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28th January 2021

Dear Carl

## BROADWAY RETAIL PARK, CRICKLEWOOD LANE – RESPONSE TO BNP PARIBAS REAL ESTATE FINANCIAL VIABILITY ASSESSMENT REVIEW

Thank you for providing us with a copy of the independent viability review report (dated January 2021) prepared by BNP Paribas Real Estate (BNPPRE) on behalf of the London Borough of Barnet (LBB). We would like to take this opportunity to thank BNPPRE for their consideration of the proposals.

Following a review of the report, we have prepared this letter to provide some additional information regarding the proposed floor areas adopted for the assessment and respond regarding some of the differences of opinion.

Although both parties agree with the majority of the assumptions adopted within the Financial Viability Assessment (FVA), there are a number of differences of opinion which we examine further below.

We summarise the current position for ease of reference below:

| REPORT | BENCHMARK LAND VALUE – (EUV +) | PROPOSED DEVELOPMENT RESIDUAL LAND VALUE | VIABILITY DEFICIT |
|---|---|---|---|
| Applicant – Montagu Evans | £21,330,000 | £6,217,010 | -£15,112,990 |
| LBB - BNPPRE | £19,552,500 | £35,702,246 | £16,149,746 |

### ILLUSTRATIVE SCHEME FLOOR AREA ASSUMPTIONS

As set out within the FVA, we have appraised the illustrative masterplan which demonstrates one way in which the parameter plans and design guidelines could be interpreted to deliver a high quality development. The Illustrative masterplan has been worked up in detail and represents the most accurate projection of how the development will come forward at the current time.

Throughout their report, BNPPRE have referred to additional value being created by the significantly increased net floor area shown in the maximum parameters area schedule. This is not realistic for a number of reasons as explained by EPR Architects below:

"While the maximum parameters applied for encompass an increased building footprint, this is primarily to make allowance for flexibility in the arrangement and position of private amenity in the form of protruding balconies. As such, and in conjunction with the guidelines set out in the Design Code, the maximum parameters do not provide opportunity for future schemes to differ substantially from that shown in the illustrative masterplan. It is likely that if an alternative scheme were to come forward with its building envelope extending to the maximum footprint while adhering to the maximum 1,100 units, the increase in area would likely result in oversized, larger residential units as an increase in unit numbers would not be in accordance with the outline application. Any increase in unit depth should take into consideration the possible adverse effects this might have on the daylight/sunlight levels within the units as not only would the unit itself become deeper but the distance between the blocks would reduce.

The increased height reflected in the maximum parameters versus the illustrative scheme makes consideration for slight variations in height that might come about in detail design development (i.e. increased floor build ups, increased plant height requirements) however follows the stepping of building height that has been tested in the townscape views and does not make allowance for a substantial increase in height that might result in noteworthy upliftment.

It should also be noted that the areas reflected for the illustrative masterplan do not include balconies (private amenity) as the building envelope was presented to use as a guide to generate NIA however given the flexible nature of the maximum parameters, the areas reflected for this would include all private amenity that would need to be provided for the residential units."

Even if it were practically possible to increase the net area whilst retaining the same number of units, in viability terms it would result in the following:

- Oversized units and reduced values per sq. ft.
- More 3 bedroom apartments which are not only less valuable per sq. ft. but more difficult to sell which would have a negative impact on the cash flow and therefore finance costs, if it were fundable at all.
- A larger gross area which would increase the construction costs, contingency, professional fees, finance and CIL.

We trust that the above is clear and resolves this query.

## RESPONSE TO BNPPRE'S REVIEW OF THE FVA ASSUMPTIONS & INPUTS

Following a review of the BNPPRE report, we have summarised overleaf the differences of opinion and addressed each difference where necessary.

