proposed appear optimistic in relation to the current surrounding market. However, we accept them as reasonable based on the applicant's vision for the scheme and in relation to the uplift in values and 'place making' that would occur as a result of the wider scheme. The rent free period of 18 months appears reasonable in relation to the rental values proposed and the evidence provided.

8.5 The applicant has assumed 25% of the larger format office space to be subject to pre-let agreements which would be required in order to get development

funding. Of the pre-let space, lower rental values of £35 per sq ft are proposed which is a reasonable assumption.

- 8.6 Empty property costs are assumed for the office space which would not be subject to pre-lets. The void period for this space is one year and empty rates at approximately half of the rental value with a 3 month grace period are reflected. Void service charge costs of £3 per sq ft per annum are reflected.

Retail Revenue

Overview

- 8.7 We are informed that a detailed design for the retail units does not exist for the scheme and whilst DVS requested details and values for proposed individual units this has not been provided. In addition we are informed that proposed breakdowns for the different classes (A1 – A5) within the retail is not available.
- 8.8 Both of these factors are value significant; smaller units tend to attract higher rental values per sq ft than larger units as do corner units and those with more prominence and return frontage. Use classes A3 – A5 tend to attract higher rental values than A1 – A2. Accordingly we would normally expect a more detailed valuation breakdown for the retail units.
- 8.9 The applicant has provided the following valuation assumptions in respect of the retail units (there is no retail in phase 4):

Use	Average Rent (£psf)	Yield	Void	Rent Free
Retail – Phase 1	£30	5.75%	12	18
Retail – Phase 2	£30	6.25%	12	24
Retail – Phase 3	£40	5.75%	9	15
Retail – Phase 5&6	£40	6%	12	18

Retail Rents

- 8.10 In support of the proposed rental values the applicant has provided retail comparables for Earl's Court Road and North End Road, the two nearest current retail locations to the scheme. The applicant asserts prevailing retail values are c. £35 per sq ft in Earl's Court Road and c. £25 - £30 per sq ft in North End Road.

- 8.11 The evidence provided details new lettings, rent reviews and lease renewals on Earl's Court Road. New lettings provide the most reliable form of evidence and carry the most weight. Analysing the new lettings only for Earl's Court Road produces an average value of over £41 per sq ft. which makes the applicants assumptions appear pessimistic regarding value.
- 8.12 We appreciate the retail in the scheme may be dispersed to a greater extent than the retail offer currently based on Earl's Court Road. This dispersion may have a downward impact on the rents achieved. Conversely, the scheme proposals would be likely to lead to increased footfall in the area which would have an upward impact on value, particularly when we consider the affluent target market.
- 8.13 In light of the above we consider a sensitivity analysis should be applied to the retail at say + £10 per sq ft increment above the values proposed by the applicant. This approach considers the impact of achieved values of £40 - £50 per sq ft. The A3 – A5 units would generally attract higher rates per sq ft as would smaller and more prominent units. Until a more detailed design and valuation approach is provided, we are unable to provide further commentary on the rental values proposed. We would expect greater opportunity to increase the revenue from the retail space as the design evolves.

Retail Yields

- 8.14 Based on the applicant's current retail vision and strategy, the initial yields do not seem unreasonable. However, as a more detailed design and strategy evolves there will be a greater level of certainty. Furthermore a change in strategy to secure anchor tenants with stronger covenant strengths would see a reduction in yield for some of the units and thus a rise in value.

Retail strategy

- 8.15 We consider it would be unlikely that a developer would sell individual retail units immediately on practical completion. Instead, a more prudent and potentially lucrative strategy would be to sell all of the units together as a portfolio once the entire scheme is built.

- 8.16 Whilst the developer would benefit from rental income from individual units as they come forward, selling all units together at the end of the scheme would allow the developer to benefit from rental growth and tenant management. Consequently we would expect to see a reduction in yield to occur. Accordingly we suggest to run a sensitivity analysis based on a yield reduction of 25 basis points to reflect the synergy of a portfolio sale which would provide an investor to manage tenant mix and drive rental income.

Rent Free Periods

- 8.17 Rent free periods in the region 15 – 24 months are assumed. These rent free periods are in excess of the local evidence provided. However, the applicant has pointed towards wider evidence across London where longer rent free periods are found. The upper end of the applicants anticipated rent free periods are in excess of what we would consider reasonable. However, the lower end would appear to sit within reasonable parameters.

Void Periods

- 8.18 An assumption that 30% of the retail units will be subject to pre-let agreements has been made to reflect the likely pre-letting that would occur in respect of the food stores and branded restaurants. It is argued the rents would reduce and rent free periods would increase for the units which are pre-let.

Empty Property Costs

- 8.19 As with the office space, the retail space which is subject to voids will incur empty property costs which comprise empty rates and service charge voids. The applicant suggests empty rates of approximately half of the rental value and service charge costs of £1.50 per sq ft per annum.

Leisure Revenue

Overview

- 8.20 As with the retail, we have not been provided with a unit breakdown for the leisure units. Whilst we are informed that detailed design does not exist at this stage of the scheme, we would ideally require a unit breakdown which details the individual type of use for each unit within the leisure category.

Rents

8.21 The applicant's evidence demonstrates a differential in the rental values achieved between different leisure uses. For example, rental values for cinemas tend to be in excess of those achieved for gyms. This places further emphasis on the importance of a unit breakdown in order to justify the average rate of £12 per sq ft proposed.

