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Sofie Fieldsend
Senior Planner
London Borough of Camden

Private & Confidential

Dear Sofie

Lupin House, 11-13 Macklin Street, London WC2B 5NH (the "Site")
Response to BPS's Independent Viability Review

We have been provided with BPS's report titled "Lupin House, 11-13 Macklin Street, WC2B 5NH – Financial Viability Review" dated February 2023. This report sets out the findings of BPS's review on behalf of LB Camden ("LBC") of JLL's Financial Viability Assessment (herein "FVA") dated September 2022 and subsequent addendum report dated December 2022.

The FVA was submitted as part of the planning application pertaining to the redevelopment of the Site. JLL's FVA concluded that the Residual Land Value ("RLV") of the proposed scheme comprising 100% private tenure residential along with office accommodation, was below the adopted benchmark land value and thus the scheme is unable to contribute towards the provision of additional affordable housing.

We have reviewed BPS's report and note that they do not accept the conclusion that the RLV of the proposed development is below their adopted benchmark land value, instead concluding that there is a surplus of **£2.73 million** compared to the deficit of **-£1.65 million** reported in our December 2022 addendum.

We note that BPS agree with our assessment in respect of the following assumptions:

- Construction costs;
- Contingency;
- Professional fees;
- Private residential disposal fees;
- Commercial disposal fees;
- Purchaser's costs; and
- Profit.

BPS disagree with the following assumptions made within the proposed scheme appraisal:
- Private residential GDV;
- Commercial GDV;
- Finance costs;
- Development timescales; and
- Benchmark Land Value

We have examined BPS's review in detail and set out our response on the above points of disagreement.

Proposed Private Residential GDV

BPS consider that the residential GDV reported within our September 2022 assessment of £1,595psf to be in line with their expectations of the achievable values of the subject flats. However, they disagree that the 5% decrease in values to £1,515psf adopted at our December 2022 is an appropriate reflection of market movement between these dates, given that the HPI data available suggests that the market remained stable between July 2022, when JLL initially valued the units, and November 2022, which was the most recent data available when BPS carried out their review. BPS have presented two new build comparable schemes at 101 Cleveland and the Postmark, neither of which we see as particularly comparable due to the respective locations, size of scheme and amenity offering which are very different to the boutique nature of the proposals at Lupin House.

When we prepared our December 2022 addendum report, there was significant turbulence in the market and very little evidence of how dramatically increasing mortgage rates and cost of living were affecting demand and achievable prices.

We have also had a fresh look at the land registry index for Camden between September and December (the dates of our reports) which shows a -1.8% fall in values in that period. We suspect this trend may have continued for the first two months of 2023 but Land Registry data is not available for that period.

In preparing this letter, we have recontacted several agents with experience in the local area and there was a consensus that, while there was significant turbulence in the market in the final months of 2022, they would not consider that achievable values have fallen between now and December 2022, provided that the property in question is not overpriced. They commented that the demographic seeking to buy flats in the area are less impacted by increased mortgage rates and therefore pricing has remained more resilient compared to other parts of London.

Whilst we feel our December pricing is justified, we have applied the land registry movement of -1.8% to our September pricing as follows:

Unit No.	Market Value Sep-22	£psf	Market Value Dec-22	£psf2	Market Value Feb-23	£psf3
1	£900,000	£1,672	£855,000	£1,589	£883,800	£1,642
2	£915,000	£1,667	£869,250	£1,583	£898,530	£1,637
3	£1,325,000	£1,620	£1,258,750	£1,539	£1,301,150	£1,591
4	£1,385,000	£1,589	£1,315,750	£1,509	£1,360,070	£1,560
5	£930,000	£1,630	£883,500	£1,549	£913,260	£1,601
6	£930,000	£1,630	£883,500	£1,549	£913,260	£1,601
7	£1,355,000	£1,614	£1,287,250	£1,533	£1,330,610	£1,585
8	£1,395,000	£1,600	£1,325,250	£1,520	£1,369,890	£1,571
9	£950,000	£1,605	£902,500	£1,524	£932,900	£1,576
10	£935,000	£1,639	£888,250	£1,557	£918,170	£1,609
11	£2,830,000	£1,538	£2,688,500	£1,461	£2,779,060	£1,510
12	£2,750,000	£1,548	£2,612,500	£1,471	£2,700,500	£1,521
	£16,600,000	**£1,595**	**£15,770,000**	**£1,515**	**£16,300,000**	**£1,566**

We therefore propose a residential GDV of **£16,300,000 (£1566psf)**.

