Agenda Item 12

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14 September 2017

Martin Brown
Runnymede Homes Limited
183 Brooklands Road
Weybridge
Surrey
KT13 0RJ

Dear Mr Brown

EASTRY HOSPITAL SITE, MILL ROAD, EASTRY, KENT

Introduction – Revised Scheme

Further to our recent correspondence, I write to set out my revised opinion of the financial viability of developing a 100 unit residential scheme on the site of the former Eastry Hospital ("the Site") based on the provision of 10 units of affordable housing, with all values/costs stated as at September 2017.

In accordance with the terms of our original instructions (I originally assessed the financial viability of the Site and report to you in a letter dated 5th August 2015), I confirm that our instructions are to prepare an assessment of the likely level of profit that the owner of the Site, Runnymede Investments Limited ("Runnymede"), is likely to earn in the event that the Site was developed out to provide a housing scheme which is now to include an element of affordable housing.

The Site comprises a brownfield site, which includes a number of historically important listed buildings, situated towards the front of the Site. In addition, the scheme also incorporates a small amount of commercial development, which extends to 3,800 sq ft and is designated for employment uses, in line with the Local Authority's planning policy. Please note that the commercial area noted above excludes the 2,572 sq ft of community space to be provided within the Chapel, which we have appraised on a financially neutral basis.

Proposed Scheme

The proposal for which Runnymede seeks planning permission is the development of a 100 unit scheme which is split between 90 private units and 10 affordable units. Within the private units, 20 are to be built within the shell of the existing buildings known as The Range and Tewksbury House, including 10 units within listed buildings, with the remaining balance of the units (90) to be new build. The affordable housing aspect of the scheme comprises eight flats and two semi-detached houses.

The net saleable area of the proposed scheme extends to 93,844 sq ft with the units providing between one and four bedrooms, each extending to between 600 and 1,580 sq. ft.

Revised Viability Conclusions

For the reasons set out in this letter, we are of the opinion that a residential led development still represents the highest and best value use for the Site, albeit the viability of the development is constrained by the costs of converting the listed building (and the value created) and the level of private housing values generally within the local market.

In our opinion the financial viability of the proposed scheme is marginal. The financial viability of the scheme is negatively impacted by the fact that Runnymede acquired the Site in 2007, and for the majority of the period of its ownership, redevelopment has been unviable.

This statement is made against a forecast development profit (taking account of the actual Site acquisition price) of some **15.33%,** which is a return **on all costs**. A profit on cost at this level, is in our opinion and experience, below that which would be required by the market in the event that the Site was to be developed by a third party.

We are aware that Dixon Searle, acting for Dover District Council, did not accept that the actual purchaser price should be adopted (a conclusion with which we do not agree). Nonetheless, we have also produced an appraisal with a reduced lead in period, effectively assuming a Day 1 acquisition in September 2017 at the historic purchase price but not taking into account historic interest costs. This approach produces a forecast development profit of **17.59% on cost**, which is in our opinion still below the required level of market profit for a scheme of this nature.

Further detailed comments are set out below.

Methodology

We have again undertaken a development appraisal of the proposed scheme in order to assess the profitability and subsequent financial viability of the Scheme.

The methodology adopted is in line with our previous advice whereby the total development costs including finance, acquisition and statutory costs are deducted from our opinion of the Gross Development Value (GDV) to produce a percentage return of profit on cost.

The difference between the projected GDV and forecast costs is the amount that, subject to the development being built out in accordance with the assumptions made in the appraisal, is likely to be available to the developer as development profit. This amount of profit is generally expressed as a percentage of development cost or revenue that is produced through the residual calculation which is then compared to general industry benchmarks in order to assess whether or not the scheme, which includes all planning liabilities, could be said to be commercially viable.

Over the course of the past few years, the market generally considers that a "viable" scheme is one that generates a profit as a return on all cost of at least 20.00%. The profit on cost measure adopted in 2015 was "not less than 15%". The market has since improved with the economy recovering, and as a result profit margins in the housebuilding industry have moved out to in excess of 20%. As such the minimum margin adopted in 2015 is now too low.

This level of profit is considered a minimum benchmark for schemes that are perceived as relatively straightforward in terms of development, for example the development of housing on sites with limited remediation requirements, relative ease of access, and often being greenfield in nature.

In contrast, more complicated development situations which could, for example, involve brownfield sites where there may be remediation costs associated with the previous use of the site, involve the conversion and refurbishment of listed structures, or are of size which is significant for the local market, a greater level of profit is often required. A number of these factors, which would increase the required level of profit, are relevant here.

Therefore currently schemes that generate a profit below 20% on cost (which is a current industry benchmark profit level) are considered by the market to be financially unviable, and as a result are unlikely to be brought forward.