8.22 Whilst the rental values proposed appear optimistic in relation to the gym evidence provided, it is pessimistic in relation to the rental values provided for cinemas. Furthermore, the target market for the leisure uses in this scheme will be more affluent than those locations from which the evidence is drawn.

8.23 The rental values are difficult to judge for this use type due to the lack of local, recent evidence for new lettings. The lack of detail provided for the proposals raises an element of doubt as to whether the values are reasonable and we suspect there would be opportunity to improve these revenues with a more detailed design.

Yield

8.24 The yield of 6% proposed for the leisure uses is supported by evidence provided and we can accept this as reasonable.

Rent Free Periods

8.25 The rent free period adopted is 18 months. This appears excessive in relation to the rental values proposed and the evidence provided. We are aware of a recent mixed use scheme where much shorter rent free periods were being negotiated in respect of the leisure components. Further explanation is required to support the assumptions made in these respects and we have requested this information from the applicant. To date this has not been forthcoming.

Void Periods

8.26 As with the retail, an assumption that 30% of the leisure space would be pre-let is made which reflects the target tenant mix and the fact that mainly independent traders are envisaged. The remaining space is subject to a one year void period.

Empty Property Costs

- 8.27 Empty rates are assumed at £6 per sq ft per annum and void service charges of £1 per sq ft per annum are assumed. The empty rates will be subject to a 3 months grace period.

Hotel Revenue

- 8.28 We referred the valuation of the hotels to our Licensed Property Specialists. They have commented that they have reservations regarding the applicants approach and question the market for a 5 star operation in Earl's Court. However, they have indicated they consider the values are reasonable and accept the figures proposed.

Other Uses

- 8.29 We are aware of other uses proposed for the scheme including education and community uses including cultural community hub, day care facility and health care.
- 8.30 These uses appear in the model but we have not been provided with supporting commentary and evidence. Education has not been valued in the model and cultural community hub, day care facility and health care have all been valued at £5 per sq ft capitalised with an 8% yield.
- 8.31 Whilst no evidence or commentary for these uses has been provided, some of the values adopted, particularly for the health and day care facilities, appears very low and well below our expectations.
- 8.32 Furthermore, it is unclear why no value at all has been adopted for education. Despite requesting this information in our previous discussion document, we have not had the opportunity to review these values.
- 8.33 The applicant's advisor Quod in a recent meeting verbally confirmed that notional values had been applied to education and community uses including cultural community hub, day care facility and health care as the accommodation was part of the in-kind S106 contribution.

9. Growth Assumptions

9.1 The merit of using an outturn approach is that it can secure a known amount of affordable housing when the scheme on a current cost approach is not viable. The downside, however, is that growth is difficult to predict and the amount of affordable housing and S106 contributions secured could look insufficient if the market grows at a faster rate.

9.2 We have considered the applicant's growth assumptions, which are a blended consensus of several agents' research forecasts and we set out below:

Prime Central London Forecasts

	2011	2012	2013	2014	2015
Savills	-1.00%	10.00%	8.00%	6.50%	6.50%
Jones Lang Lasalle	5.00%	9.00%	13.00%	11.00%	8.00%
Knight Frank	2.00%	8.00%	7.00%	6.00%	4.00%
Average	2.00%	9.00%	9.33%	7.83%	6.17%

Source: Prime Central London Forecasts provided by applicant
July 2011

9.3 For the purpose of this assessment we have adopted these growth assumptions which at first appear to be aggressive given the prevailing greater level of economic uncertainty.

9.4 However, recent market commentators have reported that revenue increases in Prime Central London since March 2009 have risen by c. 48.4%.

9.5 The applicant's appraisal model adopts a revenue growth rate for 2011 at 2%, however, with the benefit of hindsight it has been reported by Savills and Knight Frank in 2012 that price growth in Prime Central London in the year ending March/June 2012 rose between c. 8% to c. 11.5%.

9.6 On this basis, this research indicates that the appraisal model assumptions have understated market performance during this period which serves to highlight the uncertainty with forecasts over the project programme of c. 22 years. Equally it should be borne in mind the model may indeed be too optimistic and overstate market performance.

9.7 On balance we are of the opinion the growth rates adopted by the applicant are a reasonable indication of future performance for the various sector uses and would highlight there remains a greater level of economic uncertainty at the date of this report.

Summary of Commercial Revenue Contribution

9.8 We set out below a summary of the commercial revenue contribution extracted from the applicants financial model:

Commercial Revenue Contribution	£m
Retail	£179.52
Offices	£877.96
Leisure	£28.17
Hotel 5 Star	nil
Hotel Suites	nil
Hotel Serviced Apartments	nil
Hotel Boutique	£33.24
Hotel 3 Star	£49.02
Education	nil
Medical	£58.48
Cultural/CommunityHub	£6.13
Day Care Facility	£1.18
HealthCare	£2.94
Total	£1,236.63

