Response to financial viability information

GLA Case Number:	6909
Scheme Address:	Royal National Throat, Nose and Ear Hospital Site
Applicant:	330 Grays Inn Road Ltd
Local Planning Authority:	London Borough of Camden
Date:	10 May 2021
Prepared by:	Ricky Ching/ Jane Seymour

1. Introduction

1.1 This document represents the position of the Greater London Authority's Viability Team in relation to the following viability submissions made in relation to the planning application on this site:

- FVA prepared by Gerald Eve, dated December 2020.
- Review prepared by BPS on behalf of the Local Planning Authority ("LPA"), dated February 2021.

1.2 This document is not a Financial Viability Assessment ("FVA"), nor is it a formal review. It is intended to provide advice to the Mayor and will also be provided to the LPA and the applicant.

1.3 This document sets out the extent to which the viability assessments submitted comply with the Mayor's Affordable Housing and Viability Supplementary Planning Guidance ("AH&VSPG") and National Planning Practice Guidance ("PPG") and provides comments on the inputs adopted in the FVA document(s).

1.4 This document covers the following (where appropriate):

- Proposed development and affordable housing.
- Site and context.
- Form and methodology of the FVA and Review.
- Viability inputs
- Gross Development Value.
- Development Costs.
- Benchmark Land Value.
- Appraisal results and analysis.
- Overall comment and recommended next steps.
- Photographs and plans.

Viability testing in a Covid-19 affected development market

1.5 PPG states that "Viability assessment is a process of assessing whether a site is financially viable, by looking at whether the value generated by a development is more than the cost of developing it…Any viability assessment should be supported by appropriate available evidence informed by engagement with developers, landowners, and infrastructure and affordable housing providers…" (PPG para 010).

1.6 During the Covid-19 pandemic, the available evidence is limited and potentially open to a range of interpretations. Market evidence of both current values and costs as well as outturn assumptions are important factors and are considered in this assessment. The weight to be applied to any evidence is a matter of judgement and for professionals involved and ultimately the decision-maker. Assessment of risk takes in to account the potential for market conditions to vary over the period of the development. This is particularly relevant in the current circumstances.

2. Proposed Development and Affordable Housing

2.1 The proposed scheme is described as follows in the planning application:

Retention of 330 Gray's Inn Road and a two storey extension above for use as hotel (5 above ground storeys in total), demolition of all other buildings, the erection of a part 13 part 9 storey building plus upper and lower ground floors (maximum height of 15 storeys) for use as a hotel (including a cafe and restaurant); covered courtyard; external terraces; erection of a 7 storey building plus upper and lower ground floors (maximum height of 9 storeys) for use as office (for consultation purposes only: 13,275sqm office space) together with terraces; erection of a 10 storey building plus upper and lower ground floors (maximum height of 12 storeys) for use as residential (44 units and 748sqm affordable workspace, for consultation purposes only) on Wicklow Street and office space at lower ground and basement floors; erection of a 5 storey building plus upper and lower ground floors (maximum height of 7 storeys) for use as residential (32 units, for consultation purposes only) on Swinton Street and associated residential amenity space; together with a gymnasium; new basement; rooftop and basement plant; servicing; cycle storage and facilities; refuse storage; landscaping and other ancillary and associated works (for consultation purposes only the development includes 9,427sqm of hotel floorspace (182 rooms)).

2.2 The planning application proposes the following changes in the mix of uses on the site:

Land Use	Existing GIA (sqm)	Proposed GIA (sqm)	Net change in GIA (sqm)
Hospital	12,811	0	
Hotel	0	9,427	+9,427
Office/Labs	0	14,023	+14,023
Residential	0	8,187	+8,187
Gym	0	1,476	+1,476
Total		33,113	+20,302

(Source: Gerald Eve, Nov 20)

2.3 The proposal would provide for 76 residential units in the follow unit mix:

Unit Size	No. of units	Percentage
Studio	17	22%
1 bed	27	36%
2 bed	24	32%
3 bed	8	10%
Total	76	

(Source: Gerald Eve, Nov 20)

<u>Affordable housing</u>

2.4 Policy H4 of the Camden Local Plan (2017) sets out a borough-wide affordable housing target of 50% and seeks a tenure mix of 60% social rented and 40% intermediate housing. In addition, Policy H2 relating to the supply of self-contained housing from mixed-use schemes require 50% of all additional floorspace to be self-contained housing.

