Gilston Park Estate

Places for People

Appendix 8 - Supporting Viability Evidence to the Submission to East Herts District Council Delivery Study

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Our Ref: Q3033

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1 INTRODUCTION

1.1 This report has been produced for the Gilston Park Estate ("GPE") scheme as part of the supporting documentation for submission to East Herts District Council ("EHDC") to inform preparation of the Delivery Study. It is understood that the Delivery Study will support EHDC in assessing whether the sites and locations identified in the draft District Plan (Preferred Options) ("DPPO") 2014 are technically feasible and financially viable, in order to ensure that the District Plan will be deliverable and effective, as required by national policy.

1.2 The information is provided by Places for People and its professional team in relation to the GPE site. It specifically responds to Section 8 of the Site Deliverability Template (the "Template") circulated by EHDC. Responses to the other aspects of the Template are set out in the main submission document which this report supports. Further context in relation to the site, its identification as a Broad Location for development of between 5,000 and 10,000 homes in the draft DPPO, the proposals for GPE and its compliance with national criteria for site deliverability are summarised in the Main Submission which supported Places for People's representations to the DPPO consultation in May 2014.

1.3 This report focuses on scheme viability and deliverability. The financial model and supporting information contained herein is provided to assist with the Council's understanding of the deliverability of the GPE site. The financial model is based on an investment model whereby Places for People operate as a master developer over the whole life of the project and across all uses and tenures. This recognises that due to the scale, nature, type and timescale of the development it is inappropriate to rely wholly on a traditional housebuilder model alone and enables a longer term view to be taken on whole scheme delivery and critically developer return. Whilst, therefore, individual plots may be constructed by Plot Developers ("PD") i.e. housebuilders and/or other developers (including Places for People), the Master Developer ("MD") will be responsible for the significant investment in infrastructure and enabling works necessary to create serviced plots facilitating comprehensive delivery of the overall masterplan and vision.

1.4 This document is structured to provide:

- Section 2: An overview of the approach taken including the financial model used and the roles of the MD and PD, and how these relate to each other;
- Section 3: Outlines the key inputs and assumptions; and
- Section 4: Summarises the outputs of the viability appraisal and conclusions.

1.5 Ordinarily financial information provided by Places for People to inform decision making in planning would be provided on a confidential basis due to the commercially sensitive nature of its content and would not be shared with other parties. However, this submission is part of the policy and plan making process and it is understood that the information provided cannot be treated in confidence. The information provided has been kept to a high level, as is normal custom and practice for viability work supporting site allocations as part of plan making, to avoid requiring the information provided to be afforded exemption from the Freedom of Information Act. This information is robust for the purposes of plan making. It is recognised that where a planning application is progressed more detailed viability evidence may be required.

2 APPROACH

The Appraisal Model

2.1 A financial appraisal of the proposed development has been prepared using the Argus Developer Software. Whilst there is a range of alternative viability modelling tools available, this bespoke development appraisal package is widely used throughout the development industry and is considered a reasonable and robust tool to present the viability position on a development of this type, scale and complexity. Further details can be accessed at www.argussoftware.com.

2.2 Argus works in the same way as other residual appraisal models. The value of the completed development, development costs (including either the profit margin required or land costs) can be cash-flowed over the development period and the difference between the total development value and total costs are compared to either a benchmark profit or land value (depending on the inputs for the development) to identify whether the proposal represents a viable proposition. Critically for large complex multi-phased developments like GPE it is able to report on the basis of an unlevered internal rate of return ("IRR").

2.3 The appraisal in this format provides a robust basis to inform and reassure EHDC on the viability and deliverability of the proposals for GPE as required as part of the preparation of the District Plan.

Structure of the Model

2.4 The approach modelled reflects the proposed delivery model for GPE. Places for People are the MD and in this role will commit to all initial development costs and undertaking the site wide infrastructure necessary to create serviced plots which are then made available for PD to purchase.