| VIABILITY INPUT | MONTAGU EVANS (APPLICANT) | BNPPRE (LBB) | COMMENTS |
|---|---|---|---|
| **Benchmark Land Value** | | | |
| Existing Use Value | £17,775,000 | £17,775,000 | Agreed. |
| Landowner's premium | £3,555,000 | £1,777,500 | Not agreed – please see below. |
| **Total Benchmark Land Value** | **£21,330,000** | **£19,552,500** | Not agreed – please see below. |
| **Gross Development Value Inputs** | | | |
| BTR property operating costs | 25% | 20% | Not agreed – please see below. |
| BTR yield | 4% | 3.75% | Applicant willing to proceed on this basis. |
| Car parking values (per space) | Nil | £20,000 | Not agreed – please see below. |
| **Development Cost Inputs** | | | |
| Construction cost | £281,278,514 | £270,853,435 | Not agreed – please see below. |
| Sales legal fees – private | 0.5% of GDV | 0.25% of GDV | Applicant willing to proceed on this basis* |
| Sales legal fees – affordable | 0.5% of GDV | 0.25% of GDV | Applicant willing to proceed on this basis* |
| Marketing & sales – affordable | 1% of GDV | £100,000 | Not agreed – please see below. |
| Debt finance rate | 7% | 6.5% | Not agreed – please see below. |
| Developer's return – private | 20% GDV | 17.5% GDV | Not agreed – please see below. |
| Developer's return – commercial | 17.5% GDV | 15% GDV | Not agreed – please see below. |

*Although we do not necessarily agree with the BNPPRE assumption, the Applicant is willing to proceed on this basis in order to reach agreement expeditiously.

We would respond further regarding a number of the assumptions adopted below and attach an associated updated viability appraisal for your consideration at **Appendix 1.**

## BENCHMARK LAND VALUE – LANDOWNER'S PREMIUM

All parties have agreed that the appropriate Existing Use Value for testing viability is £17,775,000. The Applicant's FVA then adopts a 20% landowner's premium whereas BNPPRE have adopted a 10% premium.

There is a shortage of good quality retail warehouse stock in the Greater London area due to the continuing loss of space due to redevelopment. Well-located retail parks in London are continuing to be attractive assets despite the wider downturn in the retail market. For these reasons we are of the opinion that a 20% premium is justified.

However, in order to reach a final agreement expeditiously, the Applicant is willing to proceed based on a reduced landowner's premium of 15% as a compromise.

## BUILD TO RENT PROPERTY OPERATING COSTS (GROSS TO NET %)

The Applicant's FVA adopted a 25% allowance for management, repair and void costs. This was based on advice received from the Montagu Evans Capital Markets team that specialise in the acquisition, disposal and funding of residential investment projects including BTR. We pointed to the average results being achieved by Grainger plc who reported achieving 26% in their 2018 financial results.

BNP have tested the outcome using 20% and stated that the 25% position was only supported by what they have called anecdotal evidence. No evidence is provided by BNP to support their assumption.

We strongly disagree with BNP's position and are of the opinion that 25% is optimistic and fully supportable. Grainger plc are the UK's largest listed residential landlord and a market leader in the UK build to rent and private rented sector currently managing over 8,500 homes. As an update, Grainger reported operating costs (gross to net) of 25.9% in 2020 set out within their 2020 Annual Report and Accounts. This is achieved based on their significant economies of scale.

Jones Lang LaSalle (JLL) published a research document entitled, 'Evaluating Build to Rent Performance, Analysis of Stabilised BTR Data' in September 2018. They analysed 7 BTR schemes and found that they were achieving an average gross to net margin of 26.6%.

This evidence demonstrates that 25% is optimistic and the Applicant is therefore unwilling to adjust the assumption.

However, as a compromise on the total BTR GDV, the Applicant is willing to proceed on the basis of reducing the net capitalisation yield from 4% to 3.75% in line with BNPPRE's assumption.

## CAR PARKING VALUES

BNPPRE have included a receipt of £20,000 for the potential 110 car parking spaces. These car parking spaces will be wheelchair spaces and it is therefore unreasonable to assume that a receipt will be received for them. This has been agreed as being acceptable elsewhere with BNPPRE.

## CONSTRUCTION COST ESTIMATE

The Applicant provided a construction cost estimate prepared by Ward Williams Associates (WWA) totalling £281,278,514, excluding a contingency and professional fees. The WWA estimate was reviewed by CDM Project Services (CDM) on behalf of LBB. CDM concluded that the costs should be reduced to £270,853,435 and requested clarification on a number of cost items.

