Committee:	Date:
Planning and Transportation	**17 July 2014**
Subject: **Sugar Quay, Lower Thames Street, London EC3R 6EA** **Affordable housing contribution from proposed residential redevelopment - Appendices**	**Non Public**
Report of: **Director of the Built Environment**	**For Decision**

Appendices to the report on the Public Agenda

Appendix 1

Development Viability Review - DS2, 20th February 2014

Appendix 2

Executive Summary, Conclusions and Recommendations from a Review of the Applicant's Revised Viability Assessment - Gerald Eve, June 2014

NB

The appendices to the confidential DS2 Development Viability Review and the full Gerald Eve Review of the Applicant's Revised Viability Assessment will be available in the Members' Reading Room.

PL/ds1007
20 February 2014

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Dear David

SUGAR QUAY, LOWER THAMES STREET, EC3 – DEVELOPMENT VIABILITY REVIEW

This letter and accompanying information represents an updated Financial Viability Assessment (FVA) reflecting the development economics of the redevelopment of Sugar Quay ("the Site") on Lower Thames Street in the City of London ("the Corporation"). The updated FVA is provided in accordance with the signed S106 agreement for the site.

The planning application was submitted by DP9 on behalf of SQ Guernsey Ltd ("the applicant") in November 2012. A copy of our 2012 FVA as submitted to the Corporation in support of the planning application is attached at Appendix One.

This information is provided under cover of the Confidentiality Statement issued with the November 2012 FVA as the enclosed information falls within the definition of environmental information for the purposes of Regulation 2(1) of the Environmental Information Regulations 2004.

In undertaking this review we have used Argus Developer software as with the 2012 FVA and adopted a present day approach. A hard copy of the models can be provided upon request to your advisors.

Background

As part of the planning consent reference 12/01104/FULMAJ, there is a requirement for the applicant to make a payment of £7,503,406 (subject to indexation) to the Corporation's affordable housing fund. The affordable housing payment shall be made on or before the implementation of the planning consent as noted at section 1.1 of Schedule Three of the S106.

The Section 106 agreement has a further requirement for a review of the viability if the applicant does not agree to a "second installment" of £7,503,406 and if this is the case, the applicant must submit a "revised viability statement" at least four months prior implementation. The requirements for the revised viability statement are set out in Schedule Three of the S106 agreement.

Schedule 3 of the signed S106 states at paragraph 1.2 that *'the developer shall not implement the Planning Permission until the value of the second installment is agreed or determined (as appropriate) in accordance with paragraphs 1.3 to 1.5 of this Schedule 3'*.

Paragraph 1.3 stipulates that '*at least four months prior to implementation the developer shall (a) confirm in writing to the City of London that the second installment (affordable housing payment) shall be £7,503,406 (indexed) or, (b) submit to the Corporation the revised FVA that identifies the developer's proposed Second Installment'*. A copy of Schedule Three of the S106 and the accompanying Definitions are attached to this letter as Appendix Two.

We have updated the FVA by way of this letter as opposed to a new report and we anticipate that, supported by up to date relevant information, this will be acceptable to the Corporation and their viability advisors.

A copy of the Corporation's advisors main report and addendum report that reviewed the DS2 2012 FVA is attached as Appendix Three. The reports are dated February and March 2013 respectively.

In undertaking this assessment we have updated a number of the key development inputs and the updated information can be summarised as follows:

- Review of the Site Value for the purposes of viability which was previously included as an Alternative Use Value (AUV) reflecting the residual site value for an unimplemented office consent;
- Review of the residential values for each dwelling as consented with support from Savills Residential;
- Review of the costs for the consented residential scheme with advice from Gleeds cost consultants;
- We have also reviewed all the other development inputs and updated and commented where appropriate.

This letter sets out the revised inputs with our conclusions, in accordance with the requirements of Schedule Three of the S106 agreement, adopted planning policy and best practice guidance. The S106 states in the Definitions section under the heading "Revised Viability Assessment" (part c) that *'the assessment shall be carried out in accordance with the RICS Professional Guidance Financial Viability in Planning (GN 94/2012) (or any update or replacement of such guidance as approved by the Corporation) using a methodology consistent with such guidance and approved by the Corporation'*. We have also had regard to adopted and emerging planning policy and other best practice guidance.

