

Affordable Housing Statement

Gas Holder Site, Reading

By

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Private & Confidential

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Turner Morum Viability Report

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1. BACKGROUND AND RELEVANT EXPERIENCE

- 1.1. This report has been prepared by _____ of Turner Morum LLP, 32-33 Cowcross Street, London EC1M 6DF. I am a Member of the Royal Institution of Chartered Surveyors ("RICS") having qualified in 2013 following the award, in 2009, of an Honours Degree in Land Management from University of Reading and in 2010 a Master's Degree in Urban Planning & Development.
- 1.2. In 2010 I joined the practice of Turner Morum LLP and was made a Partner in 2018. I am a specialist in the field of development site appraisals and associated subjects.
- 1.3. I regularly advise across the whole of the UK on the value and potential of major tracts of development land and infill urban development focusing specifically on development sites within the London Boroughs. I am currently instructed by a number of Local Authorities, Landowners, Housing Associations and Developers and have extensive experience in this field. Full details of some of my recent case experience can be viewed at **Appendix 1**.
- 1.4. Turner Morum was originally appointed by Mr. Aidan Robson of Danescroft (Kenavon Drive Project Mgt) LLP ('the applicant') to undertake a viability assessment in regard to the proposed development known as Gas Holder, Reading. The proposed scheme is comprised of 130 new build residential flats totalling 8,521.2 sq m (91,721 sq ft) Gross Internal Area (GIA).
- 1.5. The site has an area of 0.71 ha (1.75 acres). It is currently used as industrial storage/depot space with a gas holder located on site; the hazardous substances consent for the gasholder was revoked at the end of 2012. A site plan can be viewed as per **Appendix 2**. The site is triangular in shape, located at the end of Alexander Turner Close and is located between the railway tracks to the North and the River Kennet to the South.

- 1.6. In this analysis I seek to assess the viability of the scheme for the proposed application through carrying out a development appraisal analysis adopting a bespoke valuation model structure within excel format. The residual appraisals and supporting information can be viewed at **Appendix 3**.
- 1.7. In undertaking this viability I am aware and follow supporting viability guidance documents as the RICS *Financial Viability in Planning and Viability Testing Local Plans* (the Harman report). I am also aware of the Planning Practice Guidance on Viability published following updates to the National Planning Policy Framework (NPPF).

2. MECHANICS OF THE ASSESSMENT

- 2.1. My residual appraisal analysis can be summarised as follows:-

- **Appendix 3 Tab 1A** – Appraisal showing a proposed scheme of 130 residential units comprising 91 market units and 39 affordable units (30%) with 19 units provided as affordable rent (49%) and 20 provided as shared ownership (51%).
- **Appendix 3 Tab 1B** – Appraisal showing a proposed scheme of 130 residential units comprising 120 market units and 10 affordable units (8%) split as 5 affordable rent (50%) and 5 shared ownership (50%).

- 2.2. I will now run through the various appraisal inputs in sequential order as they appear in my residual appraisal analysis:

REVENUES

- 2.3. Market revenues have been based on an analysis of comparable evidence within the local area and a pricing schedule provided by Cushman & Wakefield (see **Appendix 4**). Unit values range from £262k - £575k, with average market revenues of c. £495 psf. In pricing the scheme Cushman & Wakefield (CW)

have reviewed plans and elevations of the proposed scheme and priced accordingly.

2.4. In addition to the pricing schedule CW have provided me with a schedule of comparable transactions to support their position. These comparables can also be viewed as per **Appendix 4**.

2.5. The above revenue advice should be considered in the context of the current housing market in the South East. Included as **Appendix 5** to this submission is the RICS Residential Market Survey from January 2019. Within this the results of the RICS research are consistent with a weaker trend in sales market activity with headline indicators on both demand and supply edging further into negative territory. The survey goes on to note as follows:

The headline price indicator softened for the fourth month in succession, with the net balance slipping to -22%, from -19% previously. When broken down, London and the South East continue to display the weakest readings, while pricing sentiment also remains negative in East Anglia and the South West

2.6. In the context of a falling housing market with negative price trends I consider the CW pricing schedule to be a reasonable reflection of what can be achieved on this site.

2.7. Shared ownership values have been benchmarked at 70% of open market value (OMV) whilst affordable rent values have been benchmarked at 50% of OMV. I would suggest these benchmarks are both within industry benchmarks and indeed at the upper end of an acceptable range. It is intended that this appraisal analysis demonstrates the 'best case' scenario and arguably a lower % could be justified.

