Financial Viability Assessment

Lee Bay Hotel

Prepared on behalf of: Acorn Blue

REVISED – MARCH 2019

Contents

Executive Summary

This financial viability assessment (FVA) has been prepared by JLL on behalf of Acorn Blue in support of their planning application (ref: 63167) for the redevelopment of the Lee Bay Hotel.

The purpose of this FVA is to determine whether the quantum of residential development proposed by the application is the minimum required to create a viable scheme.

This follows a previous FVA undertaken by Alder King LLP in respect of the site and subsequent failure to agree the viability with Lionel Shelley of Plymouth City Council (on behalf of North Devon Council). JLL has been instructed to re-appraise the site and undertake a renewed negotiation with Lionel Shelley.

This specific report relates to an updated scheme comprising 21 no. units.

A planning decision has been deferred awaiting the outcome of these negotiations.

The viability assessment considers the total value of the completed scheme and the total cost of its delivery using recognised residual appraisal software – Argus Developer. In accordance with published viability guidance, the resulting developers profit is then compared with an appropriate benchmark profit to determine the viability of the proposed scheme.

We have assessed both the new 21 unit residential scheme as proposed and a hypothetical 17 unit scheme to mirror the approach taken by previous reports but updated to reflect the latest design work (an 18 unit scheme is now not possible).

It is our opinion that the scheme as submitted provides the minimum number of units required to deliver a viable scheme.

1 Introduction

1.1 JLL is instructed by Acorn Blue (the Applicant) to undertake a financial viability assessment (FVA) in support of a planning application for the redevelopment of the former Lee Bay Hotel (the Site).

1.2 The purpose of this independent FVA is to support the planning application to the local planning authority, North Devon Council (Ref: 63167) and to establish what represents the minimum amount of development required to make development viable. Please note that we are not under instructions to comment on the level of affordable housing; Vacant Building Credit applies and therefore affordable housing is not required.

1.3 This report has been prepared having regard to the National Planning Policy Framework (NPPF); National Planning Practice Guidance (NPPG) on Viability; the RICS Guidance Note 'Financial Viability in Planning' (RICS GN); and generally accepted principles of undertaking financial viability assessments.

1.4 In accordance with the RICS guidance (paragraph 4.5.4 RICS GN), I confirm that I have acted reasonably, transparently and fairly in undertaking this assessment.

1.5 Please note that this assessment is undertaken at a particular point in time (February 2019). Values and costs will change over time and it must be understood that our assessment is based on current estimated values and costs as at the date of this report and is not a projection of value.

1.6 This report and its contents have been prepared specifically to support the planning application in respect of the Site. No responsibility whatsoever is accepted to any third party and neither the whole of the report, nor any part, nor references thereto, may be published in any document, statement or circular, nor in any communication with third parties without our prior written approval of the form and context in which it may appear.

1.7 The advice contained herein does not constitute a formal valuation and cannot be used for purposes other than those mentioned, including loan security purposes. The advice contained in this report is exempt from the current RICS Valuation Professional Standards March 2014 – Global and UK Edition (the Red Book). I reserve the right to update, amend or vary our advice should the matter progress to a planning appeal hearing or inquiry.

Background

1.8 The current planning application is a resubmission following the refusal of application ref: 59766 on 1st November 2016.

1.9 Since the refusal of the first scheme, Acorn Blue and North Devon Council have agreed that Vacant Building Credit (VBC) applies and there is no requirement for affordable housing as part of the current application. The reason for this is that the gross floor area of the current buildings exceeds the proposed development.

1.10 We have not included the car park, café or WC's in this FVA as it is understood the land to provide these will be transferred for the nominal sum of one pound to the National Trust upon grant of planning permission.

1.11 Alder King, on behalf of Acorn Blue, first submitted a FVA in respect of the current planning application on 6th February 2018. That report concluded that the scheme as proposed was viable and could afford to make the required Section 106 contributions. It further concluded that a hypothetical smaller scheme was not viable as it could not support the required S106 contributions, nor would it result in a land value at a level to incentivise a willing seller to sell the site.

1.12 The Alder King (AK) FVA was reviewed by Lionel Shelley (LS) of Plymouth City Council (on behalf of North Devon Council) in May 2018. LS disagreed with many of the AK report inputs and concluded that 'there may be the basis for a reduction in units'.

1.13 Subsequent meetings were held between AK, LS the Council and Acorn Blue. Despite attempts to negotiate a resolution could not be found. The application was recommended for refusal by North Devon Council although this decision has been deferred pending the outcome of this FVA. Specifically, *'members were aware of the difference of opinion on whether 18 or 23 units was the minimum quantum necessary for this development and want the applicant to re-consider the number proposed with a view to reducing it back down towards the 18 our adviser believes is viable'.*(e-mail correspondence from Case Officer, 12th October 2018).

1.14 JLL has been instructed by Acorn Blue to review the FVA in the context of the above request from Members.

1.15 Acorn Blue has prepared a revised 21 unit scheme that aims to address reservations held about the 23 no. unit scheme. We have been instructed to appraise this revised scheme and compare it with the hypothetical 17 no. unit scheme.