Please note that no formal agreement was ever reached between the applicant and the Corporation in terms of the development appraisal for the now consented scheme. As such, in making a number of comparisons between the November 2012 and February 2014 FVAs, we have used the development appraisal as submitted in November 2012 as the base case. We hope that this is helpful for the Corporation's advisors.

In December 2012 the Corporation's viability assessors kindly noted that DS2 had inadvertently missed the marketing and sales costs from the appraisal contained within the FVA. This point was noted and addressed in a DS2 response dated 21 December 2012. This DS2 note and updated correct appraisal is attached as Appendix Four.

Site Value

In 2012 DS2 estimated a site value for viability purposes of £48,365,000. This site value was based upon a residual calculation of extant office consent for the site reference 10/00459/FULMAJ. We understand from DP9 that the extant consent remains live and as such relevant. In forming our opinion of Site Value we have also reviewed other transactional evidence in order to understand whether there is any further upside from this AUV and our analysis is contained below.

In terms of the justification of the office value, the office market in the City of London has improved markedly since the end of 2012 and expectations are high going into 2014. Take-up in 2013 was extremely strong, and the City enjoyed the most positive year in this regard since 2000. Demand is strong and availability of new space is now at its lowest point since 2008.

The table below illustrates the rents, yields and incentives as included in the November 2012 FVA and the updated appraisal.

Table One: Updated Alternative Use Value for Sugar Quay		
	November 2012	**February 2014**
Office Rents	Three tranches at £50, £52.50 & £55 per sq ft (pre-let, PC and six months post PC)	Three tranches at £52.50, £55 & £57.50 per sq ft (pre-let, PC and six months post PC). Reflects an average £2.50 per sq ft improvement in achievable rents
Office Yields	5.5%, 5.25% & 5.25% for the three tranches respectively	5.25%, 5% & 5% for the three tranches respectively. Reflects a 25 basis point compression in the yield
Office Incentives	24 months' rent free on each tranche (minimum 10 year term)	24 months' rent free on each tranche (minimum 10 year term)
Site Value	**£48,365,000**	**£57,034,000**

The build costs have been increased by 8.7% in line with the advice from Gleeds on the consented residential scheme. As you will note from Table One the new AUV is £57,034,000. In DS2's opinion there is some justification that a 20% profit on cost could be reduced to circa 15% with the benefit of a pre-let which would improve the site value to £62,700,000. We have however left the target return unchanged at 20% on cost.

We have removed the development management fee from the AUV appraisal as included in 2012 as per the Council's assessor's comments in their February 2013 report, albeit this is a real cost and one that might not be carried in a 20 percent gross profit on cost. All other inputs into the AUV appraisal remain unchanged other than those noted above. Table Two illustrates the sensitivities attached to a £2.50 per sq ft increase in the rental values and a 25 basis point alteration to the yield with a 20% profit on cost return.

Table Two: Sugar Quay AUV Rent & Yield Sensitivity Analysis, February 2014			
	Rent: Rate pf²		
Yield (%)	0.00 pf²	+2.50 pf²	+5.00 pf²
-0.50%	£72,906,000	£79,560,252	£86,214,502
	20.00%	*20.00%*	*20.00%*
-0.25%	£64,556,618	£70,831,576	£77,106,481
	20.00%	*20.00%*	*20.00%*
0.00%	£57,034,563	£62,967,663	£68,900,827
	20.00%	*20.00%*	*20.00%*

The green cell illustrates the current position. The table illustrates the impact on site value given changes to the rent and yield inputs in a positive economic environment for City offices as noted by a range of leading agents in their 2014 forecasts.

In terms of evidence of deals within the last 6 months to support the improvement in the office value, the Walbrook Building (23 to 29 Walbrook) was quoting a rent of £57.50 per sq ft and achieved a letting at £60 per sq ft to 'XChanging' for 50,095 sq ft third floor accommodation in November 2013. The building is located close to Cannon Street. Knight Frank and Jones Lang are marketing further space in the building for £52.50 per sq ft. Gallagher Heath also took 35,000 sq ft on the first floor of the same building in October 2013 at £57.50 per sq ft. Vanguard plc took close to 50,000 sq ft in August at £57 per sq ft.

In terms of availability in EC3, number 6 Bevis Marks is a new ground plus 14 storey office building totaling approximately 170,000 sq ft (NIA). Deloitte Real Estate and Jones Lang LaSalle are currently quoting rents of £60 per sq ft. The building is close to 30 St Mary's Axe (Swiss Re) to the north of the subject site.