2.5 The proposed delivery structure reflects that of other strategic developments requiring significant investment in infrastructure for example, Brent Cross and Earls Court.

Master Developer

2.6 Places for People are the MD, however, the proposed structure and the 'MD' role is not unique to Places for People. This is a structure that is widely used for large strategic developments. They are uniquely placed to deliver this because they are the freehold owners of an area extending to c. 1,010 ha (c. 2,500 acres). The wider documentation submitted to assist with the preparation of the Delivery Study, as well as the representations to the DPPO, provides additional details on the overall proposals. The approach proposed is consistent with the Governance structure proposed.

2.7 The viability of the site is appraised with reference to the MD IRR and the residual land value. The costs incurred by the MD include:

- Land: This is a residual and will need to be sufficient so that the MD can afford to acquire all necessary parcels of land including the value of sites already owned.
- Development Costs: The MD is liable for development costs necessary to enable the development to proceed for example planning, consultation etc.
- Site Wide Infrastructure: The MD finances the cost of site wide infrastructure necessary to create the serviced plots and bring forward the site for development - ensuring PD are provided with serviced plots.
- Fees: The MD incurs a number of fees for example, professional fees, and insurances. These are charged on the costs which the MD is delivering i.e. site wide infrastructure.
- Contingencies: A contingency of c.7% is included comprising c.5% construction contingency and 2% MD developer contingency - reflecting the risk inherent with timing, planning and delivery of infrastructure the latter of which comprises more 'unknowns' due to the site specific nature of cost items and difficulty in 'benchmarking'.

2.8 There is no finance charge at the MD level because the Net Cash Flow ("NCF") and IRR are ungeared. Places for People's view is that this element of the scheme would not be debt financed in the market today given the speculative nature of the infrastructure expenditure and would therefore be substantially reliant on being financed with equity. The IRR required should therefore reflect risk and reward accordingly.

2.9 The minimum reasonable benchmark for the GPE scheme is considered to be 20% ungeared IRR. This has regard to how this specific scheme sits in the context of other projects and the risk adjusted developer returns which may be appropriate. Given the long term nature of the scheme it is considered reasonable that sensitivity testing is undertaken to reflect market changes over the life of the development period. The base targeted IRR is 20%, however, as the risk increases i.e. if assumptions about growth are introduced, it may be appropriate to review the benchmark return threshold upwards to reflect this.

2.10 The receipts incurred by the MD are from the sale of serviced plots, i.e. the payments the PD makes to the MD to acquire the land. This is calculated using a traditional residual land value calculation, which is detailed below. The MD return or 'profit' is achieved by selling a serviced plot for more than the cost ie. a positive NCF. The MD NCF is the difference between the Total Development Costs and the Master Developer Receipts. The NCF is benchmarked using an IRR which takes account of the timing of receipts and costs and more generally the time value of money.

Plot Developer

2.11 The PD purchases the serviced plot from the MD, secures the required detailed permissions and/or discharges relevant conditions and builds out the final product in accordance with the planning permission. The PD follows a traditional housebuilder model, buying land, building and selling completed development – this is reflected in the standardised developer return of a profit on Gross Development Value ("GDV").

2.12 The PD derives the land value of the serviced plot by undertaking a traditional Residual Land Value calculation including a profit on GDV. This enables multiple plots to be brought forward in parallel, if appropriate, allowing for differentiation in terms of product facilitating choice and diversity in terms of the housing delivered.

Value

2.13 The GDV of the residential uses are calculated by multiplying a rate per sq ft by the floorspace area of the building. The model takes current day values as provided by Knight Frank specific to the proposals reflecting the place as it will be. Commercial GDV is based on assumed land payments as

advised by Knight Frank. Income is also included for ground rents on private apartments. The specific assumptions are set out in Section 3 of this report.

