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Review of Financial Appraisal Supporting Statement – April 2013 update

The Shell Centre

Prepared for

London Borough of Lambeth

May 2013

Contents

1 Introduction

BNP Paribas Real Estate was commissioned by the London Borough of Lambeth ('the Council') to advise on Financial Appraisal and Supporting Statement submitted in September 2012 by Quod, on behalf of Braeburn Estates Ltd ('BE') and Shell International Petroleum Limited ('Shell') (jointly referred to as 'the Applicant') in relation to their proposed redevelopment scheme ('the Development') at The Shell Centre, Waterloo, London ('the Site'). Since our first report was issued, there have been changes to the content of the Development, which have necessitated updates to the Financial Appraisal. Quod issued the most recent of these updates on 30 April 2013.

This report provides an independent assessment of Quod's updated Financial Appraisal, Supporting Statement and supporting documentation and evidence to assist the Council in its discussions with the Applicant in relation to an appropriate and economically viable level of affordable housing provision and financial planning obligations.

1.1 BNP Paribas Real Estate

BNP Paribas Real Estate is a leading firm of chartered surveyors, town planning and international property consultants. The practice offers an integrated service from nine offices in eight cities within the United Kingdom and 150 offices, across 30 countries in Europe, Middle East, India and the US, including 15 wholly owned and 15 alliances.

BNP Paribas Real Estate has a wide ranging client base, acting for international companies and individuals, banks and financial institutions, private companies, public sector corporations, government departments, local authorities and registered social landlords.

The full range of property services includes:

- Planning and development consultancy;
- Affordable housing consultancy;
- Valuation and real estate appraisal;
- Property investment;
- Agency and Brokerage;
- Property management;
- Building and project consultancy; and
- Corporate real estate consultancy.

This report has been prepared by Anthony Lee, MRICS MRTPI, RICS Registered Valuer, Duncan Henderson MRICS, RICS Registered Valuer and Sacha Winfield-Ferreira MRICS.

The Affordable Housing Consultancy of BNP Paribas Real Estate advises landowners, developers, local authorities and registered social landlords ('RSLs') on the provision of affordable housing.

In 2007 we were appointed by the GLA to review its Development Control Toolkit Model (commonly referred to as the 'Three Dragons' model). This review included testing the validity of the Three Dragons' approach to appraising the value of residential and mixed use developments; reviewing the variables used in the model; and advising on areas that required amendment in the re-worked toolkit. We were appointed again in 2011 by the GLA to review the Three Dragons model and our recommendations to the GLA are being considered.

Anthony Lee is a member of the RICS '*Experts in Planning Service'* panel, which was established in March 2009 to support the Planning Inspectorate on major casework and local development plan work submitted for independent examination. He has assisted the inspectors examining the economic viability of housing policies within the Core Strategies of Stockton Borough Council; Hinckley and Bosworth Council; and East North Hants District Council.

In addition, we were recently retained by the Homes and Communities Agency ('HCA') to advise on better management of procurement of affordable housing through planning obligations.

The firm therefore has extensive experience of advising landowners, developers, local authorities and RSLs on the value of affordable housing and economically and socially sustainable residential developments.

1.2 Report structure

This report is structured as follows:

Section two provides a brief description of the Development;

Section three describes the methodology that has been adopted;

Section four reviews the assumptions adopted by Quod and, where necessary, explains why alternative assumptions have been adopted in our appraisals;

Section five sets out the results of the appraisals;

Finally, in **Section six**, we draw conclusions from the analysis.

1.3 Disclaimer

The contents of this report do not constitute a valuation, in accordance with Valuation Standards VS 1.1 of the *RICS Valuation – Professional Standards – Global and UK Edition* (March 2012), and should not be relied upon as such. This report is addressed to the Council only and its contents should not be reproduced in part or in full without our prior consent.

2 Description of the Development

2.1 The Site

The Site is currently occupied by Shell's UK headquarters, which comprise Shell Tower (28 stories); three 'wings' (each 10 stories); a hard surfaced podium; and extensive basement level car parking, plant and ancillary facilities including a swimming pool, sports hall and theatre.

The Site benefits from an implemented planning permission (along with Listed Building and Conservation Area Consent) for a development scheme comprising the construction of a new office building upon the podium; a remodelling of the office accommodation provided within the wing buildings; and new retail and leisure uses at ground and basement levels across the Site.