10. Construction Costs

- 10.1 The site was inspected on 11 March 2011 and a briefing meeting for the scheme on 17 March 2011. We also met with EC Harris to review their cost model on 5 April 2011. This review was at a high level to understand how the model was compiled and the information used in arriving at the quantities and rates used.
- 10.2 The costs of the scheme can basically be split into two sections, being up to and including the "podium" and above "podium". Above "podium" is basically the buildings.
- 10.3 The costs submitted for the below "podium" works are generally based on measured quantities and rates derived from meetings with specialists suppliers/sub-contractors etc. The total cost from revision E masterplan is £3.96bn of which 1.18bn is for the podium and below which equates to approximately 30% of construction costs.
- 10.4 The costs submitted for the buildings are generally based on areas derived from the Capco Area schedule dated 24 May 2011 (updated 4 June 2011) and rates derived from benchmark schemes. With this in mind confirmation is required whether these costs have been revised to reflect the recent application revisions to the scheme.
- 10.5 A subsequent meeting was held with EC Harris on 12 September 2011 to discuss and review in detail the rates used in calculating the estimate.
- 10.6 Commercial office rates are based on low/medium rise commercial offices with a mix of workspace units and larger floor-plate offices and include fit out to basic Cat "A" standard.
- 10.7 Retail rates are for shell only with capped services and no finishes with temporary shop fronts (permanent shop fronts and fit out by Tenants)
- 10.8 Hotels are included as budget hotel with limited front of house facilities where adjacent to A4 and Boutique hotel with larger room sizes, spa, pool and extensive front of house facilities.

- 10.9 Education buildings are benchmarked against typical "City Academy" costs.
- 10.10 Medical costs included for Private Hospital to shell only with fit out by the Provider.
- 10.11 Cultural and Leisure buildings are benchmarked against similar schemes and include base fit out but exclude any equipment.
- 10.12 The Residential costs have been benchmarked against specific schemes to ensure the quality is compatible with the standards assumed when considering the "values" of the properties.
- 10.13 The detail of the benchmark schemes are contained in the EC Harris document entitled Earl's Court Regeneration Illustrative Report dated 8 July 2011.
- 10.14 All the benchmark schemes referred to were reviewed in detail and many were based on actual construction costs and we are of the opinion they are a reliable source of comparative cost information for the scheme when considering the level of design information available for the buildings at this point in time.
- 10.15 Arup Engineering who are the applicant's structural engineers working to the scheme are of the opinion that certain of the buildings require to be mounted on either springs or elastomeric bearings to reduce the effects of vibration caused by adjacent railway and underground lines.
- 10.16 This opinion was challenged by the applicant but Arup remain adamant they are necessary. Discussions were held with specialist suppliers based on the extent of work defined and budget prices were obtained and these are incorporated in the Cost Model.
- 10.17 The Cost Model includes for the demolition of the Earl's Court & Olympia Centre and associated Portal Frames as necessary together with surrounding buildings. The amounts included are based on Budget figures provided by a specialist who has been appointed on a pre-demolition basis.

- 10.18 A substantial amount of work has been focused on the pre-stressed concrete portal frames spanning the underground/railway lines to ensure that only the minimum are demolished as this will be a very problematic and consequently expensive item of work.
- 10.19 The off-site road junctions have each been considered separately and the Cost Model includes the cost of the essential works with Section 106 costs picking up the additional costs.
- 10.20 The cost of providing the Utility supplies has been split into two areas namely Primary – bringing to site, and Secondary – distributing around the site.
- 10.21 The costs are based on budget quotations from the providers.
- 10.22 The Cost Model includes for Energy Centres and these have been costed from first principles using the size of the new buildings, assessed energy loads. No reverse premiums are included in the construction costs which we have assessed and it is reasonable to assume a developer would negotiate a reverse premium with an energy provider. We have not raised this with the applicant but given the stage of design, the energy requirements and temporary phasing of implementing on-stream energy infrastructure, it is difficult to estimate.
- 10.23 These permanent facilities will not come on line until after the initial buildings are completed and occupied and accordingly the Cost Model includes for Temporary Facilities in addition, and these are linked to the phasing programme.
- 10.24 The drainage costs are high but this is because a lot of the drainage is very deep due to the existing levels in addition to the need to store run off rainwater during periods of heavy rain to ensure the amount discharged into the public sewers does not exceed the current situation.
- 10.25 The Cost Model includes for a sealed vacuum operated waste disposal system (Envac or similar) and the cost has been based on a budget quotation with allowances for the necessary builders work requirements. We have not raised

with the applicant whether this infrastructure would attract a reverse premium that could be leveraged for this infrastructure but as Para 9.22 above it is probably too early in the design process to estimate.

- 10.26 The on-site roads have all been costed as basic tarmac finish etc together with an extra over allowance included for enhanced specifications based on masterplan drawings.
- 10.27 The Cost Model also includes for the provision of a new Stabling Block for Transport for London (TfL) and London Underground Limited (LUL). The scheme has been developed with TfL and LUL and may still be subject to further revision.
- 10.28 The costs include for maintaining a facility at all times and for the cost of out of hours working as will be necessary to accommodate the continued use of the facility at all times.
- 10.29 All the costs referred to were reviewed in detail and most were based on detailed measures and historic cost information together with detailed discussions with interested parties and in my opinion are a reliable source of cost information for the scheme when considering the level of design information available at this point in time.
- 10.30 The scheme straddles the boundary between RBKC and LBHF and in considering the infrastructure. In so far as the costs that inform planning application 1 & 2 the applicant has allocated those costs to deliver the respective scheme. The costs have then been apportioned across the various buildings that fall within the LPA boundaries. For example the elements of expenditure in respect of the lost river park that fall within RBKC are borne by that scheme. However this is more pertinent when considering the metrics of application 1 as a stand alone scheme
- 10.31 The applicant has applied a development contingency within the financial model of 5% on master developer costs (excluding land) and 3% contingency on plot development costs (excluding land).