Cushman and Wakefield are marketing 40 Gracechurch Street at £55 per sq ft. The building comprises circa 130,000 sq ft of Grade 'A' accommodation in a building to close to Monument station to the north west of the subject site. No. 24 Monument Street is being marketed at £57.50 per sq ft by Knight Frank. The new building comprises 11 floors of office accommodation and the building is on the north side of Lower Thames Street close to the subject site.

Leading agents have reported a very positive outlook for the City in 2014. Jones Lang LaSalle for example state that the strength of occupier demand has put upward pressure on prime rents which increased to £60 per sq ft at the end of 2013. Typical incentives, assuming a 10 year lease, are at 12 months' rent free for each five years term certain. Strong rental growth is anticipated in 2014 with prime rents forecast to reach £65 per sq ft before the end of the year. Incentives may be squeezed and move in by 3-6 months. A copy of Jones Lang La Salles' outlook for the City office market in 2014 is attached as Appendix Five.

It is therefore our opinion that the alternative use value has improved in the time period from November 2012 to February 2014. A Site Value of £60,000,000 appears reasonable on a residual basis for the office consent.

We have also reviewed the residential land market in order to understand whether there is any upside to the AUV. It is difficult to find truly comparable sites in the City of London and DS2 have therefore attempted to identify riverside sites (or close to) in higher value areas in central London where planning permission has been achieved within the last two years and there are in excess of 150 residential dwellings (there are a number of exceptions in terms of the number of residential dwellings).

Residential / Mixed Use Development Sites

St Barts Square – this appears to be the only residential site of a significant size in the City of London that has transacted in recent memory where we have access to site acquisition costs. Planning consent was achieved in 2013 for 215 residential dwellings in a part new build and part refurbished development. The site area is 1.29 hectares and the proposed density is significantly lower than Sugar Quay. The consent provides for a significant amount of new retail and office space. The site was transacted for £55 million in 2011. Given the proposed density and mix of uses, we attach limited weight to the evidence. The scheme has a total GEA of 719,283 sq ft reflecting a land price of £76 per sq ft (based on the consented GEA).

St Dunstan's House (Fetter Lane) – this site is to the immediate north of Fleet Street and consent was achieved in March 2012 for 76 dwellings. The site was purchased by Taylor Wimpey for £34,500,000 in March 2013 according to the Land Registry title document. The site is 0.24 hectares and proposes 71,462 sq ft (GIA) of development. This equates to a land value of £482 per sq ft on the consented GIA. We understand from Molior that recent sales trips to the Far East were undertaken with asking prices averaging £1,650 per sq ft. We are unaware as to the pricing levels achieved.

The scheme has a total GEA of 75,223 sq ft reflecting a land price of £459 per sq ft. We would note that the site is being developed by a house builder who in our experience will benefit from efficiencies of scale and in-house capabilities in terms of construction which will be reflected in the land price. This should be taken into consideration in the assessment of land value.

Fulham Riverside – acquired for £32,900,000 in 2010 by Sainsbury's Supermarkets albeit a JV was formed in 2012 between Barratt London and London & Quadrant. The site has planning for 463 homes as well as a new supermarket and a variety of other retail uses. Recent marketing launch (December 2013) illustrates asking prices at circa £1,100 per sq ft. The scheme has a total GEA of 1,155,418 sq ft. We have been unable to make an accurate assessment of the real site value on a £ per sq ft basis for the consented development, but it would appear lower than that proposed at Sugar Quay.

Riverlight (Tideway Wharf) – this site was acquired for £50,925,000 in 2011 by St James, part of the Berkeley Group. The site was granted consent in December 2011 for 806 homes and a range of commercial uses. The first marketing phases have been around the £1,050 per sq ft mark. We have been unable to ascertain an accurate site value on the consented scheme however on a crude calculation based on the number of proposed dwellings, the site value on a range of measures appears to be below that proposed at Sugar Quay.

Embassy Gardens, SW8 – the site was purchased by Pridebank Limited with NAMA listed as the principal lender for £87,623,000 in October 2013. The site has consent for close to 1,900 new homes and a range of commercial development. We understand from the developers Ballymore that current marketing phases are averaging over £1,000 per sq ft. The scheme has a total GEA of 249,604 sq ft reflecting a land price for the consented development of £351 per sq ft. Given the scale of development proposed and the mix of uses, we do not believe this is a robust comparable.