All parties are in agreement that a contingency of 5% is appropriate at this stage of the project.

WWA are currently undertaking a review of the CDM assessment and will provide a response shortly. We would propose that WWA and CDM are put in direct contact in order that both cost experts can reach an agreement. We would request your agreement to this approach.

We have retained the WWA cost estimate within the updated appraisal for the time being but accept that this may require adjustment once agreement is reached.

## SALES LEGAL FEES – PRIVATE & AFFORDABLE

The industry standard assumption is a 0.5% fee for the developer's lawyers to act on the sale of the private and affordable housing. The Applicant's viability appraisal includes a 0.5% allowance but the BNPPRE appraisal adopts 0.25%.

A fee of 0.5% has been the industry standard for some time and Montagu Evans have agreed the majority of all viability submissions across London at this level. However, in order to move forward towards a final agreement on this occasion, the Applicant is willing to agree 0.25% based on current market conditions.

## MARKETING & SALES AGENCY FEES – AFFORDABLE

The Applicant's viability appraisal adopted an assumed 1% of GDV as a sales agent fee for the affordable housing. Most developers do not have the in-house expertise to tender, negotiate and agree terms with Registered Providers and will require a specialist agent to carry out this function for them.

The industry standard agency fee for undertaking this work is 1% of the package price. Based upon the viability appraisal submitted, this estimated fee totalled £1,054,219 based on the sale of 327 affordable housing units valued at £105,421,885. BNPPRE have reduced this agency fee to a fixed £100,000 or 0.095%. We do not think that this level of fee is realistic for a qualified and specialist affordable housing agent to undertake the work. A fee of 1% has been the industry standard for some time and Montagu Evans have agreed the majority of all viability submissions across London at this level. It should also be noted that the affordable housing is contained within a number of blocks over different phases so it is very unlikely that it will be sold in a single transaction.

However, as a compromise the Applicant is willing to reduce the agency fee assumption to 0.5% based on current market conditions.

## DEBT FINANCE RATE

The Applicant's appraisal adopts a debt finance rate of 7% and BNPPRE have reduced this rate to 6.5%. We have agreed that 7% is appropriate on developments across London with Councils' advisors and the GLA prior to the Covid-19 pandemic. Clearly, securing development funding has become more difficult and more expensive since the pandemic with some lenders temporarily withdrawing from the market.

Based on the Applicant's package of concessions and compromises set out above, there are various assumptions that we feel are extremely optimistic and there is a danger that if we flex every single input without giving consideration to the overall balance then the appraisal will start to look unrealistic.

## DEVELOPER'S RETURN – PRIVATE RESIDENTIAL

The Applicant's viability appraisal adopted an assumed developer's return of 20% of the private residential sale GDV and BNPPRE have reduced this to 17.5%.

Montagu Evans have been agreeing 20% on smaller and less risky schemes than the subject across London, with various advisors including BNPPRE. This rate was being agreed prior to the Covid-19 pandemic, mainly due to the uncertainty and economic conditions associated with the UK's exit of the European Union.

Clearly economic conditions have deteriorated significantly due to the pandemic and there is an argument that developers' returns should be increased above 20% to account for this significantly increased risk. The NPPF viability guidance states that "an assumption of 15-20% of gross development value (GDV) may be considered a suitable return to developers." The current economic conditions clearly require profit assumptions at or above the upper end of this range.

The Applicant is taking a significant risk by over delivering affordable housing (in viability terms) up front. This level of risk and the reliance on significant value growth to improve viability should not be underestimated. It is crucial that profit levels are adopted at fundable levels to ensure that this much needed affordable housing can be delivered in the borough.

We would therefore ask that BNPPRE re-consider their position on this basis and the agreements that have been reached with them on profit levels elsewhere.

## DEVELOPER'S RETURN – COMMERCIAL ACCOMMODATION

The Applicant's viability appraisal adopted an assumed developer's return of 17.5% of the commercial GDV and BNPPRE have reduced this to 15%.

As above, we ask that BNPPRE re-consider their position on this basis and the agreements that have been reached with them on profit levels elsewhere.