10.32 We did consider removing the development contingency sums from the model and discussed this with the applicant to understand the project risks at this stage of design.

Construction Project Risk

10.33 However given the stage of design and as at April 2012 the applicant set out they currently have a mitigated project risk to c. £741m to support the inclusion of c. £250m in the overall development appraisal model for risk over and above that included in the construction cost estimates.

10.34 Accordingly it can be seen that we would have to be able to justify significant amendments to the Risk Schedule to support the exclusion/reduction of the claimed amount.

10.35 In addition at the meeting on 30 April 2012 it was noted that since the preparation of the risk schedule some items have moved on and it has become more or less certain that the additional costs identified, for the identified items, will be incurred.

10.36 It is also worth highlighting that we have accepted the provision of the risk schedule information presented at face value. The detailed build ups provided in support of each of the claimed items is often fairly approximate, but this is only to be expected given the nature of the items and stage of design.

10.37 Following the meeting on 30 April 2012 we confirm that we accept the methodology used in the preparation of the mitigated risk value and that it supports the inclusion of at least c. £250m in the financial model.

10.38 If anything it may well be that the amount included is insufficient, given the level of cost risk that was verbally identified by the applicant and their cost consultant EC Harris.

10.39 In conclusion we are of the opinion the rates adopted are acceptable but that they should be reviewed when more detailed information is available.

11. Additional Cost Headings

Professional Fees

11.1 The applicant has adopted professional fees at 12% and for the purpose of this assessment these costs fall within an acceptable range albeit at the upper end of what we would expect to see. However, any developer taking forward this scheme would probably agree fixed fees at a rate lower than percentage sum allowances.

11.2 Given the scale of the project we would anticipate that appointment agreements would be in place with the professional team members which would set out the terms of their instruction and the staged fees that have been agreed. We question whether the applicant should more closely reflect the fees and terms of appointment within the financial model.

11.3 Furthermore it is unclear to what extent if any the applicants planning costs of c. £30m refer to as some cost headings that are business overheads and services would be captured within professional fees cost headings.

Finance

11.4 The applicant has adopted a finance rate of 7%. This rate falls at the upper end of an acceptable range and we have used this for the purposes of our assessment.

11.5 The model assumes 100% debt funding in order to reflect an ungeared IRR.

Project Programme

11.6 We have adopted the application scheme's project programme, however, should the council wish to have this verified we will need to refer to a specialist construction planner to test and determine whether the applicant's proposed timelines contained within the programme for the site preparation, construction and fit-out works are reasonable.

11.7 For example the residential plots have an assumed construction programme of 24 months across the sites.

12. Planning Obligations

12.1 We are advised by the instructing client group the scheme will deliver the following:

Earl's Court Section 106	Site-wide option
In-kind contribution (includes costs for nursery and primary schools, health, leisure, community and cultural facilities, station works, off-site highways works, off-site public realm improvements , travel plan measures)	£101,114,366
Cash contribution (includes contributions for station improvements, on and off-site bus stops, bus service and cycle route improvements, London cycle hire hubs and off –site public realm, monitoring, as well as, RBKC contributions to education and health)	£11,653,536
CIL estimate*	£34,385,355
TOTAL	£147,153,257

*assumes all existing floorspace is used in calculation

12.2 The 560 dwellings which comprise the existing Estates are to be re-provided at nil cost to LBHF and it is proposed these tenants are decanted early within the scheme programme which is a critical strand to achieving the LPA's vision for the Opportunity Area. In addition, a payment of c. £33.57m will also be made in order to secure 200 homes at Seagrave Road.

12.3 It is envisaged that 740 affordable dwellings are to be provided as intermediate tenures.

13. Exceptional Development Costs

Rights of Light

- 13.1 The applicant has provided a Rights of Light report which indicates a compensation budget of c. £84m although the applicant has adopted a significantly lower sum of c. £30m. However, this review may require revision following the December 2011 scheme amendments.

Decant Costs

- 13.2 The applicant has made allowance of c. £1.676m with the costs that are anticipated to cover the decant costs of 200 dwellings at Gibbs Green to cover the occupiers compensation, legal and moving costs.

- 13.3 The applicant advises the costs are based on a notional phasing plan for the regeneration of the estates and the applicant asserts that following more recent work undertaken has indicated the cost timing assumption is realistic but is dependent on resident consultation and need assessment, and CPO processes (if required).

- 13.4 We are advised the compensation quantum is as negotiated with LBHF Housing and Regeneration team (i.e. Statutory home loss payments to tenants, removal cost assumptions, valuation advice and conveyancing costs) which will be borne by the developer.

Oversailing Costs

- 13.5 The model assumes a master developer scheme wide allowance of c. £5m for cranes oversailing during the infrastructure works in respect of c. 20 oversailing interests. A further allowance of £5m has been made to reflect the oversailing costs that can reasonably be anticipated during construction of the individual plots.

