Clifford Pugh House, 7 Lancaster Grove, London, NW3 4HE

BPS Chartered Surveyors

Independent Viability Review – **ADDENDUM**
Application reference number: 2015/2286/P

19th October 2015

UPDATE CONCLUSIONS

1.1 This addendum follows our recent meeting with the applicant, Optic Realm Ltd, and its advisers, in which we discussed our 3rd July 2015 interim review of viability.

1.2 The applicant, Optic Realm Ltd, proposes to demolish the existing building and replace it with a six-storey building comprising 15 apartments (7 x one-beds, 5 x two-beds and 3 x three-beds).

1.3 In the recent meeting, we were informed that the applicant intends to provide the apartments as rented (PRS – private rented sector) units. This is contrary to what we were previously advised by the applicant's advisers who had based their viability assessment on an assumption of conventional private sale apartments. This change of tenure, although not currently recognised as a separate planning use class is generally accepted as generating a lower market value when compared to sale during to enhanced management costs, agents fees, letting costs and the risk of rental voids. It is therefore reasonable to reflect the financial impact of lettings compared to sales in the viability assessment provided there are safeguards to ensure that the units are not simply sold at a later without an adjustment in affordable housing contribution.

1.4 We understand that the applicant's development model is based on a build to rent approach across its estate and consequently the applicant has confirmed that it is willing to agree to restrict the use of the apartments to private rent (by restricting the tenancies to Assured Shorthold Tenancies) via the S106 Agreement. We understand that this is considered by the Council to be a satisfactory way to ensure the units remain in PRS use. Conversely if the units are sold within an agreed timeframe this would give rise to a further potential contribution to affordable housing.

1.5 Whilst the value of the PRS scheme is lower than the private sales scheme, private letting is part of the applicant's main area of business, and Lancaster Grove will add to their portfolio of investment properties which are held for their long term income and rental growth.

1.6 PRS is not seen as providing an affordable housing product, however its introduction have been welcomed and encouraged by the government and GLA as bringing institutional investment into the rented housing market thereby broadening supply, choice and quality for households.

1.7 Douglas Birt Consulting (DBC) has provided a valuation of the PRS units, with input from Savills. We have reviewed this and have concluded that this capital value estimate is reasonable, as we discuss further below in the section on PRS values.

1.8 The latest residual value calculated by DBC is £6,598,000 (without deduction of purchaser's costs). By switching from private sale to PRS apartments, this would reduce the residual value by £2,309,000, down to £4,289,000. This assessment is based on a scheme with nil affordable housing contributions. The applicant is offering £311,000 towards affordable housing, as a payment in lieu. The build costs for the proposed scheme are some £363,000 higher than the cost indicated by our Cost Consultant in his benchmarking exercise. Allowing for this proposed contribution and deducting the excess costs of £363,000 would result in only a marginal increase of £53,000 to the residual value generated by the scheme of £4,236,000.

1.9 The proposed benchmark land value is based on an extant consent to convert the former student housing to C3 residential use. The assumption is that the converted units would then be sold. We maintain our view that it is inappropriate to incorporate a landowner premium into this valuation; therefore this remains a point of disagreement. It has, however, been agreed that our suggested increase in the build cost contingency to 10% is appropriate. With respect to sales values, these were reduced to £1,175 per sqft by Savills in response to our 3rd July 2015 Interim Report's findings. We had proposed £950 per sqft, but following further discussion with Savills regarding the scheme, we agree that £950 per sqft is potentially understated and that values in the region of £1,000 per sqft are not unrealistic. We have undertaken sensitivity testing of the alternative use valuation at different levels of sales values:

Sales values per sqft	AUV (plus purchaser's costs)
£1,175 per sqft	£5,286,406
£1,100 per sqft	£4,839,534
£1,000 per sqft	£4,243,708
£950 per sqft	3,945,795

1.10 Using sales values of £1,000 per sqft would result in an AUV of £4.243m, which compares to the residual value of £4.236m assuming £311,000 of affordable housing contributions effectively resulting in a break even position. Based on these results, we agree that the current proposed payment in lieu of £311,000 represents the maximum contribution that can reasonably be delivered by a PRS version of the application scheme.

PRS apartment values – further discussion

1.11 Savills have assigned the following weekly rents to the PRS units:

- Unit 1: £1200pw
- Unit 2: £1200pw
- Unit 3: £475pw
- Unit 4:£450pw
- Unit 5:£600-650pw
- Unit 6: £1100pw
- Unit 7:£475pw
- Unit 8: £600-£650pw
- Unit 9: £600-650pw
- Unit 10: £475pw
- Unit 11:£600-650pw
- Unit 12: £500pw
- Unit 13:£700pw
- Unit 14: £450pw
- Unit 15:£450pw

1.12 These rents are supported by Savills with evidence of available properties from the local area. Like many of the proposed apartments, the available properties similarly have limited or no outdoor space, and are generally on a par with the proposed units in terms of quality of specification and prestige of location.

1.13 The one-beds at £425 and 475 per week for let are highly comparable to scheme's one-beds. These comparables are nearby, in Primrose Hill, and have good quality interior specification. The larger one-bed units have rents ranging from £600-£650 which is also supported by rents for comparable, high quality one-beds.

1.14 The proposed two bed units have been generally valued in a bracket between £650 to £750 per week. The comparable evidence includes a flat in Bracknell Gardens that is available for £750 per week, and a 2-bed in Lambolle Road at £650 per week. The latter is somewhat disadvantage by being a roof conversion, thus is comparable with the lower quality/smaller 2-beds in the proposed scheme.

1.15 A higher quality apartment, on Thurlow Road, Hampstead NW3, has a roof terrace, a balcony, is available for £1,200 pw, however given its superior amenities we would expect its rent to significantly exceed the proposed units. A flat at Maresfield Gardens is currently available at £1,200 per sqft and is in a house converted into flats. It is broadly comparable to the 3-beds in terms of quality.

1.16 The proposed gross rent from the scheme is £525,699.10 per annum and assumed deductions of £35,000 per annum have been made for management, maintenance, cleaning, contracts, security, sinking fund and voids/bad debts etc. We have experience of other PRS models and we are aware that there are significant deductions between gross and net rents to account for these factors. In our experience, operational costs can range between 20% -40% of gross rents. Knight Frank adopts an average gross to net of 25% to cover costs in its PRS index. It is expected that the applicant is likely to incur a range of costs similar to those associated with the delivery of other PRS schemes, therefore this allowance for costs at 6.6% seems reasonable.

1.17 Based on our assessment of the gross rents and the deductions, we consider the net rent to be realistic. A yield of 4.5% has been adopted to capitalise the net rents receivable and generate a sum of £10,904,423. This contrasts to the estimated £13.79m capital value of the scheme if sold private sale units. We agree the proposed yield is appropriate to a PRS scheme in this area, which is outside Central London but has the benefit of being a highly desirable residential location. We have made comparisons with a recent scheme in Swiss Cottage where rents were capitalised at 5%. Swiss Cottage is situated within London's Zone 2. CBRE's research reports that the average gross yield for properties in Zone 1 is 4.00%, whereas for properties within Zones 2 – 4 it is 5.50%. Given the location of Lancaster Grove, we would expect it to achieve a yield between Zone 1 and Zones 2 - 4. Rental growth will be factored within these yields. This strengthens our view that a yield of 4.5% (applied to the net rent) is realistic.

1.18 After allowing for capitalisation of net rents, we would expect to see a typical 20-40% discount in total values compared to a private sale sales model. This rule of thumb discount is consistent with the aforementioned Lancaster Grove values, which are 21% lower for private sale housing than for PRS housing.

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