101 AND 102 CAMLEY STREET, LONDON N1C 4PF

DEFERRED AFFORDABLE HOUSING CONTRIBUTION – BRIEFING PAPER

September 2015

This briefing paper is provided in relation to the approved developments at 101 and 102 Camley Street, N1C 4PF and in particular in respect of the matter of the requirement for a further Viability Assessments and the potential for Deferred Affordable Housing Contributions (DAHC) as set out in the respective Section 106 Planning Agreements (the 'Planning Agreements'). The paper sets out the following:

1. Gateway Sites Context and Timescales;
2. Background and context including analysis of the banking interpretation of the DAHC;
3. Outline of the proposed solution / offer and the updated viability assessments;
4. The additional planning benefits resulting from the proposed solution; and
5. Proposal for guaranteeing delivery and legal framework to achieve this.

Each of these is addressed in turn below.

Gateway Sites and Timescales

As Officers and Members are aware, these two schemes form part of the Camley Street 'Gateway Sites' along with 103 Camley Street, where the student accommodation and private homes for rent are occupied and the enterprise Incubator operated by University College London (UCL) in association with Camden Town Unlimited (CTU) is open.

The three Gateway Sites form a linked land use strategy (recently awarded by the NLA as the best mixed-use project in London and with the Mayor commending it for its contribution to London's economy) with the first phase at 103 Camley Street delivering the enterprise Incubator, which will be capable of accommodating between 100 enterprises initially and up to 250 enterprises per annum long term. It is expected that the number of enterprises will be replicated every 12-18 months with an essential churn with the successful enterprises moving to small business space locally. The first enterprises would therefore be due to develop out of and have outgrown the Incubator by late 2016 and into early / mid 2017.

The three sites form part of a linked enterprise strategy to grow and develop small and medium sized businesses and retain these in the local area. The intention is that 101 and 102 Camley Street form Phase 2 of this and follow on from the Incubator by providing 'move-on' space for new businesses emerging out of the Incubator and from the Collectives in Camden Town, UCL Advances and Camden's various HEIs. 20% of the business space at 101 and 102 Camley Street will be offered at 50% of the market value. By providing this affordable workspace in the immediate locality of the Incubator at 103 Camley Street, provision is made for businesses to move out of the Incubator and begin their next stage of growth in low cost accommodation, continue their innovation and build on the links they have already created in the area through the networking and mentoring initiatives already provided to them.

For this strategy to succeed, it is critical that Phase 2 (i.e. 101 and 102 Camley Street) remains on track for the 'move-on' discounted and small business workspace to be available as the first wave of new enterprises begin to emerge from the Incubator in 2017. The intention had been to commence development first at 102 Camley Street imminently (albeit site preparation has already begun in good faith) and allowing a two and a half to three year build period of the business space to the lower floors, the affordable workspace would be available to accommodate the first businesses emerging from the Incubator in 2017 / 2018. If the delivery of these schemes is delayed further, this will create a break in the chain leaving a shortage of available and affordable space to accommodate the emerging businesses resulting in them either failing, remaining in the Incubator so restricting new business growth / generation or seeking alternative accommodation further afield, likely out of the borough or indeed London. The linked land use strategy has been heavily endorsed by Officers, Members and the GLA so it is clearly in both the Council's and applicants interests to ensure it succeeds.

Members will also be aware of the urgency to provide affordable housing in the locality to assist in the decant strategy Maiden Lane, Agar Grove and Regents Park estates, which the developments at 101 and 102 Camley Street can contribute significantly towards, delivering a total of 67 affordable homes.

DAHC Analysis and Banking Interpretation

Context

Now that planning permission has been granted, both of the landowners at 101 and 102 Camley Street, B Webber Holdings Limited and Regent Renewal Limited respectively have been seeking a funding and / or development partner to deliver the approved schemes.

In considering the terms of the development funding, potential investors and funders have had close regard to the terms of the respective Planning Agreements for both 101 and 102 Camley Street. As recorded in the respective reports to the Planning Committee, having worked with the Council to commit to a meaningful and beneficial level of on-site affordable housing from the outset of the planning discussions, neither development was considered to be viable at planning with both having recorded deficits against Benchmark Land Value (BLV) (-£5,382,453 and -£2,620,755 at 101 and 102 Camley Street respectively).