Riverwalk House, SW1 - was acquired in July 2012 for £70,000,000. The site is adjacent to Vauxhall Bridge in Westminster and the consent includes off-site affordable housing elsewhere on Vauxhall Bridge Road. The site was granted consent this year for 113 residential dwellings. Pricing is unavailable however we understand from Molior that asking prices in recent overseas marketing campaigns have been in excess of £2,000 per sq ft. The site is not dissimilar in terms of riverside location and scale albeit the site does not have the same sales risk profile as Sugar Quay being in Westminster. The scheme has a total GEA of 265,020 sq ft reflecting a transaction price of £264 per sq ft. This is a reasonably helpful comparable.

The Corniche (Hampton House) – this site was acquired by St James for £50,000,000 in 2012. The site is in Lambeth on the Albert Embankment. The site has planning for 253 residential dwellings and some retail and office space with some of the residential going up to 27 floors. Residential values will average in the region of £1,000 per sq ft.

Abel & Cleland House – this former office building was acquired for £67,000,000 in 2010 by the Berkeley Group. The site is located just off the river behind Millbank Tower and has consent for 275 residential dwellings. Current pricing is in the region of £1,600 per sq ft but with large apartment's capital values range from £1.8m to £8m. The scheme has a total GEA of 453,692 sq ft reflecting a land price of £148 per sq ft. This is a helpful comparable given the scale of development and price point albeit it's just off the riverside.

190 The Strand – this site of off the waterfront but not dissimilar in terms of scale. The site consisting of six office buildings formerly known as Abbey Life House was acquired by a subsidiary of the Berkeley Group in 2012 for £84,000,000. The site has planning for 206 residential units and a relatively small amount of retail and restaurant uses. The sales information available is limited however there are apartments currently available with very high capital values currently ranging from £3m to £14m. According to London Residential Research, asking prices are averaging circa £2,400 per sq ft. We are unclear on achieved pricing. The scheme has a total GEA of 519,794 sq ft reflecting a transaction price of £162 per sq ft.

South Bank Tower (Kings Reach) – the site was acquired in 2010 for £50m. The site has planning for 191 residential apartments in a 42 storey tower and a range of commercial uses on the lower floors. According to Molior current pricing is averaging £1,700 per sq ft albeit this includes a range of apartments from the 11th to 27th floors. The scheme has a total GEA of 731,794 sq ft reflecting a transaction price of £68 per sq ft.

One Blackfriars – the site was acquired the former Sainsbury's head office building for £232,000,000 by St George in 2013. Planning comprises 274 residential dwellings in a 50 storey tower with a 120,000 sq ft hotel and other commercial uses. The GEA in the planning application is 806,500 sq ft which equates to £207 per sq ft land value on the GEA or with a 5% reduction for GEA to GIA a land value of circa £300 per sq ft. There is a limited amount of information available publically however we understand that there is a wide range of £ per sq ft values, however average rates on the lower floors are just above £1,000 per sq ft with values touching £3,000 per sq ft on the upper floors. We understand that the sales rate for a central London scheme is relatively slow albeit this is anecdotal evidence. The scheme has a total GEA of 806,500 sq ft reflecting a land price of £288 per sq ft.

One Tower Bridge – Berkeley paid a relatively small sum for this site in 2007 and as such no comparison can be made with the subject site. The scheme has a total GEA of 543,539 sq ft reflecting a transaction price of £110 per sq ft.

Based on the evidence available, we are of the conclusion that the AUV remains the most robust Site Value for the purposes of viability on Sugar Quay given the variation in location, density, property mix and so on of the comparable sites.

The Site Value therefore proposed is £60 million at today's date. The Site Value in 2012 was £48,365,000. The RICS GN is clear at 3.4.9 that *'It has become very common for practitioners to look at alternative use value (AUV) as a land value benchmark. This will come with its own set of planning obligations and requirements. Reviewing alternative uses is very much part of the process of assessing the market value of land and it is not unusual to consider a range of scenarios for certain properties. Where an alternative use can be readily identified as generating a higher value, the value for this alternative use would be the market value'*. As such we are of the opinion that we are compliant with both adopted planning policy and the RICS GN in this regard.

