Oxford Valuation Office
4400 Nash Court
Oxford Business Park South
Oxford
Oxfordshire OX4 2RU

Simon Mackie
Planning Agreements Officer
Planning & Sustainability
Southampton City Council
Civic Centre
Southampton
SO14 7LY

Our Reference: [redacted]/1721447
Your Reference: 19/00038/OUT

Please ask for : [redacted]
Tel : [redacted]
Mobile : [redacted]
E Mail : [redacted]

Date : 24 October 2019

Dear Simon

DRAFT REVIEW OF DEVELOPMENT VIABILITY ASSESSMENT
PROPOSED SCHEME: Nelson Gate, Southbrook Road, Southampton

I refer to our fee quote dated 22 July 2019 and your email providing the PON dated 16 September 2019 confirming your formal instructions to carry out a viability review in respect of the above proposed development. You have forwarded to us the developer's assessment to review undertaken by BNP Paribas. We have now undertaken our own research and assessment and would report as follows:

This report is not a formal valuation.

The date of assessment is 24 October 2019.

We have reviewed the Affordable Housing and Economic Viability Assessment undertaken by BNP Paribas (BNPP) dated July 2019, additional cost information dated 5th June 2019 for the new build residential tower and supporting planning statement dated December 2018 on your website.

My assessment has been made by comparing the residual value of the proposed scheme with an appropriate Benchmark Land Value (BLV) figure having regarding to the National Planning Policy Framework and the published RICS Guidance Note into Financial Viability in Planning.

The principal objective of our Brief and the subject of this report are to establish whether there is financial justification for an affordable housing contribution.

General Information

It is confirmed that the viability assessment has been carried out by Tony Williams, a RICS Registered Valuer, acting in the capacity of an external valuer, who has the appropriate knowledge and skills and understanding necessary to undertake the assessment competently, and is in a position to provide an objective and unbiased assessment assisted by [redacted], graduate surveyor.

In undertaking this assessment I have acted with objectivity, impartially, without interference and with reference to all appropriate available sources of information. In addition no performance related or contingent fees have been agreed.

Checks have been undertaken in accordance with the requirements of the RICS standards and have revealed no conflict of interest. DVS has had no other previous material involvement with the property.

The client will neither make available to any third party or reproduce the whole or any part of the report, nor make reference to it, in any publication without our prior written approval of the form and context in which such disclosure may be made.

You may wish to consider whether this report contains Exempt Information within the terms of paragraph 9 of Schedule 12A to the Local Government Act 1972 (section 1 and Part 1 of Schedule 1 to the Local Government (Access to Information Act 1985) as amended by the Local Government (access to Information) (Variation) Order 2006.

Our assessment is provided for your benefit alone and solely for the purposes of the instruction to which it relates. Our assessment may not, without our specific written consent, be used or relied upon by any third party, even if that third party pays all or part of our fees, directly or indirectly, or is permitted to see a copy of our report. If we do provide written consent to a third party relying on our assessment, any such third party is deemed to have accepted the terms of our engagement.

None of our employees individually has a contract with you or owes you a duty of care or personal responsibility. You agree that you will not bring any claim against any such individuals personally in connection with our services.

This report remains valid for 3 (three) months from its date unless market circumstances change or further or better information comes to light, which would cause me to revise my opinion.

Background:

I understand that this viability assessment is required following the submission of a hybrid planning application and the contention of the applicant that the scheme is not viable with any affordable housing.

From your brief I understand that you wish us to review the amended development scheme ref 19/00038/OUT - Hybrid planning application for mixed-use development comprising: (1) Outline planning permission (with all matters reserved) sought for a multi-storey building comprising residential (C3), hotel (C1) and retail (A1 to A5) uses alongside associated parking, landscaping and vehicular access. (2) Detailed planning permission sought for the demolition of Grenville House, erection of a three-storey podium extension to Norwich House (accommodating office (B1) and retail (A1 to A5) uses), external alterations to both Norwich and Frobisher Houses, provision of a site-wide hard and soft landscaping scheme, and associated site works including parking provision and modified access arrangements.

The redevelopment site known as Nelson Gate, immediately north of Southampton Central Station with vehicular access from Southbrook Road, comprises three 1960's office buildings known as Grenville House, Norwich House and Frobisher House now largely vacant including commercial use at lower levels and on site car parking.