- 13.6 Whilst, it is reasonable to adopt sum allowances to reflect oversailing costs the applicant has not undertaken any detailed external consultant review in determining these sums.

Party Wall Costs

- 13.7 The applicant has adopted an allowance of c. £8m to reflect party wall costs although it remains unclear how this sum has been determined. However, it is reasonable to assume that costs will be incurred in respect of party wall awards and it remains unclear whether this sum allowance is indeed under or overstated.

14. Payments to Transport For London (TFL)

14.1 The financial model adopted c. £240m payable to TFL to reflect land acquisition, relocating existing operational facilities and to re-gear the leases of EC1 and 2. We are advised by the applicant this remains the subject of on-going negotiation between the parties.

14.2 We have not been provided with information by the applicant to evidence the sums reserved in the applicant's model (as best practice requires) and in order to expedite drawing together our assessment and report we were directed by RBKC, LBHF & GLA to adopt the sums reserved in the financial model.

14.3 We are now advised by the applicant that following continuing negotiations over the last 12 months TFL are now seeking to receive c. £360m as a minimum payment from the applicant which represents an uplift of c. £120m.

14.4 Accordingly, we have taken into account the increased minimum payment required of £120m as a sensitivity test to assess the impact upon the schemes IRR performance and we comment more fully in section 15 of this report.

14.5 Clearly, as we have not been party to any of the negotiations or indeed been provided with detailed correspondence we have no further comments in this respect.

Compensation Costs

14.6 A provisional sum of £5m has been adopted by the applicant as an allowance for the compensation costs of disturbance to neighbours as a result of the works. We have not been provided with a detailed study to inform the adoption of this provisional allowance although it is reasonable to adopt a sum allowance and without supporting evidence it is unclear whether this is under or overstated.

Building Regulations Fees

14.7 The applicant has adopted a scale Building Regulation fee of £5m and we have been provided with the calculation which supports this sum which we accept.

Estate Non-Recoverables

- 14.8 The financial model assumes non recoverable estate services charges estimated to be c. £4m.
- 14.9 This cost heading provides for non-recoverable costs where through the course of phased development there will be periods when residential, commercial, retail buildings are vacant.
- 14.10 The costs allowances are intended to cover the following cost headings:
- Empty property rates
 - Insurance
 - Heating, lighting & security
 - Maintenance repairs and redecoration
- 14.11 We are unsure why the applicant (master developer) would incur these costs as they propose selling serviced plots to plot developers and these costs would more than likely be met by the plot developer. Consequently, the plot developer would be exposed to these liabilities and not the master developer.
- 14.12 We have not been provided with an indicative breakdown of how this sum is made up although it is realistic to make an allowance for non-recoverable costs but without supporting evidence it is unclear whether this is under or overstated. However, for the purpose of this assessment we have adopted these costs.

Estate Wide Marketing

- 14.13 The applicant has made an allowance of £25m to reflect estate wide marketing and we are unclear how this is broken down. Although it is reasonable to adopt a sum allowance to reflect marketing and branding given the scale of the scheme.

Planning Costs

- 14.14 The applicant has made an allowance of c. £30m to reflect the costs incurred by the applicant up to the submission of the planning application and refer you to our comments at Para 10.3 above.

Void Management Costs

- 14.15 The model makes provision for building service charge costs is c. £3.5m although the applicant has not provided an indication of how this is made up but it reasonable to assume the applicant would incur non-recoverable costs whilst buildings are vacant.

Costs of Wayleaves & Easements

- 14.16 An allowance of c. £5m has been adopted for utilities resulting from building over agreements, wayleaves and easements for drainage, water mains, data cable and substations. Whilst it is reasonable to make allowance the applicant has not provided a breakdown of how this is has been calculated.

Occupier Contributions

- 14.17 An allowance has been allocated for enhancing 200,000 sq ft of the retail accommodation that will bring the various units to the minimum standard to reflect CBRE value assumptions i.e. to 'white box' at a cost of c. £33 psf which equates to a scheme wide cost of c. £6.5m which we accept as reasonable.