Costs

2.14 The following cost items are included:

- Construction costs
- Plot specific infrastructure
- Professional fees
- Insurances
- Marketing costs and fees
- Letting costs and fees
- Contingency
- Finance
- Developer return at 17.5% profit on GDV reflecting a standard housebuilder return threshold – this can be higher where additional risk is incurred ie. growth based and is a different measure to that of IRR that is used for the MD who is taking greater risk over the duration of the project

2.15 The Total Development Costs are deducted from the GDV to derive a Gross Residual Land Value from which the costs of purchasing the land are deducted ie. stamp duty. This Net Residual Land Value is the amount that is available for the PD to purchase the serviced plot from the MD. This is inputted into the MD model as revenue over the life time of the development up to 2038.

2.16 The approach proposed is consistent with the Governance structure proposed.

Summary

2.17 Two appraisals are being run:

- Plot Developer Appraisal whereby using a residual value methodology to derive land payments which are made over the duration of the development. The residual land value, after developer return, is then treated as a land payment to the MD to purchase serviced plots. The payments are made annually and at this stage in the process no differentiation is made between different plot sizes or locations.

- Master Developer Appraisal whereby the costs incurred to create serviced plots to sell to PDs are cashflowed alongside land receipts from the PDs appraisal where they are purchasing the serviced plots and a 20% IRR. There is no land cost included in the appraisal - this is treated as an output or 'residual' of the appraisal.

2.18 Overall scheme viability is derived from the MD Appraisal and whether there is a positive net cash flow over the development period. For the scheme to be viable and deliverable over its duration the MD needs to achieve the target IRR whilst generating sufficient residual value to be able to pay for land.

3 INPUTS AND ASSUMPTIONS

3.1 The approach to development viability has involved Places for People's project team working together to ensure that based on the information available at this stage in the process the underlying inputs and assumptions are robust.

3.2 The information in this report relates to the current illustrative masterplan which accommodates around 8,500 homes. Additional detail on the development is provided in the representations to the DPPO, particularly the Main Submission report. It should be noted that as set out in the Main Submission a 5,000 home scheme would not deliver the same scale of infrastructure investment, would be an inefficient use of the infrastructure provided, would fail to respond in full to EHDC evidenced housing need and would not provide the critical mass of development to support the regeneration of Harlow.

Floorspace

3.3 The "Illustrative Masterplan Floorspace Schedule by Use" table below provides an overview of the various uses and floor areas that inform the viability study. These are illustrative at plan making stage and will be firmed up following future design evolution and refinement. These highlight the overall quantum of development assumed in the viability appraisal.

Table 3.1: Illustrative Masterplan Floorspace Schedule by Use

	ft2 GEA	m2 GEA	ft2 GIA	m2 GIA
Residential	8,471,229	787,289	8,047,673	747,925
Community	64,646	6,008	61,407	5,707
Education and Leisure	378,622	35,188	359,696	33,429
Retail	184,781	17,173	175,539	16,314
Other	8,307	772	7,887	733

3.4 For the purposes of initial testing at this stage, affordable housing has been assumed as 30% of homes across GPE on the basis of 75% of affordable homes being provided as affordable rent and

25% as intermediate housing (e.g. shared ownership, shared equity etc). The approach taken has been to assume that grant will not be available to assist with affordable housing delivery. Our view is that in a development of the scale of GPE a 30% level of affordable housing would provide an appropriate mix in a new community. If a higher level is required then further sensitivity modelling would be required and might have to reflect, for example, alternative tenure mixes, phasing changes and different assumptions about growth and risk.

Phasing

3.5 The phasing strategy for the c. 8,500 home proposal envisages unit completions over a 20 year period between 2019 and 2038. This is at an average of 425 homes per annum over the period and this informs the delivery profile in the viability assessment. Homes continue to be sold post practical completion, and at this stage it is assumed that all homes will be purchased within 12 months of practical completion.

Master Developer

3.6 The Total Development Value, on the basis of present day values, is £814 million. This is informed by the PD financial appraisal.

