

**For: Havant Borough Council
Review of EVA Update dated 27
November 2019 (submitted to the
Council by Tangent Surveyors)**

**Wellington Way
Waterlooville
Hampshire
PO7 7EE**

**January 2020
(DSP19403P)**

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1. Introduction/Review of EVA update

- 1.1.1 Dixon Searle (DSP) was commissioned by Havant Borough Council (HBC) to carry out an independent review of the Economic Viability Appraisal (EVA) supplied to the Council on behalf of the applicant by Tangent Chartered Surveyors Ltd (TCS), in relation to the proposed development at Wellington Way, Waterloooville. Following our review of the supplied information we concluded that, contrary to the submitted position, in our opinion there was potential scope for the development to make some provision towards meeting affordable housing needs.
- 1.1.2 Tangent surveyors have submitted an updated EVA which rebuts some of the points made in our review and presents new and/or updated information on some elements of the scheme proposals.
- 1.1.3 The updated EVA states that scheme without any affordable housing element or any other S106 contribution has a residual value of -£4,284,967 (i.e. is indicated to be £4.3m in deficit), before deduction of a benchmark land value for the site. This is the result of updated assumptions and additional costs which have moved the RLV downwards by over £5 million from the previous position of £814,635.
- 1.1.4 On this basis the EVA concludes that: *“the site will not be delivered with any additional s106 contributions including any Affordable Housing provision.”*
- 1.1.5 Many of the assumptions are agreed between DSP and TCS. We will comment therefore on the remaining areas of disagreement below.

Construction Costs

- 1.1.6 The EVA used an overall base build cost of £1,839/m² for the flats, stated to be based on a BCIS median rate “for PRS schemes”. There is no such category within BCIS, and DSP took the view that this type of development sits somewhere between the two BCIS categories of student residences and general flatted development. We noted that: *“the EVA refers to the proposed accommodation as ‘student halls’ and the size of the proposed properties (27m²) is more typical of student accommodation. However the flats are self-contained and the development is stated to be aimed at young professionals; it seems unlikely that many students would live in this location which is some distance from the University. The internal area of the development is 73% of the*

gross area; this is a lower percentage than for standard flatted development, but is again more typical to student development than BTR development which can involve an even larger proportion of communal space.”

1.1.7 TCS state that the the development shares very similar characteristics to a student hall of residence, although it is not intended for occupation by students. TCS consider that the mean rate (rather than median) for flatted development in this case would be more appropriate, due to the small size of the flats resulting in a higher build cost – therefore a build cost equivalent to the cost of building student housing. This argument (as to the use of the BCIS average build costs data categories) is not unreasonable in our view, based on how the scheme proposals have been described.

1.1.8 The rate of £550/m² for undercroft parking provision is agreed (£128,700 total), as are the external works costs.

Build costs – car park

1.1.9 TCS have updated the assumed costs for the construction of the multi-storey car park on the site of the existing surface car park to the latest BCIS figure of £631/m², and have also indicated that the proposed car park as now proposed has increased in size from 5,562m² to 6,931m²; therefore providing a total base build cost for the car park of £4,373,461 (an increase of £936,145 on the previously submitted position). Ancillary works costs relating to the car park are as previously submitted and agreed.

CIL/Section 106 Payments

1.1.10 These have been updated with a figure of £91,344 for recreational mitigation and a CIL liability of £841,830, therefore an increase in costs of £73,077 in comparison with those assumed previously.

Sales & Marketing Fees

1.1.11 We queried the inclusion of sales/marketing fees of 1.5% (amounting to £519,787) in addition to Purchaser's Costs (incl. SDLT) relating to the sale of the scheme to an investor which are included at 5.8% of the GDV of the units; so amounting to circa £2 million. We would expect letting costs to be included in the overall management costs for the units. TCS consider the inclusion of these fees to be 'well established' but have not explained further. We have left these costs out at this stage.

Existing Use Value – Land Costs

- 1.1.12 The original EVA did not include an allowance for purchase of the existing surface car park site on which the new multi-storey is to be built. An acquisition cost of £200,000 payable to Hampshire County council has now been included.
- 1.1.13 DSP agreed the EUV of the site based on the tenancy schedule, however we disagreed with the premium added to the EUV. We note that the condition of the units is poor and very few are currently occupied (images from a site visit undertaken by DSP in November 2019 are included below). In our opinion, in the current market valuable letting prospects for the current premises as exist are slim, and therefore very little incentive (premium) above a reasonably assessed EUV should be required. Indeed, in our view achieving the stated EUV view would require some investment/significant letting incentives to improve the condition and attractiveness of the units.