2.2 The Development

Quod advise that the Development will comprise the following:

"The main application will seek planning permission for part demolition of the Shell Centre comprising Hungerford, York and Chicheley wings, upper level walkway and associated site clearance to create a mixed use development of 8 no. buildings with a common basement to provide a range of uses comprising offices (B1), residential (C3), retail (A1-A5), leisure (D2), community uses (D1/D2). It will also provide parking and servicing space, hard and soft landscaping within the site to include the provision of a new public square, highway and landscaping works to Belvedere Road, Chicheley Street and York Road, modifications to York Road Underground station, link bridges from new buildings to existing Shell Centre and other associated works. The proposed accommodation on site comprises a revised basement and eight buildings with Buildings 1 & 2 containing offices and retail and Buildings 3, 4a, 4b, 5, 6 & 7 containing a residential accommodation with retail uses at ground floor level."

Shell will continue to occupy Shell Tower (to which only minor works will be undertaken to make good the impact of the removal of the adjoining wing buildings). Shell will also pre-let Office Building 1. The remainder of the Development will be constructed on a speculative basis.

At this point in the scheme development process the exact number and mix of residential dwellings due to be provided is uncertain. However, it is anticipated that 750 to 800 dwellings will be delivered. Within their April 2013 appraisal, Quod have included the proposed on-site affordable housing units (52 affordable rent homes designed as extra care; and 44 intermediate rent units). The April 2013 <u>excludes</u> the cost of delivery the 70 off-site affordable housing units; Section 106 payments; and costs relating to the development of Hungerford Car Park.

3 Methodology

Quod have undertaken its appraisals using Argus Developer ('Argus'). Argus is a commercially available development appraisal package in widespread use throughout the industry. It has been accepted by a number of local planning authorities for the purpose of viability assessments and has also been accepted at planning appeals. Banks also consider Argus to be a reliable tool for secured lending valuations. Further details can be accessed at www.argussoftware.com.

Essentially, such models all work on a similar basis:

- Firstly the value of the completed development is assessed.
- Secondly the development costs are calculated, including either the profit margin required or land costs (if, indeed, the land has already been purchased).

The difference between the total development value and total costs equates to either the profit (if the cost of land is known and has been included as a cost) or the residual land value ('RLV'). The model is normally set up to run over a development period from the date of the commencement of the project until the project completion, when the development has been constructed and is occupied. The cash-flow approach allows the finance charges to be accurately calculated over the development period. This approach can accommodate more complex arrangements where a number of different uses are provided or development is phased.

Adopting the residual land value approach the output of the appraisal is a RLV. To assess viability the RLV is compared to an appropriate benchmark, often considered to be the Current Use Value ('CUV') of the site plus, where appropriate, a landowner's premium. An Alternative Use Value ('AUV') may also constitute a reasonable benchmark figure where it is considered to be feasible in planning and commercial terms. Development convention dictates that where a development proposal generates a RLV that is higher than the benchmark, it can be assessed as financially viable and likely to proceed. If the RLV generated by a development is lower than the benchmark, clearly a landowner would sell the site for existing or alternative use or might delay development until the RLV improves.

Quod have adopted a CUV benchmark land value derived from an assumption that the extant consent for refurbishment of the existing wing buildings and construction of a new office building on the podium is delivered. This is deemed to be a reasonable approach. Knight Frank ('KF') have provided the CUV appraisal.

Within their appraisal Quod have included the benchmark land value as a fixed land cost and therefore the output of the appraisal is the residual profit. Under this approach the test of viability is whether a reasonable level of developer return is achieved. There are a number of measures of profitability, such as profit on cost, profit on GDV and Internal Rate of Return ('IRR'). IRR is used by Quod as the primary measure of return due to the Project's lengthy timescale.

4 Review of assumptions

In this section, we first review the assumptions adopted by Quod in their appraisals of the Development.

4.1 Private sale residential values

Quod have relied upon advice provided by Savills and KF to inform the private residential sales values adopted within their appraisal. Through analysis of the available comparable evidence and their own judgement, Savills and KF have applied average values, on a pounds per square foot basis, to blocks of floors within each building. The lowest values (£800 per square foot) are applied to floors 1 to 12 of building 4a while the highest values (£2,100 per square foot) are applied to floors 19 and 20 of building 6. The resultant average values for each building range from £1,000 per square foot for building 3 up to £1,600 per square foot for building 6. Across the entire Development the resultant average value is £1,275 per square foot.