2.5 The London Plan 2021 Policy H4 seek to maximise the delivery of affordable housing, with the Mayor setting a strategic target of 50%.

2.6 The current proposal in terms of affordable housing is 50% affordable housing by habitable room. This comprises 40% affordable rent and 60% intermediate.

2.7 There are 32 units proposed as affordable housing as set out below

Unit type	London Affordable Rent	Intermediate rent
1B2P	0	18
2B3P	0	1
2B4P	1	6
3B5P	6	0
TOTAL	7	25

2.8 Policy H2 in Camden's Local Plan promotes the provision of residential development as part of mixed-use schemes. There is a requirement to seek to provide 50% of the additional floorspace as self-contained housing the applicant has advised that it is not possible in this instance to provide all of this requirement on site. A payment-in-lieu has been calculated by Gerald Eve to be £2,946,000 against this shortfall. The applicant's position is that this payment is not due as the scheme is not currently viable.

3. Site and Context

3.1 The site is 0.53 hectares (1.32 acres) and comprises of a mixture of period hospital buildings. It was previously occupied by the Royal National Throat, Nose and Ear Hospital.

3.2 The site is well located in close proximity to public transport with King's Cross Station less than half a mile away to the north. The PTAL for the site 6b.

3.3 The surrounding context is a mix of predominantly commercial and residential uses. The site has a frontage on Gray's Inn Road and extends across Swinton Street over a mixture of 10 blocks in varying sizes (Appendix 1).

4. Form and Methodology of the FVA and Review

4.1 Both the Gerald Eve and BPS' assessments assume a fixed land cost in their appraisals to arrive at a residual profit which is considered against a target rate of return.

5. Viability Inputs

Gross Development Value

Residential: Market Tenure

5.1 Gerald Eve has relied on a Savills Residential Sales Report (Appendix 5) for the values and adopt an average value of £1,241 per sq ft for the market sale units.

5.2 Values for different size units vary from £1,392 for a Studio, £1,252 per sq ft for a one bed 2 person, £1,181 per sq ft for a two bed 4 person, £1,108 per sq ft for a three bed 5-person unit, to £1,084 per sq ft for a three bed 6-person unit.

5.3 BPS have adopted similar values for the studio and one bed units but have adopted higher values for the two and three beds – an average of £1,371 psf for the two beds and £1,299 psf for the three beds. The assumptions in terms of values for each unit size are shown in the table below from their FVA.

Beds	No. units	Av. Price	Sq m.	Sq. ft.	Av. £ sq. ft.	Min Price	Max Price
Studio	16	£650,938	43	468	£1,397	£625,000	£675,000
1	11	£750,909	56	600	£1,259	£715,000	£780,000
2	15	£1,276,667	87	933	£1,371	£1,150,000	£1,450,000
3	2	£1,600,000	115	1233	£1,299	£1,550,000	£1,650,000

(Source: BPS, Feb 21)

5.4 The following developments are considered key comparable evidence:

- **King's Cross Quarter –** Regal scheme of 118 units which sold out in February 2020. The average values achieved for the two beds was £1,401 psf and the three beds was £1,568 psf.

- **Postmark London**
  Taylor Wimpey scheme on the former Mount Pleasant Royal Mail site with 345 units due to complete by Q4 2021. Asking prices average £1,450 psf. Molior provides the following average asking prices
  - One bed - £978k
  - Two bed - £1.42m
  - Three bed - £1.84m

  This scheme provides more on site facilities than the application site but is in an inferior location.

- **King's Cross Central**
  An Argent development consisting of three blocks - Plimsoll, Fenman, and Luma. The average sales achieved in Fenman House for the two beds was £1,333 psf and the three beds £1,413. In Plimsoll the average price for the 3 beds was £1,390 psf. In Luma, Molior reports average asking prices of £1,598 psf with two beds averaging £1.38m and three beds £2.37m

- **Bourne Estate**
  Camden scheme – similar scale and surrounding but inferior location. This scheme has achieved values of £1,175 psf for one beds, £1,111 psf for two beds and £1,160 psf for three beds.