Notwithstanding the scale of these deficits and the impact on viability, the landowners remain committed to delivering the on-site affordable housing promised to the Council (approximately 25% of gross residential floor area across both schemes, equating to a total of 67 affordable homes) in the interest of mixed and balanced communities. Given the very considerable scale of the recorded deficits however, should funds be released to facilitate the construction of the developments, this would clearly be at significant risk to the investors. As described later in this paper, this is exacerbated by recent build cost inflation significantly outstripping sales value growth, which has served to increase the deficits for each of these developments. There is no evidence of sales value inflation in the Camley Street area since the viability assessments were settled with the Council's independent assessor late last year.

The two developments and their associated benefits are currently stalled due to funding uncertainties brought about by the magnitude of the hypothetical DAHC maximum cap. This uncertainty is created by the approach the banks and funders take to assessing the liability of the DAHC as summarised below.

Funding Approach

The extant Planning Agreements record each deficit per property as follows:

1. 101 Camley Street: -£5,382,453
2. 102 Camley Street: -£2,620,755

The Planning Agreements however record the maximum hypothetical DAHC per property as follows:

1. 101 Camley Street: £11,269,125
2. 102 Camley Street: £10,397,275

These figures are way beyond the level of DAHC used in other s106 agreements and were questioned at the time the matter was considered at Committee last year.

A funding bank considers its entire risk profile in determining:

a) Whether to provide bank funding
b) In assessing the level of funding to be provided

There are three types of funding:

(i) Banking or prime funding
(ii) Mezzanine funding
(iii) Equity

The prime funding bank takes the first secured charge on the property title. The mezzanine funding takes the next level of security leaving the equity at greatest risk. Ultimately both the prime funding and the mezzanine funding are assessing their maximum exposure in considering the level of funding they will introduce into a project. They would have to consider how much they would have to spend to complete the project if they were to step in. If the risk or amount is considered too great the funding proposal will be rejected. If the extent of liability is increased the level of funding in the prime and mezzanine funding categories is reduced thus increasing the need for further equity to be introduced. Prime funding and mezzanine funding operates at very different interest levels to reflect the differing levels of risk. A blended rate of interest is used in the toolkit viability assessment.

The Planning Agreements are a legal charge on the title that sits ahead of all other charges. In common with the Section 106 capital payments and Community Infrastructure Levy (CIL), the prime and mezzanine funding consider the maximum DAHC sum as a liability that sits ahead of their security even though payment is conditional. Unlike Section 106 capital payments and CIL payments which are fixed and finite, the DAHC could range from zero to the maximum cap. The prime and mezzanine funders therefore assume payment of the maximum DAHC sum in its entirety in determining:

a) The risk and exposure profile – i.e. they will or will not lend in-principle due to the risk exposure; and
b) In the event that they will lend, the level of lending they will provide against the level of security taking into account the maximum obligations contained within the Planning Agreements.

All banks operate a strict loan to value (LTV) ratio in their lending profiles. In terms of cascade the bank will take the DAHC cap into account as follows:

1. The prime bank assesses the DAHC to be the 'maximum sum' in the extant Planning Agreements as the security for this sits ahead of their security. In considering the total liability of the Planning Agreements and CIL therefore the bank's view is:

   (a) 101 Camley Street - £13,072,114 (DAHC £11,269,125 / s106 £1,176,089 / CIL £626,900)
   (b) 102 Camley Street - £12,182,702 (DAHC £10,397,275 / s106 £1,193,809 / CIL £591,618)

   A significant proportion of this is accounted for by the DAHC (near 90% in both cases).

2. As the site value is low (deficit between the Residual Land Value (RLV) below the Benchmark Land Value (BLV)), the extent of lending is suppressed to 50% of the overall LTV. The LTV is assessed after deducting the overall s106 and CIL liability including the maximum DAHC. Because the site value is so low the prime banking is limited.

3. This pushes the balance of the funding if available onto the mezzanine and equity provisions.

4. The mezzanine interest rate is currently in the order of 14-15% and is itself capped at 80% LTV. As with the prime bank the mezzanine funder also assesses the DAHC liability to be the maximum in the Planning Agreements as part of the overall Section 106 and CIL costs. Because the site value is so low the mezzanine funding is also therefore restricted.