The Site occupies a unique position within London. Blocks 5, 6 and 7 will benefit from views across the River Thames to landmarks including Elizabeth Tower and the Houses of Parliament to the west and St Paul's Cathedral to the east. Although the Site does not benefit from a position directly adjacent to the River, the Jubilee Gardens allow for unencumbered views across to the River while also providing an attractive frontage. It is accepted, however, that uncertainty regarding the future of Hungerford Car Park might impact slightly upon Block 5. The position of Blocks 3, 4a and 4b will not allow for such impressive views for units at lower levels, although these Blocks will still undoubtedly command prime central London status. Proximity to Waterloo ensures good connections across London and the South Bank, Westminster and the West End are all within easy walking distance.

Key comparables identified by Savills and KF include Neo Bankside, One Tower Bridge, St George's Tower, Marconi House, Caro Point and the Whitehouse Apartments. Savills and KF appear to consider the Development to be most directly comparable to Neo Bankside and One Tower Bridge. Given the position and nature of the Development we do not disagree with this. All three of these schemes include units that will achieve a range of values as one moves from the high value riverside units to the lower value units to the rear of the schemes. Savills and KF are keen to highlight that the proposed average capital values for the Development are higher than those being achieved at these two comparables. However, it is noted that the pounds per square foot values are lower. One assumes that this is due to varying unit mixes and average unit sizes between these schemes. However, it is interesting to note that despite average unit sizes at Neo Bankside being 36% higher than at One Tower Bridge the pounds per square foot values are broadly similar (only 2% higher at One Tower Bridge). Average unit sizes at the Development fall inbetween those provided at these two comparables and as such it is not unreasonable to assume that broadly similar average values would be achievable.

We also question Savills and KF's assertion that St George's Tower and Caro Point are better located than the subject Development. This appears to be primarily based upon the fact that these developments form part of wider, established schemes. However, we do not believe it will be challenging to establish the Development as a new prime address, as has been evidenced by the experiences at Neo Bankside and One Tower Bridge. Given the subject Development's central location we do not agree that Vauxhall or Grosvenor Waterside would be regarded as being superior locations.

For buildings 4a, 4b, 5 and 6 Savills and KF have applied varying values to blocks of floors. However, for buildings 3 and 7 a single value has been applied to the entire building. This appears to be appropriate for building 7, which only extends to 10 storeys and therefore effectively constitutes a single block (in line with the other analysis). However, building 3 is the same height as building 4b, which has been valued using 4 separate blocks of values. It is unclear why this approach has been adopted. The position of building 3 does not appear to be substantially less desirable than building 4b, however the value attributed to it is 21% lower than that applied to building 4b.

We note that values of less than £1,000 per square foot have been assumed for a relatively large proportion of the units provided within buildings 4a and 4b (and we assume 3 as well, although the analysis is not provided). Having regard to the evidence, Neo Bankside in particular, we question whether such a high number of apartments would fail to achieve values in excess of £1,000 per square foot.

As Savills and KF explain, the lack of good quality new build comparable evidence from Southbank locations makes the valuation of the residential units due to be provided at the Development very difficult. One must rely upon the evidence that is available while also making judgements as to how those comparables compare with the proposed scheme. It is also important that the very high level of proposed marketing expenditure is taken into account in assessing the achievable sales values (please refer to Section 4.14). This should allow the developer to overcome any perceived challenges in establishing the Development as a highly desirable prime central London residential location, as was achieved at Neo Bankside, for example.

The observations that we have made might lead one to conclude that the adopted sales values should increase. However, it is important to appreciate that a range of values are likely to be achievable within any given scheme and while some values might appear to be low a relatively high proportion have been attributed high values in excess of £1,650 per square foot, albeit this is not unexpected given the unique position enjoyed by the Development.

We recommend that sensitivity analysis is undertaken to assess the potential impact of higher values being achieved. For this sensitivity test we will adopt an average value of £1,330 per square foot which aligns with the average values achieved at Neo Bankside and One Tower Bridge. This will provide an understanding of the degree of sensitivity to increases in sales values within the parameters that might be supported by the available evidence.