2.8. To support the position on shared ownership I have cross referenced using a Discounted Cashflow Analysis. The basic premise of the DCF model is to take the full market value of the units and discount them over an assumed 30-year staircasing period. A capital receipt is then calculated for each tranche payment, based on the discounted Market Value figure for the year in which it

falls, whilst accounting also for the rent paid on the retained share of the property, and any associated costs. This produces a yearly income total, the sum of which produces a gross revenue figure, from which one would then deduct appropriate costs and marketing fees etc.

- 2.9. For a DCF the standard assumptions include 4 x 25% tranche payments (including initial deposit) in Years 1, 10, 20 and 30. Over this 30 year staircasing period whereby purchasers will step up to 100% equity with a corresponding reduction in rents over the period – this is then capitalised with a discount rate of 6.5% taking account of anticipated management costs, allowance for bad debts and inflation (1.5%). I have also assumed a rent charge of 2.0% on the retained portion of the unit. This produces a value of c. £310 which shows the 70% allowance adopted in my appraisal and is reasonable and if anything optimistic.
- 2.10. Following the government's recent leasehold reform consultation, I have included ground rents at the suggested cap rate of £10 p.a., which I have capitalised at a rate of 5%.

DEVELOPMENT COSTS

- 2.11. Fees and marketing costs in respect of the development are included at 3.0% of Market Housing Gross Development Value ("GDV"), and the cost of disposing of the affordable units to a Registered Provider is included at 0.5% of affordable GDV, as per standard industry benchmarks.
- 2.12. Build costs are derived from the full-site cost plan provided by Mr. Steve Sawyer from Gleeds, which can be viewed in full at **Appendix 6**. In order to construct a development appraisal within an industry-accepted template I have separated out the costs within the cost plan as either abnormal or standard build costs; this analysis can be viewed as per **Appendix 3 Tab 3**.

- 2.13. Of the gross cost plan figure of c. £1.5m I have assumed that c. £1.0m of this would be associated with 'standard construction costs', whilst the remaining £0.5m would be what one may consider 'abnormal costs'. As a result of this analysis the standard construction costs equate to c. £1.0m which I believe is a reasonable level for a complex flatted brownfield development in the current economic climate.
- 2.14. Due to the industrial use and existing gas holder on the site the cost plan shows a high level of abnormal costs (specifically decontamination) associated with this scheme. This has a significant impact on the viability of the proposed scheme and would do on any proposal on this site. It is important to note that whatever development proceeds in this location the costs involved in the decommissioning and remediation from the Southern Gas Network would remain the same.
- 2.15. The cost plan from Gleeds shows c. £0.5m of costs related to this process and as mentioned whatever the quantum of development, these costs remain unchanged. It is for this reason I consider that a large development such as this is necessary in order to yield a suitable return to make the site deliverable in the first instance and also to mean the scheme can conceivably provide some affordable housing.
- 2.16. It is worth noting that an additional cost will be incurred in relation to the relocation of the existing use on site. This is estimated at c. £450k but is not currently reflected in my appraisal. I would reserve the right to include this cost at a later stage should we be unable to agree a position on the viability.
- 2.17. Technical Fees are included at just 6% of the Standard Build Cost, an allowance which reflects the cost associated with Architects, Quantity Surveyors, Engineers, Project Management and other technical / professional consultancy fees. I would suggest this is a conservative allowance at the bottom end of an acceptable range. For reference the default position on the HCA viability toolkit is a 12% fees allowance although generally one would expect a fees position of 8% - 10% of GDV.

- 2.18. I have then made an allowance for Developer Profit at 20% (of Market GDV) for the Market Housing and 6% (of affordable GDV) for the affordable element. I would suggest these assumed returns are well within industry-accepted parameters.
- 2.19. Arguably a development could be considered unlikely to come to fruition unless it can achieve a profit margin of around 20-25% of GDV (blended). Banks require Developers to illustrate these levels of developer profit before they will provide development finance and clearly such is considerably higher than that shown in my analysis.
- 2.20. I believe this to be all the more pertinent following the Brexit referendum vote and the subsequent triggering of Article 50. The uncertainty which envelops these negotiations has fed through into the economy and particularly the housebuilding industry; I believe it to be widely acknowledged that the current climate is one of rising costs and stalling revenues (see **Appendix 5**) and as such in these times it is all the more important for developers to maintain sufficient target profit margins to ensure they are compensated for the level of risk involved.
- 2.21. There are currently no Section 106 costs included within my appraisal analysis as I have not been made aware of any that are currently required from the scheme. Should this change in due course I reserve the right to update my appraisal analysis.
- 2.22. CIL has been included at £1.572m for the 8% scheme and £1.294m for the 30% scheme calculated on the basis of £120 psm (GIA) for the market housing but excluding indexation. With both the S106 and CIL assumptions I reserve the right to adjust my calculation should the Council advise of a different obligation – this may well consequentially impact the conclusions of this analysis.