5.5 BPS has relied on similar transactions in their analysis but has noted that value of the larger units have been generally underestimated by Savills. This would seem to be supported by the evidence provided which shows that the overall values psf for the larger units are generally similar to or even higher than the smaller units.

5.6 BPS' analysis results in an average of £1,343 per sq ft. which therefore appears broadly reasonable.

Residential: Affordable

5.7 The average affordable housing values adopted by Gerald Eve are £326 per sq ft for the intermediate rent and £149 per sq ft for London Affordable Rent (LAR).

5.8 BPS have assumed £240 per sq ft for intermediate rent and £100 per sq ft for LAR units.

5.9 The intermediate rent levels set in line with Camden's income affordability criteria, assuming that all households will be on incomes of between £30,000 - £60,000 per annum and the rents will range from £185pw for a one bed and between £250-£323 pw for a two bed 4 person unit.

5.10 Based on these affordability criteria, Gerald Eve's assumptions are reasonable for both tenures.

Commercial Values

Hotel

5.11 The hotel is described to be boutique, or four-star accommodation from the planning documents. Gerald Eve has relied on a Savills' assessment of the 182-room hotel, and a total value of the of £69m (£379,000 per key) has been assumed.

5.12 BPS relying on advice of Melvin Gold Consulting in respect of the rental element has assumed £88.78m (£488,000 per key).

5.13 The difference between the two values are due to a range of assumptions, with the yield applied to the estimated income being a key factor. This is influenced by the operating model proposed – a management agreement compared with a lease to an operator

5.14 BPS have cross checked against transactional evidence the most relevant being:

- Crown Plaza Kensington which sold at £509k per room for a managed property equivalent to an exit yield of 3.46%. This is a better location and the application site has been discounted by 25%.

- Clayton Hotel, Aldgate – was forward sold at £429k per room. This is considered to be an inferior location.

- Days Inn London Waterloo sold in 2019 for £340k per room. The application site is in a better location with a superior specification.

5.15 GLA officers have reviewed hospitality transactions in central London on Co-Star. The baseline for a comparable 4-star hotel is in the region of mid £300k per room as achieved on 96-100 Clerkenwell Road, up into the region of high £500k achieved on 1-8 Russell Sq. Although the assumptions made by Gerald Eve and BPS are within this range; the retention of the façade and the boutique element of the hotel is likely to be more aligned with evidence at the higher end of this range. It appears that Savills assumptions are conservative and values should be in excess of £400k per key.

5.16 It appears that BPS has applied a net value (£83.13m after purchaser's costs) for the hotel in their appraisal which also deducts a further 6.8% purchaser's costs on all the investment valuations.

Office

5.17 An average rental value of £60 - £72.50 per sq ft has been assumed for the office space which has been capitalised at a yield of 4.5% - 4.75% by Gerald Eve. The total office GDV is £114.7m in their appraisal. A total rent-free/ void period of 24 - 36 months has been assumed with lease lengths of 5-years on lower floors and 10-years on upper floors.

5.18 These headline rental assumptions appear to be reasonable based on the evidence provided. The scheme will offer high quality office space and a rent at the top end of the evidence range is appropriate.

5.19 Gerald Eve's assumptions made in relation to the potential for business rates liability are not supported. It is likely that any developer would seek to minimise any liability for rates between completion and first occupation.

Ground Rents

5.20 Ground rents have not been included. Although the Government have indicated that they may bring forward legislation relating to the removal of ground rents, this is not currently in place.

5.21 Ground rents are likely to be included within the leases of the apartments used to evidence the residential values put forward and so it would be appropriate to either include ground rents in the appraisal of this scheme or increase the assumed sales values accordingly.

Grant Funding

5.22 The applicant should set out the extent to which grant funding has been sought.

Development Costs

Construction costs

5.23 Gerald Eve has relied on a cost plan prepared by Turner & Townsend which indicates a total build cost of £141,849,158 including 5% contingency and an allowance for D&B risk. The cost plan has been reviewed by Neil Powling for the LPA, who has advised taking out the D&B risk allowance resulting in total build costs of £134,398,424.

5.24 The removal of the D&B risk allowance is appropriate as otherwise it would amount to double counting of the contingency. Overall, the cost plan shows a cost of £390 per sq ft for the development which is at the top end for a scheme in this location with sales values at the level as expected above.