It is assumed that each block is sold within between 6 and 10 months following practical completion, equating to an average sales rate of 16.6 per month (199 per annum). One would expect a proportion of the units to be sold off-plan, with the revenue received at practical completion. Indeed, Savills and KF refer to the fact that off-plan sales of at least 30% are likely to be required by lenders. However, the omission of this assumption within the appraisals will be off-set by the relatively high absorption rate that has been assumed, which exceeds the advice of Savills and KF. We have therefore not amended this phasing in our appraisals.

4.2 Car parking revenue

The residential car parking spaces have been attributed a premium of £75,000 each, which is deemed to be appropriate.

Quod have not included any revenue in relation to the car parking spaces that will be allocated to the office occupiers. However, we have been informed that this is because it is assumed that all available spaces are sold to residential purchasers. Any spaces that are in fact let to office occupiers will achieve lower revenues. Therefore this is deemed to be a reasonable approach.

4.3 Residential storage revenue

We are informed that some storage space will be provided to residential occupiers. Savills and KF have advised that these units would achieve values in the range of £5,000 to £10,000. However, none have been included within Quod's appraisal. Although the revenue might be relatively modest we would recommend that this revenue is included within the appraisal.

4.4 Ground rents

Ground rents have been included at £500 per annum. One might expect slightly higher average ground rents to be achievable at a scheme of this nature in this location. However, this assumption is not outside of the range that might be deemed to be reasonable and the ground rents that are charged will ultimately be at the discretion of the freeholder. We have therefore not sought to amend this assumption in our appraisals.

The income has been capitalised at a 5.5% yield, which is not an unreasonable assumption.

4.5 Office revenue

The office accommodation within Building 1, which will be pre-let to Shell, has been valued using the following assumptions:

- 3 month letting void;
- Rent at £55.00 per square foot;
- 24 month rent free period;
- Yield at 5.25%; and
- Purchaser's costs deducted at 4.5%.

The speculative office accommodation within Building 2 has been valued using the following assumptions:

- 12 month letting void;
- Rent at £52.50 per square foot;
- 25 month rent free period;
- Yield at 5.75%; and
- Purchaser's costs deducted at 4.5%.

Our office letting and investment agency colleagues have confirmed that these assumptions are reasonable.

4.6 Retail and leisure revenue

On the advice of retail agent Bruce Gillingham Pollard, Quod have adopted rents ranging from £32 per square foot up to £60 per square foot for the proposed retail units, dependent upon position within the Development. Storage space has been attributed a rental value of £15 per square foot. The health club is assumed to achieve a rent of £12 per square foot.

For the most part it is assumed that 3 month letting voids are incurred and 9 month rent free periods are agreed (with some relatively minor exceptions). For the health club a 6 month letting void and 18 month rent free period have been adopted.

All retail and leisure rental income has been capitalised at a yield of 6% and purchaser's costs are deducted at 4.5%.

All of the above assumptions are deemed to be reasonable.

4.7 Construction costs

The build costs adopted by Quod in their appraisal are informed by the Order of Cost Estimate prepared by EC Harris dated 29 August 2012.

The Council commissioned Gardiner and Theobald LLP ('G&T') to undertake a full cost plan review. Although G&T have identified some areas where they would recommend amendments to the EH Harris Cost Plan, they have concluded that these changes would not exceed a 2% discount to the total construction cost budget outlined by EC Harris, which they consider to fall within reasonable estimating margins. They have therefore not recommended any reduction in the construction costs.

G&T have recommended that the Cat A fit-out allowance for the office space in the development should be reduced from £45 per square foot to £40 per square foot, which we have allowed for in our appraisal.

It is noted that Quod's appraisal includes a *"current day cost adjustment"* of £80,757914. The cost plan indicates that this is an inflation allowance. It is common practice to exclude all construction cost inflation as we are assessing the viability of the Development at the current date in the current market. If Quod and the Applicant seek to include construction cost inflation it will also be necessary to apply an allowance for anticipated growth in revenues. On the basis that the Applicant agrees to the inclusion of a review mechanism in the Section 106 agreement that is capable of capturing the value of future revenue growth, inclusion of construction cost inflation is acceptable.