- 2.23. With regard to the calculation of finance, I have included within my appraisal quarterly cashflows to reflect the cost of finance for each tested scenario. This can be seen at Tabs 5A of my appraisal and reflect the details of each scheme including the build rate of the residential units and the particular infrastructure timings. The adopted debit rate is included at 6.5%.
- 2.24. I have made the assumption in both scenarios that construction will commence in Q1 Year 1, following a period of site clearance and preparation, lasting for 18 months. I have assumed the first 40% of the market units will be disposed of in Q2 Year 2, with a completion rate thereafter of 20 units per quarter.
- 2.25. I have assumed that some of the affordable housing will be disposed of 'off-plan' via a 'golden brick' payment from a registered provider. I have then assumed that the remaining affordable will be disposed of in Q3 Year 2.
- 2.26. The results of the above assumptions provide finance costs for each scenario tested. These costs are then shown as a percentage of overall GDV and as a percentage of total build costs. Within the appraisal, it will be apparent that my finance costs equate to 5.0% of total costs. I would suggest these are very reasonable assumptions bearing in-mind this is a capital-intensive development; typical finance costs could equate to up to 10% of total costs.

3. VALUATION METHODOLOGY

- 3.1. The structure of my Residual Appraisals produces a Residual Land Value ("RLV") which is then compared with an appropriate Benchmark Land Value ("BLV"). If the RLV exceeds the BLV a surplus is generated and the scheme can be considered "Viable"; however, if the RLV is less than the adopted land value, a deficit is produced and the scheme can be considered "Non-Viable".
- 3.2. The issue of what is deemed to be an appropriate Land Value for inclusion within viability studies is, at present, a highly topical subject. Planning appeal decisions and government guidance dictates that one has to ignore the

amount actually paid for a development site and instead adopt an appropriate Existing/Alternative Use Value ("EUV/AUV").

3.3. In this case, the EUV has been calculated based on the site's existing use as an industrial storage yard, for which I have adopted a value of **£212k**. This position is based on a very conservative assumption with a rent of £0.5 psf based on 50% of the site being used as open storage (7,100 sq ft * 50% = 3,550 sq ft). This is capitalised at a yield of 9% to equate to a value of £212k.

3.4. The RICS guidance *Financial Viability in Planning* recommends a premium can be included in a range from 15% up to 40% in certain cases. In this instance I have decided not to adopt a premium on top of EUV, only applying SDLT at prevailing rates and an allowance for agents and legal fees at 1.50%. Once again I consider this as a conservative assumption which is adopted with the intention of reaching a swift agreement on the viability.

4. SUMMARY CONCLUSION

4.1. The outturn of my analysis can be summarised as follows:

Tab	Total Units	Affordable % (Units)	Residual Land Value	EUV	Surplus / Deficit
1A	130	30%	-£3,683,314	£215,587	-£3,898,901
1B	130	8%	-£2,362,963	£215,587	-£2,578,550

5. CONCLUSIONS

5.1. You will note from the table above that all scenarios show a deficit against the adopted BLV. As such, in this situation the proposal should be considered as, mathematically speaking, 'non-viable'. In these circumstances I would usually recommend that planning obligations or affordable housing provision should be reduced until the 'break-even' point is reached – where the RLV equals the EUV. However, in certain cases applicants may take the 'commercial decision' to

continue with a scheme despite it exhibiting a viability deficit; **in this way a non-viable scheme can still be deliverable.**

- 5.2. In this instance the applicant has informed me that they have made the 'commercial decision' and are committed to bringing the scheme forward with the 8% affordable housing (50/50 tenure split of affordable rent and shared ownership) however this is the maximum reasonable which can be delivered from this scheme (Tab 1B). Any requirement to provide additional affordable housing would reduce the actual developer return to an unacceptable level and mean the scheme would not be deliverable.
- 5.3. In spite of the deficit shown in the appraisal analysis the applicant has confirmed their desire to not only proceed with the scheme but also to provide the maximum amount of affordable that could be provided.
- 5.4. As mentioned earlier in this report the economic difficulties facing this development are largely linked to the decommissioning and remediation works of the Southern Gas Network. If any development is to occur on this site these costs would be incurred by any proposal. A residential led scheme is likely to be the most economically viable on this site (as opposed to say a commercial scheme) and as such provides the best opportunity for redevelopment.
- 5.5. The applicant has also confirmed to me they would be prepared to agree to a review mechanism clause based on the abnormal costs which should they prove to be less than included within this model an increased affordable provision could be delivered.
- 5.6. I hope this provides a sufficient level of information. I would welcome the opportunity to discuss the findings of my analysis with you at your earliest convenience.