5. The result is that the balance of the funding required to develop the site is pushed back onto equity as required from the site owner and development partner. Any development partner requires a high IRR against their equity funding (greater than the mezzanine rate) in addition to a greater share of profit as their risk sits behind the security of:

   (i) LB Camden – Section 106
   (ii) Prime funder
   (iii) Mezzanine funder

As a result of the above the projects have stalled because there is insufficient funding to cover the total development costs. The extent of the perceived risk by the prime and mezzanine funder coupled with the low LTV and reduced profitability increases the speculative and unsecured nature of the developments, which results in funding being declined by prime funders. This is as a result of the distortion caused by the DAHC as explained above. If the DAHC can be fixed now with the benefit to the Council of an immediate rather than contingent upfront payment, this certainty will allow for greater prime and mezzanine funding and a reduction in equity funding so that the developments can proceed.

Although it is not the intention of the DAHC to stall or restrict development in the instance of a low site value, with the deficit to BLV and high DAHC maximum cap this is unfortunately the result. This position is corroborated by the attached emails / letters received from banking lawyers at Fladgate LLP and Goodman Derrick LLP as well as property funding specialists at DTZ and CBRE that support our analysis of downside risk for their lending clients (attached at Appendix 1).

Proposed Solution

Given the viability position assessed at the time of grant of planning permission with both schemes showing a substantial deficit to benchmark land value, in order to promote the early delivery of these two schemes, it is proposed that a mutually beneficial solution will be to retain the overall percentage of affordable housing but with the DAHC review being suspended, and only being activated if the developments have not been substantially commenced within 12-months of the Deed of Variation (DoV) to the Planning Agreement for 102 Camley Street and 18-months of the DoV for 101 Camley Street (i.e. allowing for vacant possession at 101 Camley Street).

Given the greater funding certainty that it will create, both of the landowners are willing to offer an up-front guaranteed payment upon completion of a DoV to the provision of affordable housing elsewhere in the borough (and hopefully very local) reflecting a proportion of the hypothetical maximum DAHCs rather than have the schemes stall.

The viability assessments submitted in support of the planning application are re-submitted and updated to reflect today's values and build cost inflation (Appendix 2). There is little real evidence to suggest that sales values in the Camley Street area have risen significantly since the original viability assessments were agreed by the Council's advisors. Indeed there is evidence that Argent has recently reduced its residential sales values at its Plimsoll Building at Kings Cross by 10% as these units were not selling. It is acknowledged that Kings Cross and Camley Street are very different residential locations. In contrast build cost inflation continues to rise significantly. The attached letter from BTP and latest Turner and Townsend Cost Forecast for 102 Camley Street (see Appendix 3) confirms that BCIS data indicates build cost inflation of 5.24% since August 2014. BTPs own internal view is that build costs have actually inflated by 8% in this time. The latest cost forecast from Turner and Townsend has been market tested with SISK and demonstrates this build cost inflation as well as more accurately reflecting the unique constraints and costs of redeveloping the site at 102 Camley Street, which were alluded to at the time of the planning application but had not yet been crystallised. This cost forecast has been applied to the updated viability appraisal for 102 Camley Street. As confirmed by BTP, it has also been used at the basis of the cost estimate for 101 Camley Street, which despite being a larger scheme is thought to be subject to a comparable build cost.

Even allowing for some anecdotal evidence of sales values growth, if full account of build cost inflation is taken as described in the attached BTP letter and cost forecast, the updated viability assessments at today's date show that the deficits for 101 and 102 Camley Street will have actually increased to approximately -£9.5m and -£3.9m respectively. This highlights the point that it would be an erroneous starting position to consider that any future payment would be due from the schemes with evidence suggesting a widening rather than narrowing deficit.

The deficits agreed at determination of the planning application and as reported to Members are recorded in the Planning Agreements and must be taken into account in the viability re-assessments. Rather than amending these deficits to reflect the analysis above, it is proposed that the existing documented deficits are taken into account in the offer of the guaranteed upfront payment. The offer from the landowners to secure the certainty of the DAHC is to make an upfront guaranteed financial contribution on completion of the DoVs reflecting 50% of the DAHC less the recorded deficits from the Planning Agreements. For 101 and 102 Camley Street, the landowners are therefore offering the following:

- 101 Camley Street – Max. DAHC £11,269,125 less recorded deficit of -£5,382,453 x 50% = £2,943,336
- 102 Camley Street – Max. DAHC £10,397,275 less recorded deficit of -£2,620,755 x 50% = £3,888,260

The total therefore payable from both schemes as a guaranteed contribution towards additional affordable housing provision will be over £6.8m. This offer is made in order to achieve an early settlement so that the schemes can move ahead. By increasing these up-front payments, the cost to the owners significantly increases whilst the risk to the Council is removed altogether. In context a total contribution of over £6.8m from these two schemes will nearly double the total received by the Council from deferred affordable housing contributions on all schemes since the Core Strategy was adopted (i.e. increasing the total from £8.5m to £15.3m) – see the further analysis of the planning benefits below.