1.1.14 We consider, therefore, that our assumption of a 10% premium on the agreed EUV represents a reasonable incentive and indeed its inclusion represents a positively assessed benchmark value (rather than a tight one) against which to assess the scheme. Therefore, in our opinion a BLV of £2,701,950 is appropriate (now including the additional £200,000 as noted above).

Profit and Overhead

1.1.15 TCS have included profit as a fixed input at 15% of cost, which they consider to be a minimum industry standard. We disagree that this is necessarily a minimum

requirement for Build to Rent schemes, as experience shows this to have varied between schemes, and in our view this remains an aspect to consider alongside the investment yield as part of an overall view of the scheme viability.

Car Park Revenue

- 1.1.16 TCS have updated the estimated revenue from the car park to reflect the larger structure now proposed.

Investment yield

- 1.1.17 The result of the viability appraisal is undoubtedly, as acknowledged by TCS, highly sensitive to the assumption made about yield.
- 1.1.18 TCS consider that WaterlooVille is a tertiary location – we agree that this is the case in terms of relativity between locations within the South East of England that are most likely to see this form of development, however yields for the South East as a whole are stated to be less than 5% in the Knight Frank report quoted in TCS’s original viability report¹.
- 1.1.19 TCS refer to a planning appeal (for a student accommodation proposal) in which the inspector accepted that a development that is not pre-let is a higher risk, and contend that the fact this accommodation is not pre-let should be reflected in a lower yield. The planning appeal refers to student accommodation, where “pre-let” means purchased by the university and let to students, or let via the university, rather than let directly to students. This does not directly apply to the proposed type of Build to Rent development, which by its nature is directly let, and which operates on a different basis to student accommodation, with longer occupancies on average (not changing every year as per student accommodation).
- 1.1.20 Further to the examples quoted in our review, the following extract from a recent (2019) report by Ernst and Young indicates that yields for BTR average between 4% and 5% for forward funding BTR deals².

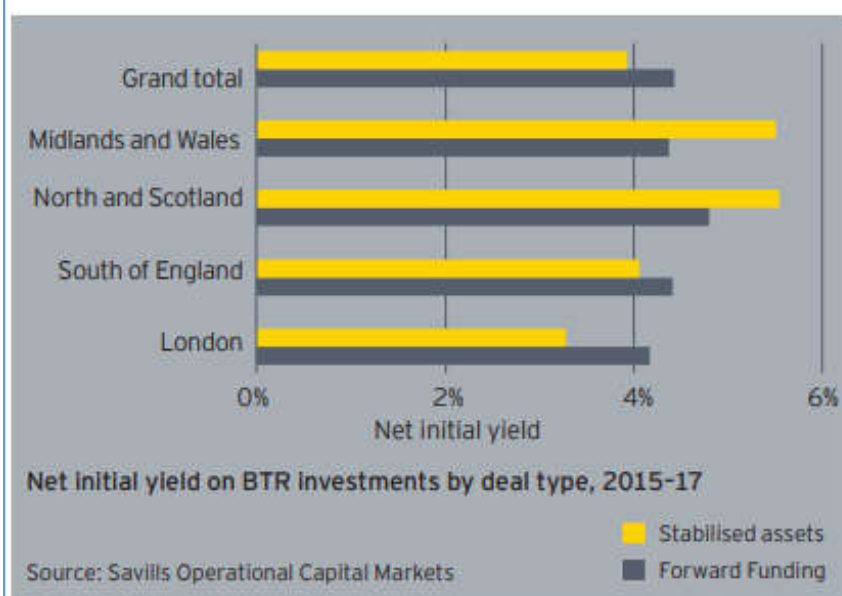
¹ <https://content.knightfrank.com/research/588/documents/en/uk-residential-investment-yield-guide-october-2019-6728.pdf>

² [https://www.ey.com/Publication/vwLUAssets/EY-Build-to-rent/\\$FILE/EY-Build-to-Rent.pdf](https://www.ey.com/Publication/vwLUAssets/EY-Build-to-rent/$FILE/EY-Build-to-Rent.pdf)

1.3 Investment rewards

Net initial yields on BTR deals averaged 4.3% from 2015 to 2017.⁴ Over this period, 18,500 units with an aggregate value of £4.1 billion changed hands. Two thirds were forward funding deals (where the yield is based on forecast income), and the remaining were standing stock.

The graph below illustrates the variation in yield across the UK. In general, you would expect the yield on forward funding deals to exceed that on standing stock as investors require compensation for taking the construction risk. The graph illustrates a wide variation in yields on standing stock, with the yield exceeding that available on forward funding deals in some of the more northern areas (although this could be due to issues with quality of some of the standing stock and attaching rental covenants).