Proposed Commercial GDV

BPS consider our assumptions for the commercial rent and rent free period to be a reasonable reflection of the market for the proposed accommodation. However, they consider the void period and yield to be pessimistic.

In terms of the void period, BPS argue that the marketing of the commercial units could commence prior to practical completion. They have therefore reduced our assumption of a 12 month void period down to six months. We consider this to be a reasonable assumption and have amended our appraisal accordingly.

In terms of the yield applied to the rental income, we initially adopted a yield of 4.5% in September 2022, increased to 5.5% in December 2022 to reflect the changes in the market over that period. BPS argue that a move of 100bps is excessive and, instead, adopt a yield of 5%, citing the Knight Frank Yield Guide for January 2023 which reported West End non-core office at 4.5%.

The investment market is still in a phase of 'price discovery' where there is little transactional activity to establish a tone of how yields have moved. Everyone accepts they have moved out, but by how much is speculation or based on sentiment in the absence of transactional data. On the basis there isn't clear transactional evidence we propose a compromise of 5.25% on the proposed commercial.

Finance Costs

BPS consider that our assumption of 7.5% debit rate adopted within out December 2022 addendum is excessive despite the increases in the Bank of England Base Rate. They firstly argue that commercial rates do not necessarily reflect movements in the base rate and, secondly, that developers are able to "*mitigate against rising interest costs by using fixed borrowing facilities*."

We do not agree with this position. Some large housebuilders may have fixed borrowing facilities but even the long term cost of borrowing for these types of developers will have increased. We have even seen cost of borrowing of registered providers increase and they are less exposed to commercial bank development finance. Smaller developers, the likes of whom might deliver a scheme of this scale, have been significantly impacted by the increased cost of borrowing and we understand development finance can cost upwards of 10%. If anything the 7.5% applied in our appraisal seems optimistic.

We have therefore maintained our assumption of 7.5% for the finance rate.

Development Timescales

<u>Construction Period</u>

BPS have adopted a construction period of 15 months based on the BCIS duration calculator, compared to our assumption of 18 months.

We do not consider it appropriate in this instance to rely entirely on the BCIS duration calculator as the subject site is not typical in terms of location or construction, involving the retention of the existing façade on a tight Central London street and we therefore consider 18 months to be an appropriate construction period to reflect this.

Gardiner & Theobald have advised that an appropriate construction period would be 18-22 months. They state that the BCIS database is an average whereas we are looking at a specific site in one of most difficult parts of London to get to from a logistical point of view. Further we are aiming at delivering a high quality product from a finishes perspective and that takes longer when compared to the BCIS database of projects. In addition due to current global economic position we are seeing much longer lead in periods and shortage of materials including plant timber and ductwork. BCIS is based on historical information and therefore doesn't accurately reflect this.

We therefore maintain our position of 18 months and note that this is conservative based on the advice received.

Residential Sales Period

BPS have assumed a sales period of three months, reflecting 50% off-plan sales followed by three sales per month post-completion. This compares to our assumption of eight months, reflecting 30% off-plan sales followed by one sale per month post-completion.

In support of their argument, BPS refer to a viability assessment they have been involved with in the area where 45% off-plan and three sales per month was agreed. We note, however, that this is simply an example of what one developer was willing to accept in negotiations and not direct evidence of sales rates being achieved in the market.

We refer to the nearby Chapter House development, which, according to Molior London, has been achieving one to two sales per quarter over the last year. Similarly, the final year of marketing at The Hexagon saw a sales rate of one to three per quarter. We would expect slow sales rates such as this for boutique schemes in Central London.

As stated in our original report, we consider these schemes to be a superior scheme and have therefore adopted a lower £psf values for the subject. We would therefore expect the sales rate at the subject to be quicker than this, but we do not consider BPS's assumptions to be an accurate reflection of the scheme or the current market.

While the market has slowed significantly since we carried out our initial appraisal and we believe there is an argument that the flats would now take longer to sell, we have maintained our original assumption of an eight month sales period. We consider this to be a reasonable reflection of the time it would take to sell units within a boutique scheme in the current market.

Commercial Lettings Period

BPS note that we have adopted a six month lettings period within our cashflow, while also assuming a six month rent free period in our investment valuation of the proposed commercial units and they consider this to be double counting.

We acknowledge this and have removed the lettings period within our appraisal in line with the BPS appraisal.