Additional Planning Benefit to the Council

As has been outlined above, it is proposed that an unconditional up-front financial contribution is paid upon completion of the DoV to the current Planning Agreements that will cement the total Section 106 and CIL payments for the developments and allow these important regeneration schemes to proceed. The extant Planning Agreements provide the Council with a total of £2,369,898 in s106 financial contributions in addition to the 67 units of on-site affordable housing (£1,176,089 for 101 Camley Street and £1,193,809 for 102 Camley Street). The total upfront 'Commuted DAHC Sum' now proposed for both developments would be over £6.8m. As this is an unconditional sum paid entirely at risk by the property owner on completion of the DoV and bearing in mind the DAHC is otherwise a hypothetic contingent with no guaranteed future payment to the Council, it represents a near 300% increase on the current guaranteed financial contributions due to the Council from the developments.

The Council's Draft Local Plan emphasises the requirement for the Council's policies to be implemented flexibly to ensure the delivery of housing despite market uncertainties having regard to individual site circumstances (paras 3.29 to 3.33). Although the Council's advisors agreed at planning approval stage that each of the schemes resulted in a significant deficit and notwithstanding the latest viability analysis, the landowners remain committed to providing a substantial proportion of on-site affordable housing as they have maintained from the outset in the interest of mixed and balanced communities. Other applicants may have sought to negotiate a lower on-site provision.

Additional funding is required for Community Investment Programme (CIP) projects with there not being sufficient borrowing capacity within the Council's debt cap to fund expenditure. Members will appreciate that an 'upfront payment' from the schemes could usefully contribute to this and should be considered in the context of a scenario whereby no further contributions are likely to be forthcoming under the current Planning Agreements and viability review clauses, which are themselves subject to considerable market risk. This is emphasised by the updated viability assessments showing a widening rather than narrowing deficit position.

These CIP projects have been heavily funded through the Affordable Housing Fund (AHF). We understand that the AHF currently stands at £20.8m of which £1.1m is committed, leaving a balance of £19.7m. Of this, £12.8m is provisionally allocated to a number of CIP projects. The 'real' AHF balance therefore only stands at £6.9m. A total guaranteed contribution of over £6.8m from 101 and 102 Camley Street would double this availability, which will become immediately available at the time of completing the DoV for these projects and not in three or more years' time if at all. This contribution to the AHF can be directed to tangible benefits locally including for example the regeneration of the subsequent stages the Maiden Lane, Agar Grove and Regents Park estates.

To put this into context and as has been summarised previously, the Council's own Section 106 monitoring records indicate that since 2011 (i.e. after the Core Strategy was adopted) an estimated 26 planning permissions have been granted that include deferred viability assessments. The developments at 101 and 102 Camley Street have by far the highest DAHC maximum liabilities (both over £10m each) with the next highest being £7.6m at 65 and 67 Maygrove Road (which only provided a very small proportion of affordable housing on-site by comparison to 101 and 102 Camley Street – only 12 of 91 units). The maximum capped DAHC total of all 26 developments (including 101 and 102 Camley Street) is estimated at near £70m. Only 12% of this has actually been paid and received (£8.5m) with half of this accounted for by one development (£4.6m from Twyman House), which was due entirely to the bank requiring a sale of that property forcing a full DAHC payment being made and a loss on the site value – again not the intention of the Council's DAHC assessment process. Following a recent post PC re-assessment, the adjacent development at 103 Camley Street realised only £12,605 of the DAHC, which represented just 0.2% of the maximum sum (£6.6m) and therefore significantly less than the proportion being proposed for 101 and 102 Camley Street to unlock these projects.

There is therefore no certainty that any deferred contribution will be due to the Council from 101 and 102 Camley Street in the future as it is a contingent payment and regard must be had to the viability position recorded at planning approval stage and the latest assessment showing widening deficits. The offer of an upfront payment of over £6.8m to overcome the funding uncertainty of these developments must be considered in this context, and will double the total contributions received from all DAHC payments since the Core Strategy was adopted.

Guarantee of Delivery and Covenant

Cementing an up-front contribution to the Council's Affordable Housing Fund will lock-in the funding for these two important regeneration schemes and achieve the early delivery of the schemes as well as the substantial range of planning benefits they provide, including the promised level of on-site affordable housing. Dentons has prepared drafts of the proposed DoV in respect of 102 Camley Street, the principle of which can also be applied to 101 Camley Street.

