Viability Submission

Private and Confidential – Commercially Sensitive Information

Botley Centre, Oxford
March 2016

Contents

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Appendices

1. INTRODUCTION AND BACKGROUND

Savills (UK) Ltd has been instructed by MACE Group (the Client) to undertake a viability assessment of proposals to deliver the regeneration of the Botley Centre to the west of Oxford (the Site).

The aim of the assessment is to identify what level of affordable housing, if any, can be delivered within the proposed redevelopment of the Botley Centre whilst allowing the project to remain financially viable.

A planning application has been submitted (reference 16/V0246/FUL) to the Vale of White Horse District Council Planning Department; the application was validated on 18th February 2016.

The Site totals circa 6.13 acres (2.48 hectares) of land which currently comprises:

- The West Way shopping centre (28 retail units at ground floor level plus ancillary and residential accommodation at first floor level)
- West Way House – office accommodation over four upper floors above units 12 and 12a of the West Way shopping centre
- Elms Court – retail and library accommodation on the ground floor with residential and office accommodation above
- The Grant Thornton Building – undercroft car parking at ground floor and office accommodation above
- Seacourt Hall – community centre and public conveniences at ground floor and ancillary accommodation above
- A number of car parking areas, either designated to building occupiers or open to the public
- Roadways, pavements and pedestrian areas

An existing site plan is shown at Appendix 1.

The land is held predominantly by three key landowners – Vale of White Horse District Council who own the West Way Shopping Centre and West Way House, Willow Partners who own Elms Court and Siemens who own the Grant Thornton Building. The remaining freeholder is the Botley Baptist Church, whilst Development Securities own a long leasehold interest in West Way House. A number of occupying tenants hold tenancies which are inside the Landlord and Tenant Act 1954 in terms of security of tenure. Finally, the roadways within the application boundary are adopted by Oxfordshire County Council.

The description of development is as follows:

Demolition and redevelopment of existing shopping centre and adjacent buildings (but excluding Elms Parade) for new retail development (Use Classes A1-A5, circa 4,756 sq M Net Internal Area) at ground floor level with development above comprising:

- 149 residential units (C3) – circa 9,832 sq M Net Internal Area
- 122 bedroom hotel (C1) – circa 3,439 sq M Net Internal Area
- 262 units of academic residential accommodation for university staff and students (sui generis) – circa 2.673 sq M Net Internal Area

plus a new community building (incorporating library) and replacement Baptist church (D1), small flexible office space (B1), associated car parking and landscaping and altered vehicular accesses from West Way, Westminster Way and Arthray Road.

Plans showing the proposed development plus a schedule of proposed accommodation, provided by the appointed architects (Make) are attached at Appendices 2 and 3 respectively.

This is a private and confidential report to Vale of White Horse District Council (the Council) which contains commercially sensitive information. All information and evidence provided in this submission must be treated in strict confidence and must only be provided to persons directly involved in reviewing the information on behalf of the Council in light of determining the affordable housing and S106 package on the Site. Any data or information supplied to the Council must not be made available or provided to any persons or organisations without explicit agreement by the Client. The Council must inform the Client of any persons that may have a conflict of interest in relation to viewing the submission and the confidential nature of the information contained within

Any advice contained or attached in this report is informal and given purely as guidance unless otherwise explicitly stated. Our views on price are not intended as a formal valuation and should not be relied upon as such. They are given in the course of our consultancy role. No liability is given to any third party and any advice attached is not a formal ("Red Book") valuation. Neither Savills nor the Client can accept any responsibility to any third party who may seek to rely upon it, as a whole or any part as such. If formal advice is required this will be explicitly stated along with our understanding of limitations and purpose.

2. METHODOLOGY

In common with guidance to the industry and planning authorities including:

- RICS Professional Guidance – Financial Viability in Planning – 1st Edition, August 2012
- Viability Testing Local Plans – Sir John Harman – June 2012
- RICS Research Paper – Financial Viability Appraisal in Planning Decisions – April 2015

we have used the residual appraisal approach to test the financial viability of the proposed scheme.