Residential Values

Savills have updated their residential report dated November 2012. This is attached as Appendix Six of this letter.

In November 2012 Savills valued the residential accommodation at an average rate of £1,511 per sq ft. This includes a range of capital values of between £395,000 and £9.53 million. It is important to reiterate that the average £ per sq ft rates do not tell the whole story. The rate is included as an average for in excess of 165,000 sq ft (NIA) of development. There are some very large unit sizes and as such adequate regard should be had to an assessment of the capital values and the comparable evidence available.

As noted at the time there were 35 apartments valued at above £2 million at Sugar Quay. The Savills analysis demonstrated that the City residential market is extremely thin at this end as demonstrated by a distinct lack of sales evidence and relatively poor sales performance on apartments with capital values above £1.5 million, a point that remains and is included in Savills' updated analysis. The City residential market is very different for example to the Westminster market where considerable sales volumes are achieved at high capital values. This isn't the case in the City of London.

Savills have revalued the proposed accommodation at Sugar Quay with regard to the comparable evidence available and their knowledge of the City of London residential market. The updated Savills average £ per sq ft values are included in the table below with reference to the November 2012 values.

Table Three: Average £ per sq ft Rates for Sugar Quay, February 2014					
Unit Type	**November 2012**	**February 2014**	**% Change**	**Avg Apartment Size (sq ft)**	**Avg Capital Value (Feb 2014)**
Studio	£1,128	£1,543	36.8%	398	£614,000
One Bed	£1,077	£1,333	23.8%	611	£814,000
Two Bed	£1,399	£1,541	10.2%	1,079	£1,662,000
Three Bed	£1,792	£1,942	8.4%	2,002	£3,887,000
Penthouses	£2,166	£2,126	-1.8%	2,285	£4,857,000
Duplex P/H	£2,160	£2,249	4.1%	3,240	£7,150,000
Averages	**£1,518***	**£1,683**	**10.9%**	**n/a**	**£1,625,000**

**the final figure of £1,518 per sq ft is as advised by Savills in February 2013 following meetings with the City of London's viability advisors following the submission of the application at the end of 2012. The application submission included an average rate of £1,511 per sq ft some £7 per sq ft lower.*

The Savills values have increased by 10.9% and are now included at an average of £1,683 per sq ft or £1,700 per sq ft once car parking is included. There remains a significant nervousness around the ability of the City Residential market to absorb what are a large number of dwellings at a high price point. The average capital value for the 165 residential units is £1,625,000. The units at the upper end of the price range have not increased and this is based on Savills review of the market and their continuing nervousness regarding sales at this price point in the City residential market.

The Savills updated market analysis clearly shows that sales at this level in the City market are uncommon. Page Four of the Savills analysis illustrates 440 residential sales in the City in the 12 months from the end of 2012 with the vast majority, 89%, below £1 million, 39 sales (9%) in the £1m to £2m price bracket and 8 sales (2%) in the £2m to £5m bracket. There were no sales above £5m.

The Sugar Quay pricing is included on page 5 of Savills report. Of the 165 residential apartments at Sugar Quay, 45 are in the £1m to £2m price bracket, 32 apartments in the £2m to £5m price bracket and 6 dwellings in the £5m plus price bracket. Simply there are more apartments in the £1m to £2m, £2m to £5m and £5m price bands than were recorded in the City residential market in the 12 months following the submission of the last FVA.

It should also be noted that whilst there are a number of large penthouse apartments with fantastic views of the South Bank and Tower Bridge there are a greater number of smaller apartments with no or limited river views fronting the office buildings and car parks with a north facing aspect. There are very few schemes on the river with scale in London with an average £ per sq ft value in excess of £1,500 per sq ft. Riverwalk House adjacent to Vauxhall Bridge currently under construction seems to be the exception albeit this site is located in Westminster and the only prices we have are asking prices.