4.8 Contingency

EC Harris have included a 7.5% contingency in their estimate for the Development. However, their estimate for the CUV scheme only includes a 5% contingency. It appears that both estimates are taken to a broadly equivalent level of detail. As such, we would expect an equivalent level of contingency to be required. We have maintained the contingency allowance at 7.5% in our appraisal of the Development but have increased the allowance in the CUV appraisal to the same level in the interests of consistency. It is worth remembering that the contingency is related to construction costs, so for the larger proposed Development the resultant sum will be substantially higher than for the CUV scheme.

4.9 Professional fees

Professional fees have been included at 11.75%, which is deemed to be a reasonable allowance for a project of this nature.

The professional fees relating to basement construction, energy centre, external works and the current day cost allowance have been weighted heavily towards the early stages of the development programme, prior to completion of the purchase of the Site. For Buildings 1 and 2 the professional fees have also been phased to be expended during the earlier part of the construction period only. We are informed that this relates to fees that have been expended in reaching this stage in the development process.

Building regulation fees have been included at £1,250,000. A £5,692,000 allowance is also included for improvements to the existing London

Underground ticket hall (this has increased from £1,000,000 in the earlier appraisals). We would welcome confirmation from the Council as to whether this is a requirement on the Development.

4.10 Insurance

Quod initially included latent defects insurance totalling £11,539,000. We have subsequently been informed that the actual figure will be nearer to £3,351,938. We have therefore reduced both of the allowances to 0.74% to reflect this lower figure.

4.11 Finance costs

Quod have adopted an ungeared IRR as their chosen measure of profitability. Therefore all potential finance costs are excluded from the appraisal.

4.12 Rights to light

Quod have made an allowance for Rights to Light compensation which has subsequently been amended to £7,560,000. We have reviewed the correspondence and evidence of negotiations with the affected parties that supports this figure. We are therefore comfortable with its inclusion.

4.13 Financial Section 106 contributions and Mayoral CIL

Quod have included Mayoral CIL contributions totalling £7,212,137. We have not been provided with the calculations that inform this figure. We would welcome confirmation from the Council as to whether it is appropriate. It has been assumed that this contribution will be paid in full at commencement of construction.

No Section 106 contributions have been included at this stage.

4.14 Marketing and disposal costs

In their first appraisal, Quod adopted the following marketing and disposal costs have been assumed:

- Residential marketing costs at 2% of residential GDV (£21,938,000);
- Retail marketing costs totalling £250,000 (equating to c. £3.50 per square foot);
- Office marketing costs at £5 per square foot, totalling £1,379,460;
- Commercial letting agent fees at 12% of annual rent;
- Commercial letting legal fees at 5% of annual rent;
- Residential sales agent fees at 2%;
- Commercial sales agent fees at 1%; and
- Sales legal fees at 0.25%.

The 2% marketing allowance for the residential accommodation is higher than we would normally expect and it is noted that it generates a very substantial marketing budget. However, we note that this figure has been recommended by Savills and KF and might therefore be regarded as being appropriate. Further to this, it is also noted that Savills and KF provide examples where comparable good quality marketing campaigns, such as those undertaken at The Heron and Neo Bankside, have allowed achieved sales values to substantially exceed prevailing levels. On this basis one might assume that the high marketing expenditure will allow for equivalent ‘market beating’ values to be achieved. This should feed back into the discussion set out within Section 4.2. A marketing budget of this magnitude would allow for an extremely aggressive, high profile marketing campaign which should be taken into account in our assessment of achievable sales values.

The commercial marketing allowances are extremely high. It is noted that in their CUV appraisal, KF have assumed a total marketing budget of £750,000. This is for 293,647 square feet of speculative office accommodation and 261,416 square feet of retail accommodation, compared with 275,892 square feet of speculative office accommodation and 78,771 square feet of retail accommodation due to be provided by the Development. Clearly an inconsistent approach has been taken in these two appraisals. Having regard to this and the advice of our agency colleagues we have adopted a single marketing allowance of £500,000, which is deemed to be a generous allowance.

The letting fees allowances appear to be reasonable.

At 2%, the allowance for residential sales agent fees appears to be high. However, Quod have explained that this accounts for multiple agents, both domestic and overseas, being appointed. It is noted that the 2% allowance has been applied to the ground rent income. We consider that a reduced fees allowance of 1% should be applied to this asset.