In this instance, the purchase price of land controlled by the three key landowners has been fixed following a marketing exercise, with the presence of a number of strong underbidders confirming that the price payable is reflective of the prevailing market conditions which would have driven the landowners' expectation of price. We have therefore applied the following approach to the residual appraisal:

GROSS DEVELOPMENT VALUE
(combined value of the completed development)

Less

COST OF LAND

Less

DEVELOPMENT COSTS
(construction, fees, finance etc)

Equals

DEVELOPER PROFIT

The level of developer profit which is generated by the residual appraisal is then examined to understand whether it matches the level which a hypothetical prudent developer in the current market would accept to take on the project. If it falls below this acceptable level, the project is deemed to be financially unviable.

The proposed scheme is first assessed to allow for full provision of affordable housing in line with adopted policy - 40% of units would be provided as affordable, split circa 25% as intermediate housing (likely to be delivered as shared ownership housing) with the remainder provided as affordable rented units.

If the initial appraisal demonstrates that the scheme would be financially unviable, scenario testing using different affordable housing levels and or tenure splits is undertaken to identify at which point the scheme does become viable.

3. APPRAISAL INPUTS

We have appraised the proposals using ARGUS Developer, a software programme which is used widely across the industry to assess and value development projects. The programme undertakes a residual appraisal by deducting costs including land acquisition price from gross development value to arrive at a residual developer profit level – crucially it tracks the financial position of the project (whether in deficit or credit) to accurately apply financing costs.

In order to assist us in appraising the project, we have produced an expected programme showing key timings for demolition, construction starts, lettings, and sales. Please see attached at Appendix 4.

A copy of our initial residual appraisal summary is attached including cashflow at Appendix 5. If you would like a copy of the ARGUS Developer .wcfx file please do let us know.

We set out below a commentary of the key inputs to the appraisal:

Residential:

We have examined key comparable sales evidence within the immediate area for new build and second hand apartments – a schedule of the evidence is attached at Appendix 6.

We have discussed with our New Homes sales team based within Oxford to arrive at anticipated sales values for the proposed dwellings – a general premium has been added to allow for the location of the new units within a vibrant mixed use development, whilst further premiums have been added on the upper floors to reflect exceptional views etc. We have assumed that all 2 and 3 bed apartments would be allocated a designated parking space whilst 1 bed apartments would on average have half an allocated space. Elsewhere in the appraisal we have assumed that up to 75 additional parking spaces will be sold off separately at circa £15,000 per space to residents.

We initially priced all units on an open market basis, which generated a Gross Development Value in the region of £46,325,000 equating to circa £450.50 per sq ft.

A discount of 14% was then applied to the total Gross Development Value, to allow for the fact that 40% of the dwellings would be sold to a Registered Provider at a discount of perhaps 35% to full market value if the Council's adopted policy on affordable housing provision was applied to the scheme. This reduced the Gross Development Value of the residential units to circa £39,840,000.

A GDV calculator is attached at Appendix 7 showing the units as individually priced.

The investment value of ground rents has been generated by applying a very low yield of 3.5% to an expected average of £500 per annum per dwelling. Colleagues working within our Residential and New Homes sales teams confirm that the ground rent assumed is at a level above which one would expect buyers to begin to seek discounts to the capital value or indeed be dissuaded from purchasing, whilst the yield has been discussed with colleagues working in the field of ground rent investment sales who confirm that the figure used is at the lower end of the range they see being applied in the market.

Retail:

The inputs on retail rents and yields (including the proposed foodstore, see below) have been supported by the applicant's commercial agent, Latham High, a well respected multi disciplinary commercial agent based in London covering a wide geographical patch. Their view has been informed by extensive discussions with potential tenants and investors prior over a number of years prior to submission of the application.

Retail rents within Block A have been set at £45 per sq ft (blended) to reflect the expectation that these units will largely be taken up by restaurant or similar operators, whilst rents with Blocks C D and E have been set at £32 per sq ft (blended) to reflect more traditional retail operators.

When capitalised at the point of sale, the yield applied is 5.75%.

We would comment that the rents and yields are significantly in excess of levels currently experienced within the existing West Way shopping centre and surrounding area, reflecting the expectation of securing good tenants of strong covenant levels, often with national presence who will be attracted to a newly regenerated local centre in a string catchment area. However we must stress that market evidence of securing rents and sales at these levels would be hard to secure, given the lack a similar offer currently.

Foodstore Rent and Yield:

A blended rent of £22 per sq ft has been applied, with a corresponding yield of 4.5%, reflecting the expectation of securing a long term lease from a retailer with strong covenant levels. Again we would note that these figures are significantly in excess of those currently being secured within the West Way shopping centre.