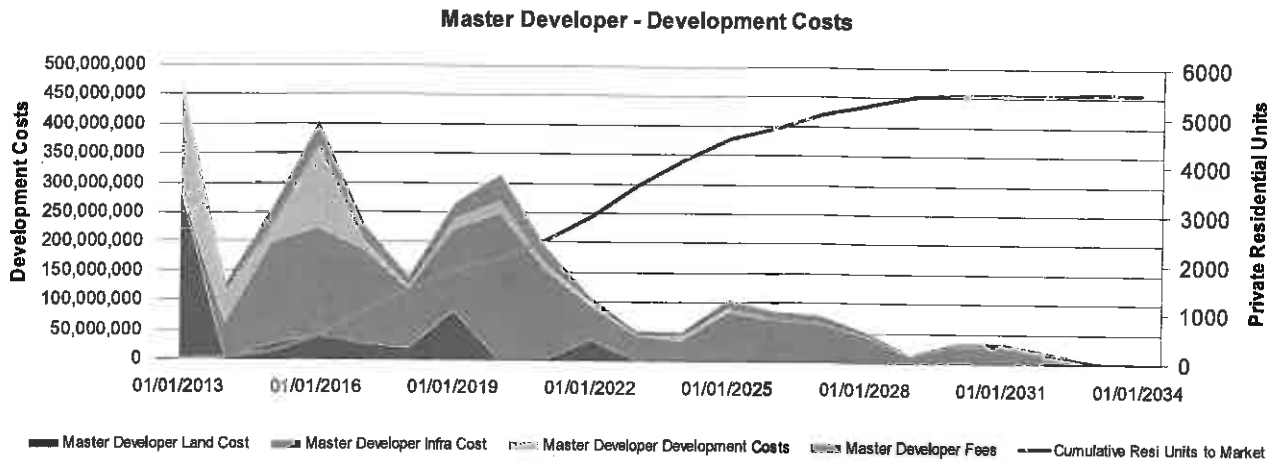
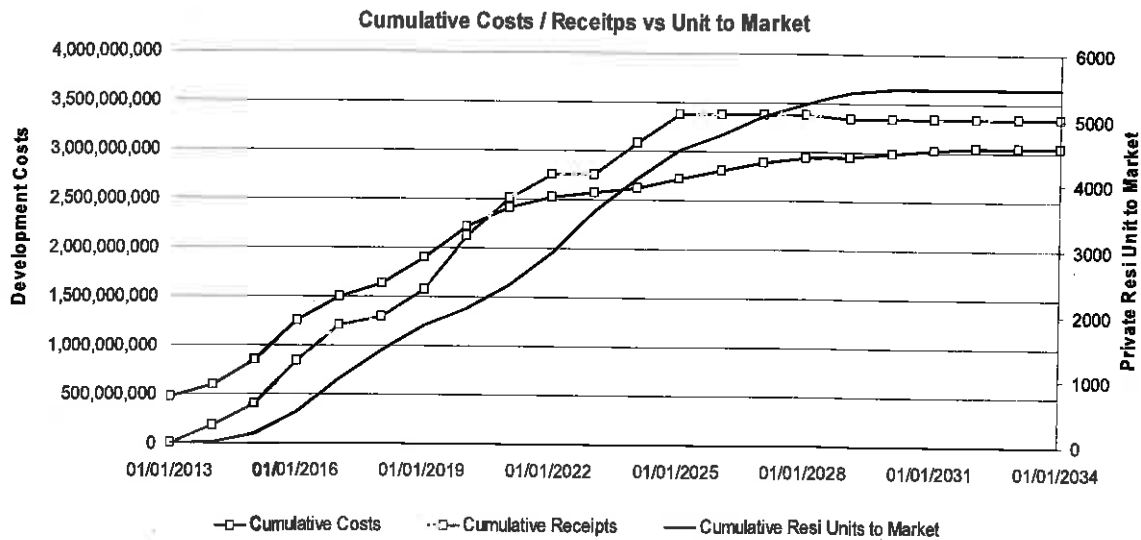
- 14.18 The approach to letting and managing the retail element of the scheme suggests that for a successful outcome the retail units will need to be held as a portfolio in order to optimise the synergy of the retail estate and in order to drive rental performance through successful asset management and branding.

Additional Reserve Matters

- 14.19 The costs calculated for the costs associated with reserved matters applications in accordance with the Borough LPA's have been determined at c. £0.5m which we accept representing the fees that would be payable.

15. Developer Return

- 15.1 Our review of the applicant's model together with supporting evidence has resulted in a number of areas where additional clarification has been required and where possible we have reached an agreed position on these areas.
- 15.2 As part of this process there has been extensive discussions relating to the assumptions which have informed the applicant's financial model and in particular the approach adopted to inform the benchmark land values and residential sales values and growth.
- 15.3 We have accepted the applicant's base residential sales values and these are grown year on year to the point at which the plots are sold by the master developer to plot developers (although it remains possible the master developer may choose to take forward plots for direct development rather than sell).
- 15.4 However the model assumes a deemed disposal date for all of the serviced plots and the values are grown to the point in the programme at which the master developer sells the plots.
- 15.5 We attach as appendix 2 a phasing diagram prepared by Farrells dated February 2012 and graphs below which show the scheme metrics as per the applicant's approach which assumes plot sales, which are assessed as at the construction start on site date for the individual plots.



Source: Graphs prepared by CBRE August 2012

- 15.6 The applicant's financial model assumes the master developer incurs costs of c. £3.05 bn and receives a return of c. £293m over c. 25 years which reflects an IRR of 8.39%.
- 15.7 Whereas over a similar project programme the plot developer(s) incurs development costs of c. £8.7 bn and realises a return of £1.9 bn reflecting an IRR of 15.53%.
- 15.8 This serves to highlights the relative risks in acting as master developer and on this basis we question whether an IRR at 8.39% is sufficient risk reward at this stage of design and raises the question of 'deliverability'.