The 1% agent fee allowance adopted in relation to the commercial accommodation is deemed to be high. For large scale office investments such as that provided by the Development, competition amongst investment agents should allow for a reduced fee. It appears that KF agree with this as they have adopted a 0.25% allowance in their CUV appraisal. We have adopted the same allowance in our appraisal of the Development.

The sales legal fee is also deemed to be high for both commercial and residential sales. Again, KF appear to agree having adopted 0.15% in their CUV appraisal. We have adopted this reduced allowance in our appraisal accordingly. It should be noted that this still results in quite high legal fees for the residential dwellings.

Following discussions, we have adopted the following rates, which are reflected in the updated Quod assessment:

- Residential marketing costs at 2% of residential GDV (£19,971,579);
- Commercial marketing costs totalling £398,866 (reduced from separate allowances);
- Commercial letting agent fees at 12% of first year's rent;
- Commercial letting legal fees at 5% of first year's rent;
- Residential sales agent fees at 2%;
- Ground rent investment sales agent fees at 1% (reduced from 2%);
- Commercial sales agent fees at 0.5% (reduced from 1%); and
- Sales legal fees at 0.15% (reduced from 0.25%).

4.15 Fixed land price and site acquisition costs (benchmark land value)

KF have undertaken a CUV appraisal on the assumption that the extant office scheme is implemented. We have reviewed KF's appraisal in order to confirm whether it provides a reasonable basis for setting the benchmark land value.

KF have undertaken their appraisal from the perspective of Shell, who are the landowner. Although unconventional, this is not an unreasonable approach as it will be necessary for Shell to achieve an adequate land receipt in order to be persuaded to release the Site for redevelopment. Therefore certain assumptions, such as the omission of land financing costs and site acquisition costs and the very low cost of finance (which we assume relates to internal sources rather than bank finance), are accepted.

However, in adopting this approach it is important to maintain an assumption that Shell would act as a rational developer. It is therefore necessary to assume that they would require a reasonable level of risk adjusted developer return in relation to the speculative aspects of the scheme. We have therefore assumed that a return of 20% on GDV would be required in relation to the new build speculative aspects of the CUV scheme and 15% in relation to the refurb elements. This is contrary to KF's approach, whereby a marginal level of return has been assumed in relation to the scheme in its entirety.

For the office accommodation that is assumed to be pre-let to Shell the same assumptions have been made as have been adopted in the appraisal of the proposed Development.

The speculative converted office accommodation has been attributed a rental value of £42.50 per square foot. An 18 month rent free period has been assumed and the income has been capitalised at a yield of 6%. These are deemed to be reasonable assumptions.

The commercial car parking spaces have been included within the CUV appraisal. These are currently missing from the appraisal of the Development.

The majority of the retail accommodation has been attributed a rental value of £18.88 per square foot. We have been provided with a breakdown to show that this includes basement and sub-basement areas, hence the lower rent level. The retail accommodation provided within the new build section has been attributed a rental value of £49.44 per square foot. The income has been capitalised at yields of 5.5% and 5.25% respectively. In Quod's appraisal of the proposed Development a 6% yield has been adopted for the retail accommodation. We have amended the yield adopted in the CUV appraisal to 6% accordingly. We also note that a 2 year rent free period is adopted in the CUV appraisal. We have reduced this to 9 months in line with the appraisal of the proposed Development.

G&T have reviewed the cost plan and have concluded that it provides a reasonable estimate of the likely construction costs. However, in line with our comments within Section 4.8 we have increased the contingency allowance to 7.5%. We have also amended the phasing of the professional fees to account for some early expenditure, in line with approach taken in the appraisal of the Development.

For the marketing, letting and sales costs we have recommended that those adopted in the appraisal of the Development are adjusted to mirror those adopted by KF in their CUV appraisal as these were deemed to be more appropriate.

It is noted that KF have omitted insurance costs from their appraisal. We have added allowances for these costs to the CUV appraisal for consistency.

As a result of our amendments, the CUV benchmark land value figure falls from £286,182,000 to £254,514,000. It should be noted that had we adopted a more conventional market based approach this reduction in the benchmark land value would have been more substantial. However, we have accepted that it is necessary to pay due regard to the specific situation at this Site.