In respect of the subject Scheme, given the inclusion of 10 affordable units (10% Affordable Housing provisions), which at the date of our previous advice was not included, the level of profit specifically produced within our appraisal, 15.33%, which is below the market minimum level of 20.00% profit on cost.

The detailed inputs which have been incorporated within our appraisal, and which underpin this conclusion, are set out below.

Viability Assessment

In line with our previous advice and instruction, we have prepared this assessment of viability of the proposed Scheme having regard to the actual cost that Runneymede incurred in acquiring the Site, which is then coupled with the GDV of the Scheme and cost to develop it, both of which have been previously provided to us by third parties and then adjusted to current day values.

These inputs have been incorporated into Argus Developer.

We highlight below the key assumptions adopted and where applicable the changes in the assumptions we have adopted which are in line with current market practice:

- Residential sales prices (which form the highest proportion of the GDV) have been adopted in line with the previous sales values produced by Colebrook Sturrock dated May 2015. These values have then been increased in line with house price growth over the period of time since our original valuation.

  The level of house price growth, as advised by Colbrook Sturrock, has been broken down into individual units types with the following house price growth recorded over the period of time since our last valuation August 2015:

  - Flats 5.00%
  - Detached 8.50%

- Semi-detached 9.00%
- Terrace 12.00%

- We have undertaken a review of construction costs having regard to tender prices submitted and collected on BCIS (Build Cost Information Service). We have analysed the current build cost for both estate housing, flats and conversion in line with proposed Scheme.

- In addition we have also had regard to build cost inflation (BCIS All in TPI) over the period of time from August 2015 to September 2017, which is recorded as 2.80% to Q3 2016 (actual), which is then forecast to increase to 7.45% in Q3 2017. The build cost adopts a locational weighting being focused on tenders that have been submitted in the Dover area of Kent. As a result of this cost price being largely forecast driven, we have had regard to BCIS General Building Cost Index which was recorded from June 2015 to May 2017 (actuals) at 4.8%. Inflation of 4.80% has therefore been added to the original estimated build costs, with the resulting £ per sq ft appearing broadly in line with prevailing build costs for the various unit types.

- This percentage increase in costs was also applied to the construction cost relating to the listed buildings, which are at a higher base price given the higher costs associated with listed building works.

- We have also reviewed the other assumptions adopted at the date of our previous valuation against current "market assumptions", in particular we have amended associated development fees, most notably stamp duty land tax, where the rate payable has been increased since our original valuation. As a result we are now adopting purchasers' costs of 6.80% as opposed to 5.80%.

- We have also amended agency fees in respect of sales and letting to be in line with current market practice.

A copy of our appraisal is attached to this letter as **Appendix 1**. As per our original advice, no allowance has been made for the payment of any s.106 or CIL contributions within our appraisal, however as highlighted above 10 units of affordable housing are assumed to be provided.

Conclusion

In summary, the outputs of our appraisal are as follows:

GDV	**£23,619,227**
Total Costs	**£20,128,277**
Profit	**£3,462,720**
Profit on Cost	**15.33%**
Profit on GDV	**13.28%**

The appraisal outputs for the Scheme do produce a profit, however it is at a level that is significantly less than that which would be commercially acceptable to a third party developer. This statement remains valid even if the actual finance costs to Runnymede are left out of account. In these circumstances, all other costs and value assumptions being unchanged, the viability of the scheme only improves to a profit of 17.59% on cost.

As noted this is, in practice, a hypothetical level of profit and is higher than the profit that Runnymede is likely to earn (given that it acquired the Site in 2007 and has incurred interest since that date), and is less than that which would ordinarily be required by a developer in the market seeking to bring a scheme forward.

I trust that this note alongside our previous valuation advice, which should be read in conjunction with this note, is sufficient for your purposes. We would of course, be happy to discuss our appraisal in more detail with you.

Yours sincerely,

Mark Whitfield
Partner
Montagu Evans

Day 1 September 2017

Summary Appraisal for Phase 1

Currency in £

REVENUE

Sales Valuation	Units	ft²	Rate ft²	Unit Price	Gross Sales
Private Units	80	79,725	259.82	258,924	20,713,930
Listed Building	10	7,068	182.58	129,045	1,290,450
Affordable Housing	10	7,051	170.15	119,970	1,199,700
Totals	**100**	**93,844**			**23,204,080**

Rental Area Summary	Units	ft²	Rate ft²	Initial MRV/Unit	Net Rent at Sale	Initial MRV
Commercial	1	3,800	10.00	38,000	38,000	38,000

Investment Valuation					
Commercial					
Market Rent	38,000	YP @	8.0000%	12.5000	
(1yr Rent Free)		PV 1yr @	8.0000%	0.9259	439,815
GROSS DEVELOPMENT VALUE				**23,643,895**	
Purchaser's Costs		6.80%	(29,907)		
				(29,907)	
NET DEVELOPMENT VALUE				**23,613,987**	
NET REALISATION				**23,613,987**	