3.7 For the purposes of the viability assessment, it has been assumed a yearly land payment is received from one of the plot developers for the acquisition of a serviced development plot. These are profiled within the model between 2018 and 2037.

3.8 The Total Development Cost borne by the MD, on the basis of present day costs, is £492 million, comprising:

- Infrastructure costs as summarised in the table below:

Infrastructure Summary	Estimated Costs (8,500 units)
ON SITE INFRASTRUCTURE	**166,570,204**
Enabling Works and Demolition	10,482,931
Strategic Earthworks	4,410,000
Roads	51,592,102
Drainage	18,666,185
Utilities	34,144,362
Landscaping & Woodland	47,274,624
OFF SITE INFRASTRUCTURE	**80,229,695**
Roads	65,354,695
Drainage	750,000
Utilities Upgrades	14,125,000
COMMUNITY INVESTMENT	**103,876,571**
Sports & Leisure Facilities	4,200,000
Education	76,286,125
Health	8,032,500
Community Development	3,557,400
Transport & Travel	7,511,296
Environmental Management	220,500
Waste Management	1,968,750
Public Art	2,100,000
MISCELLANEOUS	**68,160,945**
Section 38 Agreement	10,646,579
Landscape Adoption Costs	4,727,462
Section 278 Agreement	12,820,939
Professional Fees & Survey Costs	39,965,965
SUB TOTAL	**418,837,415**
PHASING AND TEMPORARY WORKS	**10,420,935**
DESIGN DEVELOPMENT & CONTINGENCY	**21,362,918**
INFRASTRUCTURE TOTAL	**450,600,000**

- Financial contribution towards other Council priorities e.g. M11 junction of £10,000,000

- Professional fees associated with planning up to outline planning permission of £3,000,000 – the budget indicates this could be higher.
- Insurances at 0.5% equal to £2,253,000
- Master Developer Contingency at 2% equal to £9,012,000 (in addition to the 5% construction contingency in the cost plan)
- Developer return on the basis of a 20% ungeared IRR
- "Development Plot" Sales and Marketing at 2% equal to £13,559,551

3.9 It should be noted no allowance is included for land acquisition. It is recognised that this is an area where there are differences of opinion in terms of how this is best addressed in the context of planning for viability versus how a developer would purchase land. Instead the approach taken has been to derive a residual value which will be required to pay for land acquisition/assembly.

Plot Developer

The key assumptions which inform the RLV appraisal for the PD are summarised in the table below:

INPUT/ OUTPUTS	Application Input (per sq. ft.)
Revenue	
Residential Sales Rate Revenue	£316 p.s.f
Residential Sales Rate Revenue – Affordable Rent	£162 p.s.f.
Residential Sales Rate Revenue – Intermediate	£162 p.s.f.
Ground Rent Revenue	£250 per unit 5.5% yield
Land	
Land value	Output of appraisal
Stamp Duty	4%
Disposal Fees	1%
Legal Fees	0.75%

Costs	
Construction cost – Houses	£95 p.s.f.
Construction cost – Flats	£123 p.s.f.
Construction cost - Affordable Rent	£99 p.s.f.
Construction cost - Intermediate	£99 p.s.f.
Contingency (including Governance)	5%
On Plot Infrastructure	£110,000 per acre
Professional Fees	11.5%
Insurances	0.50%
Sales & Marketing	3%
Disposal Fees	0.5%
Profit on Private Units (% of GDV)	17.50%
Profit on AH Units (% of Cost)	6%
Finance	6.5%

3.10 The PD Total Development Value, on the basis of present day values, is £2.29bn comprising:

- Residential (inc Ground Rents): £2.25bn
- Non-residential: £44.4m

3.11 The PD Total Development Cost, on the basis of present day costs, including profit is £1.48bn.

The difference between the PD Total Development Value and the PD Total Development Cost is the Residual Value and is £814 million over the duration of the development. If pro rata this is c. £40.7 million per annum in land receipts. This is inputted into the MD model. Growth can then be applied to the PD model which increases the residual value, and in turn, the MD receipts.