We have asked the Council's Legal Officers to approve the draft DoV and this is currently being reviewed by the Council with Dentons. The upfront 'Commuted DAHC Sum' will be paid by the landowners on completion of the DoV. This sum is therefore available for the Council to utilise immediately. By making a payment of this sum up-front and unconditionally, the landowners and the development partners will be committed to implementation of the schemes within the agreed timeframe or the benefit of this substantial payment is lost, which will not make commercially sense. It should be noted that the DoV also requires that the schemes are substantially commenced as part of an ongoing construction project. This is therefore not a token gesture of implementation but would represent a genuine commitment to actual delivery of the schemes as part of a continual build process.

The proposed DoV specifies that if 'Substantial Commencement' does not occur within the agreed timeframe, the existing DAHC provisions of the Planning Agreements continue to apply and in calculating the DAHC payable under the relevant clauses no account shall be taken of the payment of the upfront 'Commuted DAHC Sum' made by the landowners – in those circumstances they will still be liable to pay to the Council the whole of any DAHC calculated in accordance with the existing Planning Agreements. In other words the upfront payment will be lost. There is therefore a clear incentive once the Commuted DAHC Sums have been paid on completion of the DoV to build out the developments.

With regard to the affordable housing specifically, the existing Planning Agreements already require that the affordable housing is fitted out and transferred to a Registered Provider before the market residential units can be occupied. This obligation is retained. Therefore, once the payment is made upon completion of the DoV, the affordable housing is committed to, as the only way to recoup funds is to complete the sale of the market units, which in turn can only be achieved once the affordable housing has been transferred. Given the initial outlay of the Commuted DAHC Sum and other Section 106 payments and CIL due on demolition and implementation, it will be necessary to complete the development as soon as possible to avoid a protracted finance period and increased interest and construction costs. The Council can be assured therefore that the on-site affordable housing as well as the small business space and affordable workspace will all be delivered as soon as practically able.

As protection to the Council against future amendments or appeals to the level of affordable housing, if required, Dentons has prepared the attached draft Deed of Covenant (DoC) that the landowners are providing as commitment to the Council. The DoC can bind the sites for the benefit of the Council's adjacent land such that the developments cannot be occupied other than after the currently committed level of affordable housing (circa 25% by gross floor area) has been made available.

There can be no doubt that such a Deed of Covenant will be enforceable and can therefore provide certainty to the Council. If however an agreement cannot be reached concerning the upfront DAHC payments the owners will be left no alternative but to consider an appeal to the planning consents. The owners are advised that with the recorded deficits the appeals will succeed. This will result not only in the removal of the DAHC payments altogether but further will result in the reduction of the on-site affordable content – a result neither party wishes to see happen.

Summary

The analysis detailed above alongside the attached supporting correspondence from banking lawyers and property funding specialists demonstrates the real difficulties caused by the structure of the DAHC and requirement for a further viability assessment. The unique circumstances of these developments both with substantial recorded deficits (created by the mutual desire to commit to a good level of on-site affordable housing) and exceptionally high maximum DAHCs heighten their risk profile. The result is that these important regeneration schemes are currently stalled. Whilst not the Councils intention, this is a direct consequence of the DAHC and the way a funding partner assesses its liability.

A significant proportion of the maximum DAHC sums taking into account the recorded deficits have been offered in order to lock the certainty of these payments and allow the developments to proceed. This is despite updated viability assessments showing that these deficits have increased when taking into account recent build cost inflation notwithstanding anecdotal sales value increases with no actual evidence in the Camley Street area. In the event of appeal the increased deficit will necessarily be referenced as will the attempt by the owners to reach a resolution with the Council to avoid an appeal taking place. Removal of the funding uncertainty will result in the early delivery of these schemes, which are required for the success of the linked land use strategy and enterprise benefits, which have recently been recognised by the NLA and Mayor of London for its contribution to London's economy and as the best mixed-use scheme in London 2015. As demonstrated by the draft DoV and DoC provided, this solution provides the best possible prospect that these developments will be completed as promised.

Members are therefore asked to consider the proposed solution favourably, taking into account the significant benefits of the schemes alongside the guaranteed contribution towards additional affordable housing set against otherwise only a contingent re-assessment with no certainty that any further contributions would be due.