OUTLAY

ACQUISITION COSTS				
Fixed Price			1,700,000	
Stamp Duty		4.40%	74,800	
Town Planning			25,000	
				1,799,800
Other Acquisition				
Other Acquisition			400,000	
				400,000
CONSTRUCTION COSTS				
Construction	**ft²**	**Rate ft²**	**Cost**	
Commercial	4,378 ft²	176.75 pf²	773,811	
Private Units	79,725 ft²	143.86 pf²	11,469,239	
Listed Building	7,068 ft²	176.75 pf²	1,249,269	
Affordable Housing	7,051 ft²	143.86 pf²	1,014,357	
Totals	**98,222 ft²**		**14,506,676**	**14,506,676**
PROFESSIONAL FEES				
Architect		10.00%	1,450,668	
				1,450,668
MARKETING & LETTING				
Marketing			44,000	
Letting Agent Fee		10.00%	3,800	
Letting Legal Fee		5.00%	1,900	
				49,700
DISPOSAL FEES				
Sales Agent Fee		1.00%	206,840	
Sales Legal Fee		0.50%	103,420	
				310,260
FINANCE				
Debit Rate 6.50% Credit Rate 0.00% (Nominal)				
Land			246,799	
Construction			713,047	
Other			604,666	
Total Finance Cost				1,564,513
TOTAL COSTS				**20,081,616**
PROFIT				
				3,532,371

Performance Measures

Profit on Cost%	17.59%
Profit on GDV%	14.94%
Profit on NDV%	14.96%
Development Yield% (on Rent)	0.19%
Equivalent Yield% (Nominal)	8.00%
Equivalent Yield% (True)	8.42%
IRR	18.06%
Rent Cover	92 yrs 11 mths
Profit Erosion (finance rate 6.500%)	2 yrs 6 mths

APPRAISAL SUMMARY

MONTAGU EVANS LLP

Including histroic land acquisition costs

Summary Appraisal for Phase 1

Currency in £

REVENUE						
Sales Valuation	**Units**	**ft²**	**Rate ft²**	**Unit Price**	**Gross Sales**	
Private Units	80	79,725	259.82	258,924	20,713,930	
Listed Building	10	7,068	182.58	129,045	1,290,450	
Affordable Housing	10	7,051	170.15	119,970	1,199,700	
Totals	**100**	**93,844**			**23,204,080**	
Rental Area Summary				**Initial**	**Net Rent**	**Initial**
	Units	**ft²**	**Rate ft²**	**MRV/Unit**	**at Sale**	**MRV**
Commercial	1	3,800	10.00	38,000	38,000	38,000
Investment Valuation						
Commercial						
Market Rent	38,000	YP @	8.0000%	12.5000		
		PV 1yr 9mths @	8.0000%	0.8740	415,147	
GROSS DEVELOPMENT VALUE				**23,619,227**		
Purchaser's Costs		6.80%	(28,230)			
				(28,230)		
NET DEVELOPMENT VALUE				**23,590,997**		
NET REALISATION				**23,590,997**		
OUTLAY						
ACQUISITION COSTS						
Fixed Price			1,700,000			
Stamp Duty		4.40%	74,800			
Town Planning			25,000			
				1,799,800		
Other Acquisition						
Other Acquisition			400,000			
				400,000		
CONSTRUCTION COSTS						
Construction	**ft²**	**Rate ft²**	**Cost**			
Commercial	4,378 ft²	176.75 pf²	773,811			
Private Units	79,725 ft²	143.86 pf²	11,469,239			
Listed Building	7,068 ft²	176.75 pf²	1,249,269			
Affordable Housing	7,051 ft²	143.86 pf²	1,014,357			
Totals	**98,222 ft²**		**14,506,676**	**14,506,676**		
PROFESSIONAL FEES						
Architect		10.00%	1,450,668			
				1,450,668		
MARKETING & LETTING						
Marketing			44,000			
				44,000		
DISPOSAL FEES						
Sales Agent Fee		1.00%	206,857			
Sales Legal Fee		0.50%	103,428			
				310,285		
FINANCE						
Debit Rate 6.50% Credit Rate 0.00% (Nominal)						
Land			1,545,281			
Construction			313,344			
Other			84,156			
Total Finance Cost				1,942,781		
TOTAL COSTS				**20,454,210**		
PROFIT						
				3,136,787		
Performance Measures						
Profit on Cost%		15.34%				
Profit on GDV%		13.28%				
Profit on NDV%		13.30%				
Development Yield% (on Rent)		0.19%				
Equivalent Yield% (Nominal)		8.00%				
Equivalent Yield% (True)		8.42%				
IRR		12.81%				
Rent Cover		82 yrs 7 mths				
Profit Erosion (finance rate 6.500%)		2 yrs 3 mths				