- 15.9 We disagree with the approach adopted by the applicant as the model ignores residential growth in values that occurs between construction start on site and the commencement of marketing and phased release of the dwellings to inform individual plot residual land values.
- 15.10 The approach adopted is broad ranging and does not take into account the opportunity of competitive bidding for the plots that could reasonably be anticipated over the project programme of c. 22 years.
- 15.11 We are of the opinion the exit strategy assumed by the applicant is not a consistent approach, as is common with the viability assessment of planning applications that we assess on the basis that sites are built out by the applicant.
- 15.12 The approach adopted by the applicant suggests that any applicant choosing to adopt a plot sale approach for an outturn model can avoid the capture of any revenue growth between the transfer date and the eventual marketing and phased release and sale of the dwellings.
- 15.13 Standing back from this we find it hard to comprehend why indeed the applicant or any other developer would sell the land short if they believe that residential values will grow as per their forecast growth assumptions which underpin their outturn financial model.
- 15.14 With this in mind we would envisage the master developer as a minimum would enter into joint venture agreements with individual developers in order they could share in any increase in values beyond the land sale date(s) by way of overage and/or clawback agreement.
- 15.15 The applicant maintains the growth reflected in the model is significant and the growth rates are considered to be aggressive. We do not agree and refer you to our comments under Section 9 above. This was not agreed with the applicant and so they requested that we consider growth by way of a sensitivity analysis after altering a number of the base model assumptions that indicate an IRR of 8.39%.

15.16 We set out an analysis of the sensitivity analysis below:

New Baseline Model		26.06.2012		
New Baseline IRR		8.39%		
Sensitivity No.	Sensitivity	IRR Before	IRR After	IRR Change / Impact
Sensitivity 1:	Amend Payments to Tfl **See Footnote 11	8.39%	3.54%	-4.85%
Sensitivity 2:	The Revised Base Viability Model will be tested on the basis of the Affordable Housing values being increased from £210 psf to £250 psf.	8.39%	8.79%	0.40%
Sensitivity 3:	The Revised Base Viability Model will be tested on the basis of the retail rents being increased by £10 psf.	8.39%	9.03%	0.64%
Sensitivity 4:	The Revised Base Viability Model will be tested assuming that cost growth is extended to the mid point and value growth is extended to 15 months pre PC.	8.39%	14.36%	5.97%
Sensitivity 5:	The Revised Base Viability Model will be tested assuming that cost growth is extended to the mid point and value growth is extended to the mid point of the Marketing Period i.e. 12 months Pre PC .	8.39%	16.51%	8.12%
Sensitivity 6:	The Revised Base Viability Model will be tested assuming that cost growth is extended to the mid point, 60% of the residential values will be grown to the mid point of the marketing period, i.e. 12 months pre PC and the remaining 40% of the residential values will be grown to the mid point of the post PC sales period, i.e. 6 months post PC	8.39%	21.84%	13.45%
Sensitivity 7:	Selling entire retail as a portfolio on PC with the yields trimmed by 0.25bps	8.39%	8.50%	0.11%
Sensitivity 8:	Substitute the premium apartments for standard plus as premium sell at a loss.	8.39%	9.86%	1.47%

Footnotes:

Tfl Payments as at 28.5.2012 - Depot Land Payment £10.35m, Depot Development Cost £130m, Tfl Regear Cost £100m

Tfl Payments as at 26.6.2012 - Depot Land Payment 110.175m, Depot Development Cost £130m, Tfl Regear Cost £120m

- 15.17 Whilst all of the sensitivity changes to the base model indicate a change in the IRR performance the principle change/impact to the IRR set out in the table above occur in Sensitivity 1, 4, 5 & 6.
- 15.18 In respect of Sensitivity 7 the applicant has disregarded our request to prepare a model that assumes that all retail accommodation is held by the developer or joint venture partner and they receive rental income until practical completion of the scheme whereupon it is sold as a portfolio. The applicant asserts that this is not the intended disposal strategy as modelled. However we disagree and refer to our comments at Para 13.17 -13.18 above.
- 15.19 In running the sensitivity analysis the baseline model assumptions remain constant other than amendments to reflect that particular sensitivity. For Example Sensitivity 1 the baseline model remains constant other than increasing the payment from £240m to £360m to determine the impact which results in a reduction in the IRR from 8.39% to 3.54%.
- 15.20 To avoid the potential to distort the model results the payment is reset to £240m in considering all other sensitivities.
- 15.21 The most significant change in the IRR occurs with Sensitivity 6 where the baseline model is tested assuming that cost growth is extended to the mid point, 60% of the residential values are grown to mid point of marketing period i.e. 12 months pre practical completion and the remaining 40% of the residential values are grown to the mid point of the post practical completion sales period i.e. 6 months post practical completion. This results in an increase of the IRR of 13.45% from 8.39% to 21.84%.
- 15.22 We have not considered the cumulative effect of changing both variables but if Sensitivity 1 & 6 were considered in a single model the net effect would be an IRR of c. 17%. As this does not exceed the applicant's minimum threshold IRR of 20% and would not be deemed viable.
- 15.23 On the basis of the information provided by the applicant the combined S106 package including the amount and type of affordable housing being proposed

at 10.6% reflects the maximum reasonable proportion the scheme can cross fund.

15.24 However, if the increased TFL payments are not accepted the IRR results indicate there could potentially generate an IRR in excess of 20%.

16. Conclusions

Developers Return

- 16.1 The new baseline model indicates an IRR of 8.39%. This would be below the applicant's minimum threshold IRR of 20% and the scheme would not be viable or deliverable. The sensitivity analysis set out above and more specifically Sensitivity 6 identifies that an IRR in excess of 20% could be achieved.

TFL Payment

- 16.2 However the summary also shows that if the TFL payment is increased as assumed in Sensitivity 1 and is accepted the IRR performance does not exceed the minimum IRR performance threshold and we understand negotiations are ongoing between the applicant and TFL as at the date of this report.