Benchmark Land Value

BPS have concluded a Benchmark Land Value of £4,565,000 compared to our conclusion of £6,873,900. We provide a comparison below:

	JLL Dec-22	BPS
Office	£3,130,000	£2,130,000
Residential	£2,598,250	£2,019,000
Premium	20%	10%
Benchmark Land Value	**£6,873,900**	**£4,565,000**

Existing Residential Accommodation

While we have assessed the value of the existing residential accommodation on a capital value basis, BPS have considered it as a rental investment, arguing that this is more appropriate given nature and access issues of the accommodation. We have reflected the nature and access issues in our valuation. Whilst the property would appeal to investors we dispute any suggestion that the units could not be sold individually or that is appropriate to ignore evidence of comparable apartment sales which include those purchased by investors.

Regardless of the valuation approach adopted, we do not consider a conclusion of £891psf to be a reasonable reflection of the market in the area. To put this in context, £891psf represents a c. 45% discount to BPS's adopted value of £1,595psf for the proposed residential. Although the proposed accommodation will be superior to the existing, the latter is in good condition, notwithstanding the shared commercial access, and we have not had any evidence or indication from local agents that such a significant difference in value is appropriate.

Given the nature, location and access arrangements, of the existing flats, we consider BPS's valuation approach to be reasonable, albeit it is unclear why they haven't also considered the capital value of the subject units as well. In order to consider their investment approach, we have conducted research into rental values in the local area and BPS's conclusion of a £100,980pa net rent appear to be reasonable.

In terms of the yield applied to the rental income, we note that BPS have applied what they refer to as an "optimistic" yield of 5% to the net rental income. We consider a 5% yield to be pessimistic for flats located in Prime Central London. We have referred the Knight Frank Prime London Lettings Report for January 2023, which points to an average yield of 3.8% for Prime Central London.

The apartments are in good condition and situated in a desirable location. Accordingly, we would not expect there to be difficulties in securing tenants. Taking this into account, we have applied a lower yield of 4% to the net rental income to sense check the capital value approach.

This generates a capital value of £2,524,500 (£1,114psf), compared to the £2,598,250 (£1,146psf) adopted in our December 2022 addendum appraisal based on a capital value approach.

We note that the resulting capital value on a £psf basis is within the range of comparable evidence provided at our original assessment. We also consider this to be a more reasonable reflection of the local market compared to the £891psf put forward by BPS, which they acknowledge falls far below the tone of evidence.

We therefore revise our Existing Use Value for the residential accommodation to **£2,524,500 (£1,114psf)**.

Existing Commercial Accommodation

The areas of disagreement in terms of the valuation of the existing commercial accommodation are the rental value of the vacant floorspace and the yield applied to the passing rent.

In terms of the rental value of the vacant space, we considered this on the basis that it could not be let at market rent without significant refurbishment and repair and would therefore be likely to be let as ancillary space. We therefore adopted a rental value of £10psf and a void and rent free period of 18 months. In contrast, BPS have applied nil value to this space, arguing that the previously agreed leases do not include any ancillary space and the marketing exercise carried out by NextGen generated no demand. We fundamentally do not agree with the proposal that lettable space (even at very low rates per sqft) is worth nothing.

Although the space is currently vacant, we do not accept the argument that floorspace in Central London can have no value. We therefore considered £10psf to be a reasonable assumption for this floorspace, being significantly below the tone of evidence for good quality space in the area, while still acknowledging that it has value.

In terms of the yield, BPS have capitalised their assumed rental income of £160,000pa at 7%, while we had applied 6% to the passing rent and 7% to the reversionary income to reflect the additional risk associated with this element.

We note that in their discussion of the proposed office space, BPS refer to the yields quoted in Knight Frank's January 2023 Yield Guide. This guide is now reporting West End Non-Core at 3.75%-4% in February 2023. Although the subject accommodation is not Grade A, we consider a yield of 7% to the passing rent to be excessive and maintain a yield of 6% on the passing rent, which we consider to be reasonable compared to the evidence originally gathered and recent yield guides. We have also viewed this in the context of the value applied to the proposed space. Indeed the values adopted by JLL equates to approximately £305 psf NIA for the existing floorspace and £1,047 psf NIA for the proposed – an effective discount of 71%. We consider this more than accounts for the differences in accommodation.

We therefore maintain our office EUV at **£3,130,000**.