Build Costs

Gleeds have updated the November 2012 elemental breakdown. Their addendum dated 11 February 2014 is attached as Appendix Seven of this submission. The revised costs include inflation at 8.7%. Gleeds have included the calculation for their uplift in construction costs on page 2 of their addendum. A breakdown of the increased costs as included in the updated DS2 present day development appraisal are as follows:

Table Four: Analysis of Sugar Quay Build Costs, February 2014		
	Nov 12	**Feb 14**
demolition	£2,000,000	£2,173,200
car park / basement	£4,054,400	£4,405,511
resi shell & core	£32,968,089	£35,823,126
resi fit out	£34,270,350	£37,238,162
restaurant café	£1,022,240	£1,110,766
gym	£2,918,833	£3,171,604
statutory connections	£958,500	£1,041,506
external works	£2,027,875	£2,203,489
renewables	£1,229,247	£1,335,700
total	***£81,449,534***	***£ 88,503,064***
prelims @17%	£13,846,421	£15,045,521
sub total	£95,295,955	£103,548,584
OH&P @4%	£3,811,838	£4,141,943
sub total	***£99,107,793***	***£107,690,528***
design reserve @3%	excluded	£3,230,716
Contingency @5%	£4,955,390	£5,384,526
TOTAL COST	***£107,036,416***	***£116,305,770***
TOTAL COST (rounded)	**£107,000,000**	**£116,300,000**

This derives a total construction budget of £116,300,000. This is an increase from £107,000,000 in November 2012. Gleeds will provide a duty of care letter if this is required and they are of the opinion that this is a fair and reasonable reflection of the costs at the date of the assessment.

You will note that the original cost plan contained a 5% contingency and a 3% design reserve. In November 2012 DS2 included only the contingency in the appraisal however we are advised by Gleeds that both figures should be included as legitimate development costs. We have made this amendment to the new appraisal and can provide further justification if required.

The cost inflationary measure is higher than that forecast in Section 11 of the November 2012. Gleeds have been asked about this and state that the market has moved considerably over the last 6 months with a combination of returning confidence, more opportunities, availability of funding and a lack of labour. Prices have risen as order books are being filled. It is becoming harder to find Contractors that will tender certain projects and the sub-contractor market is even worse.

There is a vast difference between the outlook for 2014 and beyond as recorded in 3Q12, than now. Gleeds Inflation report in 3Q12 against our report 4Q13 states inflation as follows:

3Q12 Report (Gleeds)

3Q12 – 3Q13 0.5%

3Q13 – 3Q14 2.0%

3Q14 – 3Q15 3.0%

3Q15 – 3Q16 5.0%

3Q13 Report (Gleeds)
4Q13 – 4Q14 4.50%
4Q14 – 4Q15 5.0%
4Q15 – 4Q16 5.0%
4Q16 – 4Q17 5.0%

BCIS Actual Inflation for the first half of 2013 is 5%, when Gleeds were predicting only 0.5%, which illustrates how things have changed over the period of forecast to actual.

Other Development Inputs

The table below illustrates a list of the development inputs as included in the 2012 FVA and the updated appraisal. In making this comparison we have reviewed the development appraisal as submitted with the 2012 FVA.

Table Five: Analysis of Sugar Quay Proposed Scheme Development Inputs, February 2014 (excluding build costs and residential values)

Input	November 2012	February 2014	Comment
Purchaser's Costs on Commercial Property	5.88%	5.80%	Amended
Stamp duty, agents & legal fees on land purchase	4% / 1% / 0.5%	4% / 1% / 0.5%	Unchanged
Mayoral CIL	£501,900	£1,229,800	As advised by DP9
S106 payment	£5,000,000 (AH payment) & zero other planning obligations	£7,503,406 (AH payment	As consented and subject to indexation. No further obligations (or 278 works) are included
Professional fees	12%	12%	Unchanged
Commercial marketing	£2 psf	£2 psf	Unchanged
Letting agent / legal fee	15% / 5%	15% / 5%	Unchanged
Residential marketing	2%	2%	Unchanged
Residential agent / legal fee	1.5% / 0.5%	1.5% / 0.5%	Unchanged
Development management fee	2%	Zero	Removed
Finance	7%	7%	Unchanged

Development & Sales Timings

We have updated the timings as follows:

- Project start date – January 2014
- Pre-construction – 9 months
- Build contract – 36 months
- Post completion – 12 months

In terms of sales, we have assumed deposits will be drawn down equal to 10% of the achieved pricing. There is no guarantee however that this will be the case.

For the studio apartments and one and two bed accommodation we have assumed that circa 10% will be sold in October 2014 as a requirement of any funding agreement. The figure could potentially be higher. A further 60% of the sales are made during construction with a nine month post completion sales period for these units.