4 OUTCOMES

4.1 The development viability appraisal has been run on the basis of the approach set out in Section 2 and the inputs and assumptions set out in Section 3.

4.2 On the basis of the information available, assuming 30% affordable housing and current day costs and values, including a 20% ungeared IRR, the baseline viability evidences a positive residual value of c. £12.5m. On the basis of present day costs and values the scheme is able to support its own infrastructure along with 30% affordable housing without growth. Being able to achieve a 20% ungeared IRR and deliver a positive residual value without growth evidences the deliverability of this key site – it is not uncommon for large strategic schemes to be wholly reliant on growth to be 'viable'. Furthermore, the significant investment in place making will inevitably improve the overall sales values, however this may take time to be achieved and during this period market conditions may vary and the scheme will be subject to cost inflation.

4.3 Scenarios have been tested introducing cost inflation and value growth, where this is included the residual value increases. It is normal custom and practice to consider growth for multi-phase schemes. This is consistent with the NPPG. As there is inevitable uncertainty over growth over the project timeframe, a range of scenarios have been tested on the basis of incremental inflation and growth. The developer return has been maintained but as the risk exposed increases it is reasonable for the developer return to increase. This evidences the potential for the scheme to derive additional returns over and above the base appraisal over the duration of the scheme. For example where current day values are maintained for 5 years and value growth at 5% achieved thereafter and cost inflation is consistent at 3% throughout the development period, the residual value increases to £24.8 million.

Cost Inflation	*Growth*		
	4%	5%	6%
	Master developer RLV	Master developer RLV	Master developer RLV
2%	£28.9m	£45.6m	£64.3m
3%	£8.0m	£24.8m	£43.5m
4%	Nil	£1.2m	£20.0m

4.4 This highlights that even having regard to the significant infrastructure costs to be provided without recourse to public funding, under a range of economic conditions, the proposals at GPE are viable and deliverable, only becoming challenging when cost inflation outstrips value growth which given historical trends is considered to be a low risk to delivery.

GPE MASTER DEVELOPER APPRAISAL
LAND OUTPUT_IRR FIXED AT 20%

Development Appraisal
Quod Ltd
07 August 2014

APPRAISAL SUMMARY

QUOD LTD

GPE MASTER DEVELOPER APPRAISAL
LAND OUTPUT_IRR FIXED AT 20%

Summary Appraisal for Phase 1 GPE

Currency in £

REVENUE					
Sales Valuation	**Units**	**ft²**	**Rate ft²**	**Unit Price**	**Gross Sales**
Up to 2038 (8,500 units)	1	814,216,500	1.00	814,216,500	814,216,500
NET REALISATION				**814,216,500**	
OUTLAY					
ACQUISITION COSTS					
Residualised Price			12,538,249		
				12,538,249	
CONSTRUCTION COSTS					
Construction		**ft²**	**Rate ft²**	**Cost**	
Up to 2038 (8,500 units)					
- Servicing costs				450,599,999	
				450,599,999	
Master Developers Contingency			2.00%	9,012,000	
Road/Site Works				10,000,000	
				19,012,000	
PROFESSIONAL FEES					
Professional Fees to Outline PP				3,000,000	
Insurances			0.50%	2,253,000	
				5,253,000	
MARKETING & LETTING					
Development Plots Sales & Marketing			2.00%	16,284,330	
				16,284,330	
TOTAL COSTS				**503,687,578**	
PROFIT					
				310,528,922	