In addition we understand that Norwich House and Frobisher House benefit from prior approval for a change of use from offices to dwelling houses which allow for a provision of a combined 212 residential units within the building and therefore the existing internal space of these two buildings is not the subject of this hybrid application. However we are advised that the scheme now includes:

- Residential – 247 flats of which 137 are within the existing fabric of Norwich and Frobisher House (not part of this application) and 110 in respect of the redevelopment of Granville House in a part 20 storey and part 10 storey building.
- Office accommodation
- Hotel accommodation – 225 bed
- Commercial accommodation including retail

In addition we are advised that the whole site is owned freehold by the City Council subject to a number of long leases to the developer and terms have been agreed to re-gear the existing leases. At this stage it is assumed that the site is held freehold and no rental income or land receipts are included for the Council.

BNPP conclude that the amended scheme is not viable with any affordable housing or further contributions but have included the following:

- CIL of £781,943
- Section 106 contributions estimated to be in the region of £203,032.

However we are advised that the following planning obligations are required:

a) Affordable Housing – 35%
b) Highway/Transport – TBC
c) SDMP - £58,000
d) Employment and Skills - £28,834
e) Late Night Use – TBC
f) Carbon Management - £61,728
g) CIL – £953,243

The Scheme:

We have been provided with the assessment undertaken by BNPP on behalf of the developer which lists the floor areas etc. For the purpose of this assessment we assume the areas provided are correct and have assessed the scheme as proposed without affordable housing at this stage as follows:

Residential Summary	Number	Average Floor Area	Total Floor Area	Total Floor Area
		Sq m	Sq m	Sq ft
Unit				
1 Bed Flats	74	46.45	3,437	36,996
2 Bed Flats	36	65.03	2,341	25,199
Total	**100**		**5,779**	**61,195**

Commercial Summary	Number	Net Floor Area	Total Gross Floor Area	Total Gross Floor Area
		Sq m	Sq m	Sq ft
Hotel	225 Beds	5,623	7,594	81,742
Office		1,608	1,857	19,989
Retail		537	617	6,641
Total		**7,768**	**10,066**	**108,372**

In addition to the above we are advised that the net to gross ratio for the residential is 87.49% or a total gross area of 6,604 sq m (71,086 sq ft). There are also some small discrepancies between the areas in the cost plan and the appraisal but we have at this stage adopted those in the appraisal although confirmation of areas, both net and gross is required.

Viability Assessment:

This report deals with each major input into the viability assessment of the scheme. This assessment has been undertaken following our own research into current sales values, current rentals and current costs. We have used figures put forward by BNPP on behalf of the applicant if we believe them to be reasonable.

I have used a bespoke excel based toolkit with cash flow to assess the scheme which is attached as Appendix 1 and 2 whilst BNPP have used the Argus model.

We would summarise our assessment of the Scheme as follows:

1) Development Value -

a) Residential:

Both PRS and Private Sale schemes are considered as follows:

1) PRS – BNPP have assessed the rentals following advice from Avison Young who have undertaken research into rentals achieved in the area over the last 6 months and have adopted the following average rents:

- 1 Bed Flats - £865 per month
- 2 Bed Flats - £1,300 per month

This equates to gross rent of £1,329,720 less management and operational costs of 22.5% with a net rent of £1,030,533 per annum.

The net rent has been capitalised at 4.7% taking into account recent evidence with a capital value of £21,926,235 before deduction of purchaser's costs of 6.8%.

We have undertaken our own research in the area and also taken account of similar assessments in Southampton over the last 6 months and are of the opinion that the rates adopted are reasonable.

Rental levels for 1 bed flats range from approx £675 per month to £930 per month with an average of approx £748 per month for this type of unit. In respect of 2 Bed units the rentals range from £850 to £1,750 with an average of £1,122 per month for this type of unit.

In addition it is standard practice to deduct 20% to 25% management costs and adopt a yield of 4.75% to 5.25% supported by the evidence.

Overall we have also adopted a capital value of £21,926,234 but less purchaser's costs of 6.75% (based on current rates of SDLT and 1.8% for fees) with a net total of £20,538,798.

2) Private Sale – BNPP have assessed the sale values of the flats following advice from Avison Young who have undertaken research into values achieved in the area over the last 6 months and have adopted the following average sales values:

- 1 Bed Flats - £161,500
- 2 Bed Flats - £260,000

Overall this represents a total capital value of £21,311,000 (£3,688 per sq m).

We have undertaken our own research in the area and also taken account of similar assessments in Southampton over the last 6 months and are of the opinion that the values adopted are reasonable.