Profit

5.25 The profit allowances adopted by the consultants acting for the LPA and the applicant are as follows:

Type of Development	Gerald Eve % on GDV	BPS % on GDV
Market Tenure Housing	20.00%	17.50%
Affordable Tenure Housing	6.00%	6.00%
Commercial	15.00%	15.00%

5.26 The Mayor’s AH&V SPG sets out that evidence should be provided by applicants to justify proposed rates of profit, taking into account of the individual characteristics of the scheme, the risks related to the scheme, and comparable schemes.

5.27 A rate of 17.50% for Market Tenure Housing is appropriate for this scheme and reflects comparable schemes that have been referred to the Mayor.

Professional fees

5.28 Professional fees of 12% on build costs have been adopted by Gerald Eve and BPS. A typical range for professional fees is in the region of 8-10%. For a scheme such as this, an assumption of 10% is considered to be reasonable. No evidence provided otherwise and the total fees allowance in Gerald Eve’s appraisal is over £17m so this requires further justification.

Finance

5.29 A finance rate of 7% has been assumed by Gerald Eve which is higher than the GLA would expect to see and should be reduced to no more 6.5%. BPS has applied a rate of 6.5% which is considered to be reasonable.

Community Infrastructure Levy and Financial Section 106 Planning Obligations

5.30 Gerald Eve and BPS have assumed an allowance of £4,535,719 with respect to CIL payments and £2,000,000 for payments relating to financial planning obligations. These amounts should be checked and verified by the LPA.

6. Benchmark Land Value

6.1 Gerald Eve has adopted a number of different approaches in arriving at the Benchmark Land Value ("BLV"), and this is set out in the table below:

BLV component	Assessment
EUV	£38.9m
EUV + premium	£46m
AUV - redevelopment	£23.2m
AUV – D1 refurbishment	£39.6m
AUV – office refurbishment	£39.1m

(Source: Gerald Eve, Dec 20)

6.2 The approach they have relied on is an Alternative Use Value following refurbishment for D1 uses which produces a RLV of £39.6m. This is marginally higher than their EUV of £38.9m.

6.3 BPS do not consider that the existing buildings are capable of occupation in their current state although they say that they have not been able to carry out a site visit to verify the position. On the basis that neither advisor has relied on this approach, the EUV has not been considered further in this review.

6.4 BPS have therefore adopted the same approach as Gerald Eve – an AUV based on a D1 refurbishment. However, their figure is significantly lower at £12.2m with the primary difference being the value of the refurbished scheme.

6.5 Although Gerald Eve have provided a full appraisal to assess the AUV based on a redevelopment for offices/residential they have not taken the same approach on their refurbishment AUV. This means that they have not taken into account finance, fees or a risk/return element despite the costs being close to 50% of the estimated value once refurbished. This could reasonably be expected to add a further 20-25% to the costs.

6.6 Gerald Eve's assessment of refurbished values are also considered high at £500 psf taking into account the size and layout of the existing buildings and the fact that, as BPS point out, many of the comparables includes redevelopment/refurbishment potential rather than being sales for the continuing use. Their overall AUV assessment for D1 use is therefore considered to be overstated.

7. Appraisal Results and Analysis

7.1 Gerald Eve's appraisal uses a fixed land cost of £38.6m and arrives at a residual profit equivalent to -5.6% on Gross Development Value. This is lower than their blended target profit of 15.6% and equate to a profit deficit of c £49m.

7.2 BPS, on behalf of the LPA, consider there is a surplus profit of £4.7m which could be used to improve the tenure mix within the proposal.

8. Overall Comments and Recommended Next Steps

8.1 As Gerald Eve, on behalf of the applicant, has identified that the scheme is generating a deficit, the applicant is required to demonstrate how the scheme is deliverable, in accordance with paragraph 3.10 of the AH&VSPG.