In relation to the larger 3 beds, penthouses and duplex penthouses we have assumed that these will not be sold during the pre-construction period. The income for these dwellings is included in the nine month post completion sales period.

We are of the opinion that based on the information provided by Savills there is a significant risk that the sales period will be extended given the high average capital values. If this is the case, financing costs and marketing costs will increase thus reducing the viability of the project.

Updated Appraisal Results

The revised development appraisal with a fixed land value of £60,000,000 derives a residual profit on cost of 11.52%. The ungeared Internal Rate of Return (IRR) is 11.69% and the profit on value is 10.47%. The revised AUV and consented scheme appraisals are contained at Appendix 8 and 9 respectively.

In November 2012 DS2 adopted an IRR in the FVA. Whilst the Corporation's advisors were in agreement that an IRR could be used as a target return, we were unable to agree on the rate at which it should be set. As such in assessing the measure of viability we have targeted a more traditional profit on cost approach.

We are of the opinion that a 20% profit on cost is a reasonable rate of return and indeed could be higher depending on funder's requirements. The current rate of return in the revised appraisal is below the target rate of return and as such the scheme in accordance with adopted planning policy is unviable and cannot support any additional planning obligations for affordable housing.

Table Six: Residential Sale Value and Construction Cost Sensitivity Analysis

		Construction per sq ft				
		-10.00%	-5.00%	0.00%	5.00%	10.00%
Sales £ per sq ft	-10%	£39,281,641	£35,573,678	£31,865,712	£28,157,690	£24,449,750
	-5%	£47,130,987	£43,423,033	£39,715,073	£36,007,109	£32,299,142
	0	£54,980,389	£51,272,374	£47,564,425	£43,856,468	£40,148,505
	5%	£62,829,756	£59,121,788	£55,413,760	£51,705,815	£47,997,861
	10%	£70,679,119	£66,971,154	£63,263,187	£59,555,219	£55,847,203

Looking at the appraisal another way, with a fixed rate of return of 20% profit on cost, the residual land value is £47,564,000. Table 6 illustrates the impact on the residual land value given incremental changes in the residential sales values and the construction build costs.

Table 7 illustrates the development inputs for the capital sums for the 2012 FVA and the updated 2014 version.

Table Seven: Analysis of 2012 and 2014 FVAs for Sugar Quay			
Input	**November 2012**	**February 2014**	**Comment**
Residential revenue	£241,979,095	£269,593,604	Increased revenue through valuation from Savills
Commercial revenue	£2,719,653	£4,059,719	Uplift as a result of comments from Corporations viability consultant
Other revenue	£3,406,000	£3,406,000	-
Benchmark Land Value	£48,365,000	£60,000,000	Uplift in AUV
Core construction costs	£75,233,912	£81,749,806	As a result of the revised Gleeds costs
Contingency	£4,955,390	£8,615,242	As a result of the updated Gleeds costs and also the inclusion of the design reserve
Demolition	£2,000,000	£2,173,200	As a result of Gleeds cost inflation
CIL / S106 costs	£5,501,900	£8,733,208	Includes updated CIL an S106 payments and affordable housing payment
Other construction	£21,873,881	£23,768,158	As a result of Gleeds cost inflation
Professional Fees	£12,487,582	£13,956,769	As a result of Gleeds Cost inflation
Marketing, Letting & Disposal Fees	£8,558,719	£10,911,542	Increased revenues
Development Management Fee	£2,081,264	Nil	Removed
Finance	£27,218,056	£30,598,116	Increased build costs, increased peak borrowing requirement and higher Site Value (higher AUV as a fixed cost)

Summary

To summarise, the Site Value has increased to £60 million. Residential values and build costs have both increased and these increases have been factored into our revised appraisal. The residual profit for the proposed scheme is below the target rate of return and as such the scheme cannot afford to make any additional affordable housing payment in accordance with the signed S106 agreement.

We anticipate that this letter and accompanying information will now be passed to your viability consultants for review and we look forward to hearing from them.

Please let me know if anything is unclear.

Yours sincerely

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Partner, DS2

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EXECUTIVE SUMMARY

1. Gerald Eve is instructed by the City of London Corporation under the terms of the S106 dated 16th September 2013 relating to development of Sugar Quay, Lower Thames Street EC3. The terms of the S106 Agreement have also been taken in to account in terms of our "date of assessment" and compliance with the RICS GN (94/2012).