Sales values for these types of units in the area for 1 bed flats range from approx £103,000 to £245,000 with an average of approx £158,250. In respect of 2 Bed units the sales values range from £192,500 to £365,000 with an average of £277,000 (£337 per sq m).

b) Affordable Housing:

At this stage no affordable housing has been included although policy is 35%.

However, were we to include affordable housing, we would assess a value of 45% of market value for social rented units, 55% of market value for affordable rented units and 65% of market value for shared ownership units.

c) Ground Rents:

We assume that the private residential units will be sold on a long leasehold basis however the government announced last year that they would crackdown on unfair leasehold practices in respect of ground rents. However since no legislation has been enacted the policy of DVS is to include ground rents at this stage. If this changes it could affect this assessment.

We have therefore adopted average ground rents on the private sale scheme of £250 per annum capitalised at 5% less purchasers cost which we believe is achievable in the current market.

BNPP have not included for any ground rents.

d) Hotel:

BNPP have adopted a total revenue of approx £1,255,072 (stated as £22.82m in the BNPP report) on the basis of a rent per room of £5,600 capitalised at 4% with a total value before purchaser's costs of 6.8% of £31,376,800. This is based on a lease offer equating to £5,603 per room from Bespoke Hotel Group and a yield based on the Knight Frank guide dated April 2019. This equates to a capital value of £140,075 per room.

We have researched values for hotels in the area as follows:

- Holiday Inn Express, Southampton – Sold in 2016 for £19m or approx £108,000 per room
- Holiday Inn Express, Portsmouth – Sold in 2017 for £14.5m or approx £97,000 per room
- Travel Lodge Portsmouth – Forward funded in 2018 at £19.05m or £125,000 per room (Yield of 5.17%)
- Hilton, Reading – Sold in 2017 for £27.75m or £132,000 per room (Yield of 5.7%)

In addition other assessments included for hotels on the basis of approx £120,000 to £130,000 capital value per room. These included for higher rents but higher yields.

We have had regard to the evidence provided and our own research into the values of hotels in the region and do not believe that the values adopted by BNPP are understated and have adopted the same as reasonable. We have also adopted £31,376,800 less purchaser's costs of 6.77% (based on current rates for SDLT and 1.8% for fees)

e) Commercial:

The scheme includes for both office space and retail accommodation in the Norwich House extension which has been assessed by BNPP as follows:

In their report BNPP state that they have assessed the retail space of 5,781 per sq ft on the basis of £20 per sq ft (£215.28 per sq m) capitalised at 6% with a total value of approx £1.45m after research undertaken by Avison Young.

However their appraisal they include for both retail at £1,927,000 before costs (£20 per sq ft capitalised at 6%) and offices at £6,923,200 before costs (£20 per sq ft capitalised at 5%).

We have undertaken our own research into office rental values and yields and are of the opinion that the rates adopted by BNPP are reasonable. However it appears that no rent free periods or voids are included in their appraisal which I would normally expect but at this stage I have also excluded as the costs include for fit out.

f) Purchasers Costs:

BNPP have deducted purchaser's costs on all investment based capital values at 6.8%.

Although it is correct to deducted purchasers costs this should be at the current rate of SDLT plus fees etc of 1.8%. This ranges from 4.89% to 6.77% depending on the value of each element.

g) Gross Development Value (GDV):

On the basis of the proposed scheme with no affordable housing the total values adopted by BNPP and DVS are scheduled below:

1) PRS Scheme:

Use	BNPP £	DVS £
PRS Residential	21,929,235	21,926,234
Hotel	31,376,800	31,376,800
Commercial - Offices	6,923,200	6,923,200
Commercial - Retail	1,927,000	1,927,000
Less Purchaser's Costs	4,226,420	3,921,165
Total	**£57,926,815**	**£58,232,069**

2) Private Sale Scheme

Use	BNPP	DVS
Private Residential	21,311,000	21,311,000
Ground Rents	0	550,000
Hotel	31,376,800	31,376,800
Commercial - Offices	6,923,200	6,923,200
Commercial - Retail	1,927,000	1,927,000
Less Purchaser's Costs	2,735,436	2,560,370
Total	**58,802,564**	**59,527,631**

2) Development Costs -

a) Build Cost:

BNPP state that the scheme construction costs are approx £36.20m plus externals, demolition and contingency in accordance with the cost plans provided as follows:

- Residential - £14,217,143 – Budget review dated June 2019 from WTP but no detail provided
- Hotel - £15,201,000 – WTP cost plan nr. 6 dated 26/3/2019
- Commercial - £6,898,000 – WTP cost plan dated April 2019 incl inflation which should be removed
- External Works - £5,347,200 representing 60% of the external costs for the whole scheme calculated on a floor area basis and equates to 14.7% of build costs. However this also includes inflation which needs to be removed
- Demolition - £400,000 – WTP Cost Plan April 2019
- Contingency – 5%
- **Total Cost - £43,879,150**

Following advice from our QS I have compared these against current median rate BCIS rebased to Southampton and have adopted the following:

Use	Gross Area Sq m	BCIS Rate £	DVS Total
Residential – Flats	6,604	1,905	£12,580,665
Hotel	7,594	2,188	£16,615,672

Commercial - Office	1,857	2,090	£3,881,130
Commercial – Retail	617	2,090	£1,290,034
Externals	15.08%		£5,181,152
Total			**£39,548,653**
Demolition			£400,000
Contingency	5%		£1,977,433
Overall Total			**£41,926,086**
Difference			**£1,953,064**

We have estimated the net and gross areas from both the BNPP appraisal and the cost plans but these need to be confirmed.

The office and retail rates adopted assume the space is fitted out but if this is provided as shell this would be reduced but capital incentives may need to be included.

The externals for the whole scheme total £8,912,000 including inflation and include for:

- Site preparation
- Undercroft car parking etc
- Roads, Paths, Paving and Decking
- Retaining structures and steps
- Fencing and gates
- Soft Landscaping
- External services incl district heating
- External access

BNPP have applied 60% of the cost based on floor areas however ideally a more accurate assessment should be made. I have also included 60% of the cost at this stage but excluding inflation.

I have also included £400,000 for demolition of Grenville House as per the WTP cost plan as reasonable at this stage.

b) Build Contingency:

BNPP have included a 5% contingency on the build cost which is agreed as reasonable. However I have also applied this to the External works.

c) Professional Fees:

BNP have included professional fees at 10% which is within our normal range of 7.5% to 12.5% for this type of scheme and is agreed.

d) Section 106 Costs / CIL:

BNP have included the following figures:

- CIL - £781,943
- Highways/Transport - £50,000
- SDMP - £42,470
- Employment and Skills - £28,834
- Late Night Use - £20,000
- Carbon Management - £61,728
- Total - £984,975

We have been provided with the following figures by the Council which we have included:

- CIL - £953,243
- Highway/Transport – TBC but I have adopted £50,000
- SDMP – £58,000
- Employment and Skills - £28,834
- Late Night Use – TBC but I have adopted £20,000
- Carbon Management - £61,728
- Total - £1,171,802

In addition I have assumed that they are payable at start on site.

e) Sale and Marketing fees:

BNPP have adopted the rates as follows:

1) PRS Scheme

- Commercial Agent letting fee – 10%
- Commercial Legal letting fee – 5%
- Sale agent and marketing fees – 1%
- Legal sale fee – 0.5%

2) Private Sale Scheme –

- Sale Agent Fees – 1%
- Marketing fees – 1.5%
- Legal Sale Fee – 0.25%
- Commercial Agent letting fee – 10%
- Commercial Legal letting fee – 5%

The rates agreed are industry standards and are agreed as reasonable for this type of scheme save for legal fees where I have adopted 0.25% as reasonable and agreed on other schemes.

f) Finance costs:

BNPP have adopted a debit rate of 7% with no credit rate. We have adopted an inclusive debit finance rate of 6.5% and credit rate of 2% to include for bank arrangement fees etc as achievable and which we have agreed on other similar schemes.

g) Developers Profit:

For mixed use schemes we would normally adopt a profit level of between 15% and 20% of GDV in accordance with NPPF.

The profit levels have been agreed as follows:

Residential – 17.5% of GDV
Hotel – 15% of GDV
Commercial – 15% of GDV

In respect of the PRS scheme BNPP have adopted a reduced profit on the residential element of 12% which is within the range we normally consider of 10% to 15% and is agreed.