Performance Measures

IRR	20.00%
Profit Erosion (finance rate 0.000%)	N/A

HOUSE BUILDER RESIDUAL APPRAISAL
PROFIT FIXED_LAND OUTPUT

Development Appraisal
Quod Ltd
07 August 2014

APPRAISAL SUMMARY

QUOD LTD

HOUSE BUILDER RESIDUAL APPRAISAL
PROFIT FIXED_LAND OUTPUT

Summary Appraisal for Phase 1 Residential Dev

Currency in £

REVENUE						
Sales Valuation	**Units**	**ft²**	**Rate ft²**	**Unit Price**	**Gross Sales**	
Private residential - Houses	4803	5,253,369	316.00	345,631	1,660,064,604	
Private residential - Flats	1203	847,087	316.00	222,510	267,679,492	
Affordable Rent	1933	1,563,629	162.00	131,044	253,307,898	
Intermediate	642	383,584	162.00	96,792	62,140,608	
Mixed Use Land fixed income	1	1	2,247,465.00	2,247,465	2,247,465	
Education/Community receipt	1	1	42,200,038.00	42,200,038	42,200,038	
Totals	**8,583**	**8,047,671**			**2,287,640,105**	
Rental Area Summary				**Initial**	**Net Rent**	**Initial**
	Units	**ft²**	**Rate ft²**	**MRV/Unit**	**at Sale**	**MRV**
Ground Rents on Private Flats	1	1	300,750.00	300,750	300,750	300,750
Investment Valuation						
Ground Rents on Private Flats						
Current Rent	300,750	YP @	5.5000%	18.1818	5,468,182	
GROSS DEVELOPMENT VALUE				**2,293,108,287**		
NET REALISATION				**2,293,108,287**		
OUTLAY						
ACQUISITION COSTS						
Residualised Price (340.00 Acres 2,394,754.41 pAcre)			814,216,500			
				814,216,500		
Stamp Duty		4.00%	32,568,660			
Disposal Fees		1.00%	8,142,165			
Legal Fee		0.75%	6,106,624			
				46,817,449		
CONSTRUCTION COSTS						
Construction	**ft²**	**Rate ft²**	**Cost**			
Private residential - Houses	5,253,369 ft²	95.00 pf²	499,070,055			
Private residential - Flats	847,087 ft²	123.00 pf²	104,191,701			
Affordable Rent	1,563,629 ft²	99.00 pf²	154,799,271			
Intermediate	383,584 ft²	99.00 pf²	37,974,816			
Totals	**8,047,672 ft²**		**796,035,843**	**796,035,843**		
Contingency		2.50%	20,835,896			
				20,835,896		
Other Construction						
On plot infrastructure	340 ac	110,000 /ac	37,400,000			
				37,400,000		
PROFESSIONAL FEES						
Prof fees		11.50%	95,845,122			
Insurances		0.50%	4,167,179			
				100,012,301		
MARKETING & LETTING						
Sales & Marketing		3.00%	57,832,323			
				57,832,323		
DISPOSAL FEES						
Unit legals		0.50%	11,215,963			
				11,215,963		
MISCELLANEOUS FEES						
Profit on Private Flats GDV		17.50%	46,843,911			
Profit on Private Houses GDV		17.50%	290,511,306			
Profit on Affordable cost		6.00%	11,566,445			
				348,921,662		
FINANCE						
Debit Rate 6.500%, Credit Rate 1.000% (Nominal)						
Land			175,397,548			
Construction			(109,142,256)			
Other			(6,435,011)			

HOUSE BUILDER RESIDUAL APPRAISAL
PROFIT FIXED_LAND OUTPUT

Total Finance Cost		59,820,281
TOTAL COSTS		**2,293,108,218**
PROFIT		
		69
Performance Measures		
Profit on Cost%	0.00%	
Profit on GDV%	0.00%	
Profit on NDV%	0.00%	
Development Yield% (on Rent)	0.01%	
Equivalent Yield% (Nominal)	5.50%	
Equivalent Yield% (True)	5.69%	
IRR	2.39%	
Rent Cover	0 yrs 0 mths	
Profit Erosion (finance rate 6.500%)	0 yrs 0 mths	