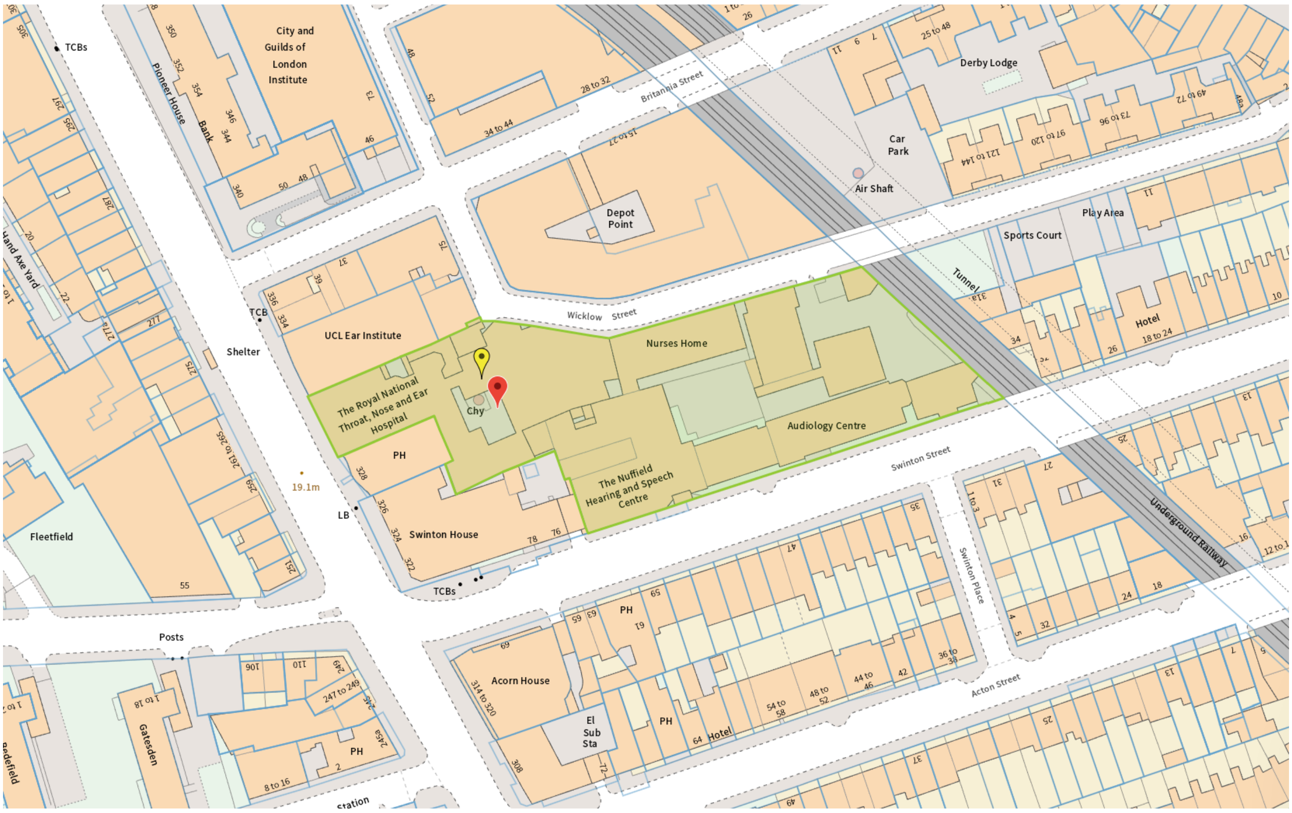
8.2 Molior reports that Groveworld bought the site in December 2018 for £55m. It is hard to understand how this can be reconciled with Gerald Eve’s appraisal which if profit was inputted as a cost, would show a negative residual land value.

8.3 The deficit identified by Gerald Eve is excessive and it is likely that the scheme could achieve close to a break even position if the viability assumptions outlined above were reviewed. Any surplus could be used to provide additional low-cost units within the scheme.

9. Review Mechanisms

9.1 The Section 106, in accordance with the London Plan 2021, will need to include early and late-stage review mechanisms. The mechanisms should use the formulas set out in the Mayor’s Affordable Housing and Viability SPG and the drafting should be based on the GLA’s S106 Review Mechanisms template.

Appendix 1 Site OS map and Google satellite image



Proposed elevation plan (Gray's Inn Road)

(Source: Allford Hall Monaghan Morris, Nov 20)

Proposed elevation plan (Swinton Street)

(Source: Allford Hall Monaghan Morris, Nov 20)