Overall these profit levels are reasonable in the current market and reflect the risks surrounding this scheme.

h) Development Programme:

The following programmes have been adopted by both parties as reasonable:

1) PRS Scheme

- Site Purchase – Month 1
- Lead In – 3 months including for demolition
- Build Period of 18 months
- PRS units sold 1 month after Practical Completion (PC)
- Commercial Sales sold 1 month after PC
- Hotel sold 1 month after PC

2) Private Sale Scheme

- Site Purchase – Month 1
- Lead In – 3 Months including for demolition
- Build Period – 18 months
- Sales – 50% sold on completion and the remaining units sold over a 6 month period reflecting approx 9 units per month.
- Commercial sales sold 1 month after PC
- Hotel sold 1 month after PC

NB no void periods have been included for the commercial element of the scheme.

i) Land Value:

Following various appeal cases it is well established that viability assessments are carried out in order to calculate the residual land value that the scheme can afford which is then compared to the benchmark land value (BLV) taking into account both current NPPF/PPG and The RICS Guidance note, Financial viability in planning, 1st edition.

Under NPPF/PPG the guidance states that the benchmark land value should be based on the Existing use value of the land plus a premium for the landowner in order to bring forward the site for redevelopment less any abnormal costs etc.

NPPF have based the BLV on the existing use value plus a premium as follows:

1) Existing Car Park – 86 spaces and based on current tariffs estimated a gross income of £166,440 per annum less 70% occupancy and 20% operational costs with a final net income of £93,166 per annum or £1,083 per space. BNPP have capitalised this at 8% with a EUV of £1,164,575 and added a 20% premium with a total of £1,397,490.

2) Existing Value of Grenville House – BNPP state that there is a total of 19,863 sq ft with an existing income of £281,615 which they have capitalised at 6% with a EUV of approx £4.7m plus a 20% premium with a total value of approx £5.63m

3) In summary BNPP have adopted a BLV of approx £7.03m

We have undertaken our own research as to rental values and yields including our own internal records as to existing income.

1) In respect of Grenville House we have considered the existing rentals including the car park spaces allocated and rented but then capitalised at a yield of 6.5% taking into account investment sales in the vicinity with a EUV of £4,482,656. We have then included a premium of 15% in accordance with recent assessments in Southampton recently.

2) Car Park – We are unclear if there has been double counting of the numbers within the BNPP assessment since some of the spaces are allocated within leases of Grenville House which we understand from our records total 16. We have therefore valued the remaining 70 spaces on the basis of £850 per space in accordance the recently letting to Bamboo Ltd and capitalised at the same yield as BNPP of 8% as reasonable for car parking with a EUV of £743,750. We have then included a premium of 15% in accordance with recent assessments in Southampton recently.

3) In summary we have adopted a BLV of £6,010,367

In addition acquisition costs of 1.8% plus current SDLT rates are included and agreed.

Overall assessment and Recommendations:

BNPP have assessed the all private 110 unit residential scheme, hotel with 224 rooms and the office and retail space and concluded the following:

1) PRS Scheme – Against their BLV of £7.30m their assessment showed a negative profit of £4,006,822 (-6.45%) but on the basis of a target blended profit of 13.94% this shows an overall deficit of approx £12.77m.

2) Private Sale Scheme – Against their BLV of £7.30m their assessment showed a negative profit of £3,259,277 (-5.3%) but on the basis of a target blended profit of 15.87% this shows an overall deficit of approx £13.02m.

Taking into account the large deficit of each scheme we must question its deliverability.

We have also assessed the schemes as detailed above and our appraisals included as appendix 1 and 2 show the following:

1) PRS Scheme – This shows a deficit of £7,875,312 which would reduce the profit to a minimal amount of £243,304 assuming a BLV of £6,010,367.

2) Private Sale Scheme – This shows a deficit of £8,258,262 which would reduce the blended profit to £1,203,658 (2%) assuming a BLV of £6,010,367.

The key differences between the parties are:

- Ground Rents
- Purchasers Costs
- Build Costs
- CIL and 106
- Legal fees
- Finance rate
- Benchmark Land Value

Both parties agree that the schemes are not viable at varying degrees and their inability to provide affordable housing however due to the levels of viability I still must question the deliverability and sustainability of the scheme in its current form. However please confirm if you wish me to undertake a further analysis on a sensitivity basis as to the key inputs of value and cost.

I trust this report provides the information that is required however please do not hesitate to contact me if you have any queries and I would welcome the opportunity of discussing this with you in greater detail.

Yours sincerely

[redacted]
Registered Valuer
[redacted]
DVS

Appendix 1 – Proposed PRS Scheme Appraisal
Appendix 2 – Proposed Private Sale Scheme Appraisal