## UPDATED VIABILITY APPRAISAL

Based on the package of concessions and compromises detailed above, we have prepared an updated viability appraisal for your consideration and attach a summary as **Appendix 1.**

For ease of reference, we summarise below the previously reported viability positions alongside the proposed update.

| REPORT | BENCHMARK LAND VALUE – (EUV +) | PROPOSED DEVELOPMENT RESIDUAL LAND VALUE | VIABILITY DEFICIT / SURPLUS |
|---|---|---|---|
| Montagu Evans FVA (Jul 20) | £21,330,000 | £6,217,010 | -£15,112,990 |
| BNPPRE review (Jan 21) | £19,552,500 | £35,702,246 | £16,149,746 |
| Montagu Evans update (Jan 21) | £20,441,250 | £13,445,734* | -£6,995,516* |

*Updated figures subject to the final agreement reached on the construction cost estimate.

We hope that the above is clear and results in an agreed approach that can be adopted in order to conclude the viability discussions.  If you have any further queries then please do not hesitate to contact us.

Yours sincerely,

**Jonathan Glaister MRICS / Partner**

**Email: jonathan.glaister@montagu-evans.co.uk**

# APPENDIX 1

# UPDATED FINANCIAL VIABILITY APPRAISAL

# Cricklewood Lane
# Financial Viability Appraisal
# Jan 2021 Update

Development Appraisal
Montagu Evans LLP
22 January 2021

## Cricklewood Lane
## Financial Viability Appraisal
## Jan 2021 Update

**Appraisal Summary for Merged Phases 1 2 3 4 5 6 7 8 9**

**Currency in £**

**REVENUE**

| **Sales Valuation** | **Units** | **ft²** | **Sales Rate ft²** | **Unit Price** | **Gross Sales** |
|---|---|---|---|---|---|
| Block B - Affordable Rent | 86 | 72,133 | 345.00 | 289,371 | 24,885,885 |
| Block B - Shared Ownership | 84 | 57,903 | 500.00 | 344,661 | 28,951,500 |
| Block C - Shared Ownership | 157 | 103,169 | 500.00 | 328,564 | 51,584,500 |
| Block C - Private Residential | 172 | 122,048 | 704.00 | 499,545 | 85,921,792 |
| Block D - Private Residential | 224 | 143,532 | 704.00 | 451,101 | 101,046,528 |
| **Totals** | **723** | **498,785** | | | **292,390,205** |

| **Rental Area Summary** | **Units** | **ft²** | **Rent Rate ft²** | **Initial MRV/Unit** | **Net Rent at Sale** | **Initial MRV** | **Net MRV at Sale** |
|---|---|---|---|---|---|---|---|
| Block A - Build to Rent | 377 | 248,281 | 33.52 | 22,076 | 6,241,860 | 8,322,480 | 6,241,860 |
| Block A - Commercial | 1 | 3,923 | 25.00 | 98,078 | 98,078 | 98,078 | 98,078 |
| Block B - Commercial | 1 | 5,406 | 25.00 | 135,158 | 135,158 | 135,158 | 135,158 |
| Block D - Commercial | 1 | 707 | 25.00 | 17,685 | 17,685 | 17,685 | 17,685 |
| **Totals** | **380** | **258,318** | | | **6,492,780** | **8,573,400** | **6,492,780** |

**Investment Valuation**

| | | | | | |
|---|---|---|---|---|---|
| **Block A - Build to Rent** | | | | | |
| Current Rent | 6,241,860 | YP @ | 3.7500% | 26.6667 | 166,449,600 |
| **Block A - Commercial** | | | | | |
| Market Rent | 98,078 | YP @ | 6.0000% | 16.6667 | |
| (6mths Rent Free) | | PV 6mths @ | 6.0000% | 0.9713 | 1,587,688 |
| **Block B - Commercial** | | | | | |
| Market Rent | 135,158 | YP @ | 6.0000% | 16.6667 | |
| (6mths Rent Free) | | PV 6mths @ | 6.0000% | 0.9713 | 2,187,943 |
| **Block D - Commercial** | | | | | |
| Market Rent | 17,685 | YP @ | 6.0000% | 16.6667 | |
| (6mths Rent Free) | | PV 6mths @ | 6.0000% | 0.9713 | 286,287 |
| **Total Investment Valuation** | | | | | **170,511,517** |

| | | | |
|---|---|---|---|
| **GROSS DEVELOPMENT VALUE** | | | **462,901,722** |
| Purchaser's Costs | | -10,856,539 | |
| Effective Purchaser's Costs Rate | 6.80% | | |
| | | | -10,856,539 |
| **NET DEVELOPMENT VALUE** | | | **452,045,184** |
| **NET REALISATION** | | | **452,045,184** |