Hotel:

Again, the figures used within the appraisal are supported by Latham High following discussions with key operators and investors who are active in the hotel sector. We would stress that no lease or forward sale has currently been agreed and thus there remains an element of risk in securing agreements which reflect these figures, which sit at the upper end of what is consider to be achievable in the Oxford market.

A base rent of £6,000 per annum for each room has been applied, along with a 5% yield which assumes a long lease is taken by a nationally branded company with strong financial covenant.

Student Accommodation:

We have liaised with our specialist Student Accommodation team who are very active in the Oxford market, to arrive at suitable rent levels, occupancy rates, management and running costs and investment yield to apply to the appraisal.

We have applied a rent of £810 per month (£187 per week) to the majority of the rooms (standard 30 sq M ensuites), and adjusted where required for the larger rooms and flats. This rental level is at the upper end of what is achievable within the Oxford market, for example:

- Dorset House Headington — £170 to £200 (studio flat) per week
- Slade Park Cowley — £154 per week
- Westminster Hall Harcourt Hill — £195 per week (studio flat)

We have assumed 95% occupancy rates and £1900 per room running costs per annum. We attach a schedule at Appendix 8.

A yield of 6% has been applied to the investment sale, which generates capital values in the region of £122,000 per standard room. We have sense checked this against a schedule of comparable investment sales in the Oxford market which range from just under £90,000 per room to circa £125,000 per room – we would therefore stress that the capital values generated by our appraisal are at the upper end of what is achievable in the current market.

Library and Business Space:

Rents of £10 per sq ft and £20 per sq ft have been applied to the Library and Business Space respectively, along with yields of 6% and 6.5%.

The library rent level reflects the current agreement with the County Council on the existing facility within Elms Court, whilst the yield reflects the strong covenant of the prospective tenant – although we would note that assuming the library space is restricted to D1 community use, in the event that the County withdraw the facility (which must be a threat given the current focus on reducing public body spending year on year) it would be difficult to secure a use compliant occupier at a similar rent level.

The business space rental figure reflects levels achieved on good quality office space elsewhere in the Oxford market, although again we would comment that the new space sits some way from other established business centres within Botley (notably the Seacourt Tower building and Minns Business Park) and as such may struggle to attract occupiers of strong covenant.

Acquisition Costs:

As discussed earlier, the appraisal allows for the fixed price purchase of land from the three key landowners, being £24,500,000, with appropriate stamp duty, agent and legal fees applied.

We have also applied a Town Planning cost of £2,750,000 at the point of acquisition, we are reliably informed by the applicants that this covers the running total cost of all external consultant costs, application fees, legal advice which have been incurred to date in promoting the site and making the application. In reality, these costs have been accumulated over an extensive period of time and thus will have attracted additional financing costs which are not captured by our financial modelling.

Construction Costs:

A full cost summary, attached at Appendix 9, has been provided by Robinson Low Francis, independent cost consultants. They have priced the construction costs, including demolition and risk contingency, at circa £66,825,000. We have not included their assessment of inflation over the life of the project – in line with all prudent valuation and appraisal exercises, we have assumed current costs and income levels, rather than allowing for any growth over time.

Additional Costs:

As discussed earlier, the residual appraisal assesses the developer profit generated assuming securing of land from the two key landowners at the agreed price of £24,500,000.

The applicants will, in addition, need to buy out or compensate a number of freehold, leasehold and protected tenancy interests in order to deliver the project - figures have been included within our appraisal as set out below:

- Freeholders of Elms Parade – control of land within their demise is required to square off the development site and ensure that access, servicing and good presentation can be provided to the retail and residential elements within Block E – a nominal sum has been allowed
- The long leaseholders of the upper floors of West Way House and tenants with security of tenure under the 1954 act within the West Way shopping centre and Elms Court – the figures have been provided by the client's specialist consultants Aspire as their professional view on the likely compensation which will be required – it is worth noting that no additional professional costs have been added to these sums to reflect the significant work which may need to be undertaken to negotiate settlements and or pursue legal routes to securing vacant possession

Please note that at present it is assumed that the Botley Baptist Church will not require any financial remuneration for release of their site, and that the provision of a new Baptist Church and associated facilities within Block F of the proposed scheme at zero cost will be considered adequate compensation for them.