Landowner's Premium

BPS have adopted a landowner's premium of 10% to both the office and residential elements, compared to the 20% adopted in our appraisal. They argue that, while the office accommodation is income producing, the marketing exercise carried out by Next Gen demonstrates that there is limited demand for the space and a freeholder would, therefore, require little incentive to give up the asset. BPS have not mentioned the residential accommodation in this section of their report but we note that the same premium has been applied.

While a marketing exercise was carried out on the office accommodation, no such exercise was carried out in relation to the residential accommodation. This is in good and saleable condition and is capable of being income producing. Consequently, there should be a difference in the premium applied to the residential and office accommodation and we do not consider a premium of 10% would be a reasonable incentive a landowner would require to give up the asset.

Taking this into account, we are willing to accept BPS's premium of 10% on the office accommodation, while maintaining our 20% on the residential. This generates blended premium of 14.5% and a Benchmark Land Value of **£6,472,400**.

Conclusion

This letter sets out JLL's response to the areas of difference between JLL and BPS in respect of the proposed scheme, together with additional evidence and justification. Whilst we have maintained our position on construction programme, finance and sales rates, we have amended our position on commercial yield and letting periods, existing residential values and landowner's premium GDV in order to reach a comprised position.

We have updated our appraisal to reflect the changes set out above and provide a summary below:

	Proposed Scheme
Residual Land Value	£6,023,865
Benchmark Land Value	£6,472,400
Surplus/Deficit	**-£448,535**

The appraisal summary for the proposed scheme is provided at Appendix 1.

If you have any queries in relation to the above, please do not hesitate to contact us.

Yours sincerely,

Edmund Couldrey
Director
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Appendix 1

Appraisal Summary

Lupin House - Proposed Scheme
221219

Development Appraisal
JLL
01 March 2023

APPRAISAL SUMMARY	**JLL**

Lupin House - Proposed Scheme
221219

Appraisal Summary for Merged Phases 1 2

Currency in £

REVENUE

Sales Valuation	**Units**	**ft²**	**Sales Rate ft²**	**Unit Price**	**Gross Sales**
Residential Apartments	12	10,409	1,565.95	1,358,333	16,300,000

Rental Area Summary	**Units**	**ft²**	**Rent Rate ft²**	**Initial MRV/Unit**	**Net Rent at Sale**
Office Space	1	4,893	60.49	295,978	295,978
Totals	**1**	**4,893**			**295,978**

Investment Valuation

Office Space					
Market Rent	295,978	YP @	5.2500%	19.0476	
(6mths Rent Free)		PV 6mths @	5.2500%	0.9747	5,495,263
Total Investment Valuation					**5,495,263**
GROSS DEVELOPMENT VALUE				**21,795,263**	
Purchaser's Costs			(373,678)		
Effective Purchaser's Costs Rate		6.80%			
				(373,678)	
NET DEVELOPMENT VALUE				**21,421,585**	
NET REALISATION				**21,421,585**	

OUTLAY

ACQUISITION COSTS				
Residualised Price			6,023,865	
				6,023,865
Stamp Duty			290,693	
Effective Stamp Duty Rate		4.83%		
Agent Fee		1.00%	60,239	
Legal Fee		0.80%	48,191	
				399,123

CONSTRUCTION COSTS

Construction	**ft²**	**Build Rate ft²**	**Cost**	
Construction Costs	22,456	350.55	7,872,000	
Contingency		7.50%	590,400	
CIL			35,737	
				8,498,137
Section 106 Costs				
Section 106 Costs	12 un	2,000.00 /un	24,000	
				24,000

PROFESSIONAL FEES				
Professional Fees		12.00%	944,640	
				944,640

MARKETING & LETTING

Lupin House - Proposed Scheme
221219

Letting Agent Fee	10.00%	29,598	
Letting Legal Fee	5.00%	14,799	
			44,397
DISPOSAL FEES			
Resi Sales Agency Fee	1.50%	244,500	
Comm Sales Agent Fee	1.00%	51,216	
Resi Sales Legal Fee	0.50%	81,500	
Comm Sales Legal Fee	0.50%	25,608	
			402,824
TOTAL COSTS BEFORE FINANCE			**16,336,985**
FINANCE			
Debit Rate 7.500%, Credit Rate 2.000% (Nominal)			
Total Finance Cost			1,514,333
TOTAL COSTS			**17,851,318**
PROFIT			
			3,570,267

Performance Measures

APPRAISAL SUMMARY JLL

Lupin House - Proposed Scheme
221219

Initial
MRV
295,978
295,978

Lupin House - Proposed Scheme
221219