While the initial yield may give investors a sense of the income return available, that is only part of the picture. Over the last 15 years capital growth has contributed a further 5.2%⁵ p.a. to total returns on UK BTR assets (however this is based on relatively small portfolio of existing assets).

1.1.21 The same report acknowledges that valuation of institutional investments “is a challenge for investors of private asset classes where there is no market observable price. It is even more of a challenge for assets in relatively new markets like BTR, where there is limited data”.

This is pertinent to the proposed development, which as well as being in an ‘untested’ location for BTR, is unusual in that it is to be built in the style of student accommodation but intended as Build to Rent. It differs from most build to rent proposals which tend to offer accommodation equal to or superior to a standard private rental option. Whilst we consider these factors to be reflected in the assumptions that are being made on rental income, we agree that they make it likely a yield at the upper end of the typical BTR range would apply.

- 1.1.22 We consider TCS’s approach of sensitivity testing different yield assumptions (ranging from our assumption of 5% up to TCS’s assumption of 5.75%) to be appropriate.

2. Summary and Conclusions

- 2.1.1 We have reviewed newly submitted costs and updated information. There are still some points of disagreement or uncertainty, including in relation to the Benchmark Land Value, the yield applied to the rental income, and the marketing costs.
- 2.1.2 We note the conclusion of the original viability submission, which stated that the developer aims to resolve the significant deficit through *“improvements in Investment Yield and reduction in delivery costs”*, and by *“undertaking the scheme on a significantly reduced development profit”*. This is consistent with the latest guidance in that the viability assessment process should be envisaging how a proposal will be delivered. Therefore, we have applied our suggested profit level of 12% on cost and have followed a similar approach to TCS regarding sensitivity testing of different yield assumptions. We have at this stage, as above, continued to exclude the sales/marketing costs which we consider should be included in the deduction from rent for general management of the units, with investors’ costs covered by the ‘purchaser’s costs’ of circa £2 million. The results are as follows:

Yield on Rental Income	Resi GDV	Car Park GDV	Total Revenue	Total Costs (DSP assumptions)	Residual Value of Scheme	BLV (DSP assumption)	Surplus/Deficit
5.75%	£ 32,139,130	£ 2,801,003	£ 34,940,133	£ 37,685,142	-£ 2,745,009	£ 2,701,950	-£ 5,446,959
5.50%	£ 33,600,000	£ 2,801,003	£ 36,401,003	£ 37,685,142	-£ 1,284,139	£ 2,701,950	-£ 3,986,089
5.25%	£ 35,200,000	£ 2,801,003	£ 38,001,003	£ 37,685,142	£ 315,861	£ 2,701,950	-£ 2,386,089
5.00%	£ 36,960,000	£ 2,801,003	£ 39,761,003	£ 37,685,142	£ 2,075,861	£ 2,701,950	-£ 626,089

- 2.1.3 We also note that there might be further costs when the scheme comes forward – for example relating to nitrates pollution mitigation, in which case (assuming no other input changes) the viability of the scheme would reduce (worsen) from the current position.
- 2.1.4 The newly submitted information indicates higher costs than originally submitted, and we accept the point that, assuming the development proceeds as currently proposed, the build costs are likely to be closer to those associated with ‘student accommodation’ rates than the median rate for 6+ storey flatted accommodation generally, in this case. The most significant assumption is the rental yield and this has been tested at various levels, reflecting the acknowledged uncertainty.
- 2.1.5 In conclusion, we consider that the likely viability of the scheme has now been tested as far as possible at this stage, and based on the most recent information, even taking

a positive view of development value indicates that the scheme viability appears marginal in terms of normal measures of viability. On this basis, we are now able to conclude that as above the viability has been investigated and tested to a suitable extent, with the extended review exercise finding (as submitted) no clear scope for the support of affordable housing obligations at this time, based on the proposal as explained.

- 2.1.6 We need to be clear again that our review is based on current day costs and values assumptions as described within our review based on the current scheme as submitted. A different scheme may of course be more or less viable – we are only able to review the information provided.
- 2.1.7 No viability appraisal or review can accurately reflect costs and values until a scheme is built and sold - this is the nature of the viability review process. In this sense, the applicant and their agents are in a similar position to us in estimating positions – it is not an exact science by any means, and we find that opinions will usually vary.
- 2.1.8 The appraisal results are highly sensitive to a change in assumptions – as shown by the difference in outcomes between the applicant’s submitted position of August 2019 and that of November 2019, as well as by the effect of yield assumptions shown in the table above. If planning for a scheme of this size is to be approved without any contribution towards affordable housing, the Council may wish to consider a review mechanism which allows viability to be revisited at a later stage.
- 2.1.9 DSP will be happy to advise further as required.

Further/supplementary Report Ends
January 2020