Finance:

The ARGUS Developer appraisal model assumes that all costs associated with site acquisition and project delivery are funded by borrowing, and an appropriate debit rate is applied (to reflect set up costs as well as actual interest rate) – whilst normally a developer would put in some equity, the model reflects the fact that the developer should expect an interest rate equivalent to the debit rate on his equity, to reflect holding or lost opportunity cost.

This principle is well established in the arena of formal valuations and in viability testing for planning purposes.

However our client has advised us that in this particular case they are prepared not to expect a return on their equity to reflect lost opportunity cost, in addition to the developer profit level. As such we have applied a debit rate of 3.6% to the project rather than the standard 6% rate which we are advised by our valuation colleagues (who undertake loan security valuations of development projects for a wide variety of funders including the main national high street lenders) is appropriate to cover all costs associated with funding in the current market – this reflects an assumption that 40% of all costs is covered by equity rather than debt,

General:

Appropriate legal costs and letting, acquisition and sales agent fees have been allowed for at the acquisition, letting and sales stages – you will note that we have not added any budget for marketing costs, assuming that these are covered within the standard agency fees.

Please note that our appraisal has not allowed for any financial contributions which may be sought by the Council under a S106 agreement, nor for any Community Infrastructure Levy payments which may become payable in the event that the emerging Charging Schedule is adopted prior to determination of the application.

4. RESIDUAL DEVELOPER PROFIT LEVEL

You will note that the initial residual appraisal generates a developer profit level of circa 11.5% on cost or 10.5% on GDV.

This is significantly below a level which a prudent developer should or could accept in return for taking on the risk of a scheme of this complexity and scale. As a guide, the Community Infrastructure Levy Viability Study Oct 2014 produced by HDH Planning and Development Ltd on behalf of the Council, cited 20% on Gross Development Value as being an appropriate normal developer profit level to ensure that a scheme is viable.

5. FINDING A VIABLE SOLUTION

Following the initial appraisal, which demonstrated that the project would be financially unviable in the event that standard affordable housing policies were applied, we undertook scenario testing to understand what if any affordable housing could be provided.

It quickly became clear that very limited if any affordable housing provision could be made available under the traditional tenure models (affordable rented, shared ownership etc). Even assuming all residential properties would be sold at full open market value, the resultant developer profit level was shown to be well below the target level of 20% on GDV as stated within the Council's own CIL viability study.

Notwithstanding this, in liaison with our client we explored the potential to include a number of dwellings as Starter Homes, as promoted by the emerging Housing Bill supported by central Government.

Such Starter Homes, which would need to be defined within the S106 agreement associated with the consent, would be available to qualifying buyers (aged under 40 with no existing property ownership) at a discount of 20% to market value, a with a cap of £250,000 per dwelling (after discount).

We attach at Appendix 10 a summary of a revised appraisal which identifies the residual developer profit level if 10% of the dwellings (i.e. 15 units) we provided as Starter Homes. The GDV was reduced from circa £46,325,000 assuming all dwellings were open market to circa £45,575,000. Please note that only 1 bed dwellings will be able to be offered as Starter Homes, as all 2 and 3 bed dwellings would remain above the value cap after applying the discount.

You will see that the residual developers profit level in the revised appraisal is at 16.8% on cost, or 15.0% on GDV.

Clearly this remains significantly below the target profit level of 20% on GDV. However our clients have confirmed that they are willing in this particular instance to work with the Council, accepting the lower profit level, and offering to provide 10% of the dwellings

6. CONCLUSIONS

We trust that our appraisals and accompanying report clearly demonstrate that, at the fixed price agreed following marketing of the opportunity, the project is unable to deliver a residual developer profit level of 20% on GDV which was outlined in the Council's own CIL viability study as being a normal profit level which a developer should expect to receive in order to make a proposed scheme financial viable to them, even assuming zero affordable housing provision.

Our client is however prepared to offer to provide 10% of the proposed dwellings as Starter Homes, whilst noting that even at this level, the scheme delivers a residual profit level well below the target of 20% on GDV.

If the Council would prefer, our client would be prepared to offer a financial contribution in lieu equivalent to the 10% Starter Homes offer.

We and they reserve the right to review the appraisal and the offer as matters progress, particularly with regard to the S106 agreement and potential introduction of a Community Infrastructure Levy.

We look forward to discussing further with the Council and any appointed advisor in due course if and when appropriate.