**OUTLAY**

| **ACQUISITION COSTS** | | | |
|---|---|---|---|
| Residualised Price | | 13,445,734 | |
| | | | 13,445,734 |
| Stamp Duty | | 662,287 | |
| Effective Stamp Duty Rate | 4.93% | | |
| Agent Fee | 1.00% | 134,457 | |
| Legal Fee | 0.50% | 67,229 | |
| | | | 863,973 |

**CONSTRUCTION COSTS**

| **Construction** | **ft²** | **Build Rate ft²** | **Cost** | |
|---|---|---|---|---|
| Block A - Build to Rent | 359,076 | 261.45 | 93,880,552 | |
| Block A - Commercial | 4,359 | 261.46 | 1,139,704 | |
| Block B - Commercial | 6,007 | 261.46 | 1,570,590 | |
| Block D - Commercial | 786 | 261.46 | 205,508 | |
| Block B - Affordable Rent | 103,239 | 261.46 | 26,992,836 | |
| Block B - Shared Ownership | 82,872 | 261.46 | 21,667,838 | |
| Block C - Shared Ownership | 143,790 | 261.46 | 37,595,215 | |
| Block C - Private Residential | 170,102 | 261.46 | 44,474,802 | |
| Block D - Private Residential | 205,582 | 261.46 | 53,751,470 | |
| **Totals** | **1,075,813 ft²** | | **281,278,514** | |
| Contingency | | 5.00% | 14,063,926 | |
| CIL | | | 17,667,315 | |
| | | | | 313,009,754 |

| **PROFESSIONAL FEES** | | | |
|---|---|---|---|
| Professional Fees | 10.00% | 29,534,244 | |
| | | | 29,534,244 |

**MARKETING & LETTING**

## Cricklewood Lane
## Financial Viability Appraisal
## Jan 2021 Update

| | | | |
|---|---|---|---|
| Letting Agent Fee | 10.00% | 25,092 | |
| Letting Legal Fee | 5.00% | 12,546 | |
| | | | 37,638 |
| **DISPOSAL FEES** | | | |
| Sales Agent Fee | 0.25% | 389,629 | |
| Sales Agent Fee | 1.00% | 38,033 | |
| Sales Agent Fee | 0.50% | 527,109 | |
| Sales Agent Fee | 3.00% | 5,609,050 | |
| Sales Legal Fee | 0.10% | 155,852 | |
| Sales Legal Fee | 0.50% | 19,016 | |
| Sales Legal Fee | 0.25% | 730,976 | |
| | | | 7,469,665 |
| **MISCELLANEOUS FEES** | | | |
| Developer's Return - BTR | 15.00% | 24,967,440 | |
| Developer's Return - Commercial | 17.50% | 277,845 | |
| Developer's Return - Affordable | 6.00% | 3,230,243 | |
| Developer's Return - Commercial | 17.50% | 382,890 | |
| Developer's Return - Affordable | 6.00% | 3,095,070 | |
| Developer's Return - Private | 20.00% | 17,184,358 | |
| Developer's Return - Private Sale | 20.00% | 20,209,306 | |
| Developer's Return - Commercial | 17.50% | 50,100 | |
| | | | 69,397,253 |
| **FINANCE** | | | |
| Debit Rate 7.000%, Credit Rate 0.000% (Nominal) | | | |
| Total Finance Cost | | | 18,286,923 |
| **TOTAL COSTS** | | | **452,045,184** |
| **PROFIT** | | | |
| | | | **0** |
| **Performance Measures** | | | |
| Profit on Cost% | 0.00% | | |
| Profit on GDV% | 0.00% | | |
| Profit on NDV% | 0.00% | | |
| IRR% (without Interest) | 7.84% | | |