Since submission of their original report Quod have suggested that a landowner premium of 20% to 30% should be added to the CUV figure. Given the requirement to undertake such substantial works to realise the CUV figure we have recommended that the premium should only be 10% in this instance, resulting in a benchmark land value of £279,965,000.

5 Analysis

Within Section 4 of this Assessment we have recommended the following amendments to the appraisal of the Development:

- Fixed land value reduced to £279,965,000;
- Cost inflation allowance included on the condition that the Applicant agrees to include a review mechanism in the Section 106 agreement;
- Fit-out allowance reduced to £40 per square foot; and
- Reduced sales and marketing allowances.

We have also made the following amendments on the basis of additional information being submitted:

- Rights of Light compensation figure amended to £7,560,000; and
- Insurance allowances reduced to 0.74%.

These amendments have been accepted by Quod in their updated appraisals. As discussed within Section 4.1, we have also undertaken a sensitivity test whereby increased average sales values of £1,330 per square foot are assumed to be achieved. This effectively equates to an uplift of 4.3%. In order to maintain the varying values between the buildings we have applied this as an overall percentage uplift in the sensitivity test.

Our appraisal results are shown in the table below:

Sales values	Ungeared IRR
Base	11.82%
4.3% uplift	13.57%

Quod advise that the Applicant requires a minimum ungeared IRR of 20%, which we are informed accords with the position adopted at comparable projects such as Battersea Power Station and Earls Court. The Development is large in scale and relatively complex, thus carrying a reasonable degree of risk. However, it should be noted that these comparable schemes are far greater in scale and complexity than the subject Development which will inevitably increase the level of risk associated with them. It is also noteworthy that the subject Development benefits from a substantial pre-let to Shell, which accounts for circa 15% of the total scheme GDV. This will reduce the level of risk associated with the Development.

Taking all factors into consideration, an ungeared IRR of 20% is deemed to be a broadly reasonable target IRR in the current market. Therefore these initial results indicate that the viability of the Development is challenging. However, in order to fully understand these appraisal results in a manner that is perhaps more familiar to the Council we have added finance costs to allow us to observe the geared IRR, the profit on cost and the profit on GDV. We have adopted a finance rate of 7%, which is intended to be inclusive of bank fees. The results are shown in the table below:

Sales values	Geared IRR	Profit on GDV	Profit on cost
Base	5.61%	12.90%	14.81%
4.3% uplift	7.62%	16.89%	20.67%

As with the ungeared IRR results, the geared IRRs are below the level that would indicate that the Development is economically viable. However, the profit on GDV and profit on cost outputs demonstrate that the overall level of profitability is not unreasonably low where the 4.3% uplift in sales values is allowed for. The reason that these indicators appear to provide contradictory results is that the IRR takes full account of the delay incurred by the developer in receiving their return. The project is 'in the red' by a significant amount for a substantial length of time, which impacts upon the IRR but has less impact upon the profit on GDV and profit on cost outputs. This is the reason that this measure of profitability is often adopted for long term projects of this nature.

It is worth noting that at this stage the residential storage units have been excluded from the appraisal, which will produce additional revenue (albeit at a marginal level).

6 Conclusions

We have undertaken a thorough assessment of Quod's viability submissions and engaged in discussions with both Quod and their client in order to address the issues that have arisen. In particular, the fact that it will be necessary for Shell to achieve an adequate land receipt in order to be persuaded to release the Site for redevelopment. This has been demonstrated by their having walked away from a number of deals to sell the Site over the last decade.

Taking into account all of the changes set out in Section 5 and the most recent changes to the scheme content, our appraisals have confirmed that the viability of the Development is challenging in the current market. Given the long term nature of the project, the applicant has adopted the IRR measure of profitability, which identifies the project to be 'in the red' by a significant amount for a substantial length of time.

Based on current costs and values, we consider that the proposed delivery of 20% affordable housing (through a combination of on-site and off-site delivery) is the maximum that the site can viably provide. It is important to consider that the appraisal does not include the costs of delivering the off-site affordable housing; Section 106 payments; and delivery of Hungerford Car Park. However, over the life of the planning application and the development period the prospects for an improvement in the economics of the Development are good. We therefore recommend that the Section 106 agreement includes a review mechanism to re-consider viability at an appropriate future point in the development period.