- 16.3 This indicates the current scheme is the maximum reasonable affordable housing offer at this point in time. However, in accepting this it should be borne in mind that we are being asked to consider an outline planning application where only three blocks of accommodation have been designed in detail.

Outline Stage of Scheme Design

- 16.4 A fundamental area of concern to us is the level of detail that informs the residential sales revenue and construction costs and the reliance upon average unit sizes, blended capital values and the broad ranging unit assumptions that have been adopted to inform the anticipated residential sales revenue of c. £10.81bn out of the entire scheme value of c. £12.05bn.
- 16.5 We are of the opinion that as and when buildings have been designed to include floor layout the dwellings should be valued on a plot by plot basis having regard to location, specification, amenity, aspect which will more accurately inform a blended capital value that can be reasonably generated by an individual dwelling or apartment block.

Revenue

16.6 We set out below a summary of the revenue contribution for the entire scheme which we have extracted from the applicant's financial model:

Scheme Wide Revenue Contribution	£m
Resi Town Houses	£316.77
Resi Premium	£3,549.00
Resi StandardPlus	£3,862.00
Resi Standard	£2,945.00
Resi Affordable	nil
Resi Intermediate Affordable	£141.89
Resi Decant Affordable	nil
Resi Decant Intermediate Affordable	nil
Sub-Total	£10,814.66
Retail	£179.52
Offices	£877.96
Leisure	£28.17
Hotel 5 Star	nil
Hotel Suites	nil
Hotel Serviced Apartments	nil
Hotel Boutique	£33.24
Hotel 3 Star	£49.02
Education	nil
Medical	£58.48
Cultural/CommunityHub	£6.13
Day Care Facility	£1.18
HealthCare	£2.94
Total	£12,051.29

Benchmark Land Value

16.7 Current best practice guides us to have regard to Market Value (MV) of the land and in this respect we are unsure whether the current use value (CUV) plus marriage value as relied upon by the applicant to determine the benchmark land value of EC1/2 and NAL will exceed a policy compliant alternative use value (AUV) of the site. If exceeded the benchmark land value would be overstated and this would artificially reduce any surplus that may be available for planning obligations.

16.8 In determining the Marriage Value of EC1/2 and NAL the applicant is relying upon a negative land value and it is our opinion that if the exhibition centres

were to remain in situ it would drive a developer to explore a different scheme proposal to mitigate the constraints and impact of not developing the EC1, EC2 and NAL land. Furthermore, in considering the redevelopment of the land that falls within RBKC which is ostensibly phase 1 of the site wide scheme there is some concern in our minds that this may not be "Deliverable" i.e. given the low level IRR return as a first phase.

Programme

- 16.9 The project has a programme of c. 22 years and the model relies upon forecast revenue growth and cost inflation. These factors coupled with the stage of design development of the scheme highlight the opportunity for the scheme as a whole to either outperform or underperform the current assumptions.

Review Mechanism

- 16.10 With this in mind we recommend the scheme should be reassessed by way of a mechanism to test viability of a phase/plot closer to the point of implementation to more accurately assess viability having regard to more detailed design information to inform construction costs, revenue and assumptions as the scheme is refined.
- 16.11 A review mechanism can set out the methodology of review which in this case should entail a comprehensive review of any given phase/plot ahead of implementation as the inputs i.e. values and costs will have a greater degree of certainty relative to the detailed application and evidence prevailing at that time.
- 16.12 As the project progresses the inputs and evidence will be drawn from project based costs incurred and residential sales prices which will more accurately indicate the revenue the scheme is capable of generating and the reasonable costs of construction that can be anticipated.
- 16.13 Clearly as and when the viability of the individual phases and plots is understood in more detail the parties can then assess whether or not the LPA's seek to put in place a mechanism to capture any improvement in the schemes actual performance relative to the individual viability review or

whether to roll-over to pump prime future plot development and phases of the scheme.

16.14 The applicant does not consider a review mechanism to be appropriate in view of the specific circumstances of the scheme i.e. comprehensive regeneration and the differentiation when compared to other strategic regeneration schemes which for example includes the delivery of the estate regeneration without recourse to public money and a S106 package of c. £147.15m (in-kind contributions, cash and CIL see Para 11.1 above for breakdown).

16.15 The applicant asserts:

'that in the event that a review mechanism were, against the wishes of the developer, to be pursued it should be noted that:

- *S106 package currently being put forward at time of application being determined would be reduced.*
- *There would be uncertainty over the timing of the delivery of these benefits – as they would be triggered by meeting agreed benchmark return levels – or indeed if they would ever be met at all.*
- *The overriding objective of delivering comprehensive regeneration and the delivery of a significant number of new homes, market and affordable, would be put at risk.*
- *This will present a further challenge to securing already limited sources of funding – to be deliverable schemes need not just be viable but also fundable – the inclusion of a complex review mechanism presents a significant risk in this regard.*
- *The necessary complexity of a review to enable it to deal with the specifics of this project should not be underestimated'*

16.16 Therefore, the precise nature of a review mechanism and indeed whether the applicant will agree will need to be more closely considered in the round of any discussion and offer the applicant and/or plot developer may ask the LPA to consider in order to ensure comprehensive development of that phase and the wider realisation of the Estate Regeneration and the wider opportunity area vision.