2. DS2's residual methodology approach for the Scheme appraisal is generally consistent with the RICS GN 94/2012 and generally accepted practice except where identified in this report.

3. The Site is in a world class location.

4. A present day appraisal is an appropriate approach, subject to sensitivity analysis, albeit this does not necessarily reflect the potential uplift which could result from a growth in sales values of completed units for this particular scheme.

5. It is also reasonable to include growth into an appraisal for the Scheme given its world class location, the project timescale, and prime central London market for residential. Recent evidence suggests that the city residential market has "out priced" prime London.

6. The specification both of the external appearance and internal fit out is aimed at the prime central London market for high end luxury accommodation.

7. A number of allowance and contingencies have been allowed for which we would normally expect to have been refined at this stage in the schemes evolution i.e. 4 months prior to implementation.

8. DS2 and Savills have identified that there is a general value tone change from units without a river view to those with an oblique view, and those with a full view.

9. DS2 has not fully addressed the likely and significant upside in respect of values, notwithstanding Savills' letters. Given the unique characteristics of the Site, the market for the units, should fall within a prime central London context.

10. A number of units in the Scheme are considered to be under-priced.

11. There are varying degrees of upside for each Unit within the Scheme, depending on its aspect, and its position.

12. Sensitivity analysis demonstrably shows the propensity for the upside notwithstanding an increase in costs more reflective of this world class riverside location.

13. On the basis of the information provided by the Applicant, adjustments set out above, and sensitivity analysis, we are of the view the Scheme can afford a full payment in lieu of affordable housing on-site.

9 Conclusions and recommendations

9.1 Gerald Eve, have undertaken a detailed Review of DS2's RVA, in line with CoL's obligations under the S106 and have reached the following preliminary conclusions:

a. The Site is a world class location.

b. DS2's RVA and appendices are generally consistent with the RICS GN 94/2012 and accepted practice in undertaking assessments of this nature. We do however have reservation concerning the appraisals given the implied date of assessment (see paragraph 1.3) and the RICS GN (paragraph 3.5).

c. We have assessed the updated financial information for the Scheme, and we have varied a number of inputs in light of our research, knowledge and experience in appraising the viability of central London residential schemes.

d. Whilst DS2 has not included growth into its appraisal and relied on a present day model, we are of the view that it is also unreasonable to consider using growth and inflation when assessing the Scheme, given the development programme and volatility of the city and prime London market.

e. DS2's target profit on cost for a present day appraisal is 20%. This is not fully justified in their report.

f. We consider a 17.5% IRR as an appropriate target, with assumptions on growth and inflation, and having regard to the risks associated with the development of the Scheme.

g. DS2 and Savills have identified that there is a general value tone change from units without a river view to those with an oblique view, and those with a full view.

h. With regard to the residential values provided to the flats which are fronting the river, we are of the view that there is significant potential for these properties to sell at prices in excess of the pricing put forward by Savills.

i. The upside on each unit varies proportionally relative to its location in the

Scheme, it therefore follows that the upside on a unit with a river view has a considerably higher upside then those with no river view.

j. Given the location, the commercial rent and yield applied to the Scheme is considered to be lower than what we would anticipate. We are also of the view that the capital value for the car parking is at the lower end of a potential range.

k. On review of the professional and other fees, we are of the view that the majority are consistent with what we would expect for a development of this nature.

l. We have relied on the Gleeds' cost report, and have applied a tolerance of plus/minus 5% to 10% in our sensitivity analysis. Should it emerge that further scrutiny on costs is required, and say for example changes to the Scheme's cladding occurs. We would have expected given the implied start on site date that value engineering would have removed the 5% design reserve. Other allowances and contingencies should also have being either reduced or removed altogether.

m. The specification both of the external appearance and internal fit out is aimed at the prime central London market for high end luxury accommodation.

n. On the basis of the adjustments set out in this report and the information provided by the Applicant, we are of the view the Scheme can afford a full payment in lieu, or, the entirety of the Second Instalment as defined in the S106, as £7.5m, as opposed to the £NIL offer put forward by the applicant.

o. We appreciate that our recommendation is not binding and under the terms of the S106 the Applicant may wish to dispute our conclusions, and the financial viability of the Scheme be determined by a suitably qualified third party.