1.16 Updated costings have been obtained from Acorn Blue, in conjunction with Taylor Lewis and Classic Builders in order to provide an evidence base for the costs used. A breakdown is attached to this report.

Information Sources

1.17 I have been provided with, and relied upon, information provided by the Applicant and its consultants including the following:

Information	Source	Dated
Accommodation schedule	Acorn Blue	October 2018
Financial Viability Assessment	Alder King	6th February 2018
Viability Review	Plymouth City Council	May 2018
Build costs	Acorn Blue	Feb 2019

2 Background

Location and Description

2.1 The property is located in the village of Lee, adjacent to Lee Bay and occupies a site of 1.79 ha (gross). The site's postcode is EX34 8LR. The Lee Bay Hotel closed some time ago and the building is now in a very poor state.

2.2 The site area includes the derelict hotel but also an area of car parking that the applicant intends to transfer to the National Trust.

2.3 Acorn Blue has submitted a planning application (resubmission) (Ref: 63167) for residential redevelopment of the hotel site comprising; demolition of the existing hotel, erection of 23 no. residential units, new public open space, extension to the existing public car park, erection of a new café and WC block and associated landscaping, drainage and highway works.

2.4 A planning decision was deferred for up to 3 months at a planning committee on 14th November 2018.

Description of proposed scheme

2.4 Acorn Blue proposes a 21 no. unit scheme split between three small blocks.

2.5 An accommodation schedule for the proposed development is provided below:

Building	No. Units	GIA (sq m)*	GIA (sq ft)	NIA (sq m)	NIA (sq ft)
North West Apartments	13	1,532	16,491	1,229	13,229
Middle Building	4	530	5,705	506	5,447
Upper Building	4	472	5,080	452	4,865
Total	21	2,109	27,276	2,187	23,541

2.6 A full accommodation schedule is appended to this report.

2.7 Note the 17 unit scheme is based on the Upper Building not being built.

3 Viability Approach & Benchmark Developers Profit

Viability Approach

3.1 This section highlights the key planning guidance that is relevant to the application and this FVA.

2018 NPPF Consultation

3.2 On 5 March 2018 the Government published a draft version of the National Planning Policy Framework (NPPF) for consultation. This is the first major update of the Framework since it was published in March 2012. As part of this consultation they have provided a separate piece of guidance on viability 'Draft Planning Practice Guidance for Viability'. This attempts to add clarity to the viability assessment process by defining the criteria for certain inputs. We believe this report follows the new guidance.

3.3 The new NPPF was published on 24th July 2018 and the Viability guidance has been updated as part of this review.

3.4 The most important revision is in respect of land value. The new guidance seeks to bring clarity to the way that a Benchmark Land Value (BLV) is set. BLV should be established on the basis of existing use value plus a premium that incentivises the land owner to release the land for development (EUV+). The premium should reflect the minimum return that it is considered a reasonable land owner will release their land for development.

3.5 In addition, The Department for Communities and Local Government issued an updated National Planning Practice Guidance (NPPG) planning guidance on 'Viability' in July 2018. In the Viability and Decision Taking section the guidance states the following;

"Viability assessment is a process of assessing whether a site is financially viable, by looking at whether the value generated by a development is more than the cost of developing it. This includes looking at the key elements of gross development value, costs, land value, landowner premium, and developer return."

3.6 Below we detail our approach in accordance with both the 2018 NPPF and 2018 NPPG.

RICS Guidance Note: Financial Viability in Planning

3.7 The RICS GN was published in August 2012. The purpose of the guidance note is to enable all participants in the planning process to have a more objective and transparent basis for understanding and evaluating financial viability in a planning context. It provides practitioners with advice in undertaking and assessing viability appraisals for planning purposes.

3.8 The RICS GN provides all those involved in financial viability in planning and related matters with an objective methodology framework and set of principles that can be applied for both plan making and development management.

3.9 Financial viability for planning purposes is defined as follows:

"An objective financial viability test of the ability of a development project to meet its costs including the cost of planning obligations, whilst ensuring an appropriate site value for the landowner and a market risk adjusted return to the developer in delivering that project."

3.10 The RICS GN also addresses the term "competitive return" as set out in the NPPF as follows:

"A 'Competitive Return' in the context of land and/or premises equates to the Site Value as defined by this guidance, i.e. the Market Value subject to the following assumption: that the value has regard to development plan policies and all other material planning considerations and disregards that which is contrary to the development plan. A 'Competitive Return' in the context of a developer bringing forward development should be in accordance with a 'market risk adjusted return' to the developer, as defined in this guidance, in viably delivering a project."

3.11 In assessing the viability of the Scheme, we have adopted a residual valuation model in accordance with the RICS GN. This approach uses various inputs to establish the gross development value (GDV) of the proposed scheme from which the development costs are deducted to arrive at either a residual Site Value or developer's return (profit).

3.12 In this FVA we have adopted site value as an input to development costs, leaving a residual developer's profit as the output from which to benchmark viability. This approach is summarised below:

Gross Development Value

less

Development Costs (Including Site Value)

less

Planning Obligations

equals

Residual Developer's Profit

3.13 When a developer's return is adopted as the benchmark variable, a scheme should be considered viable, as long as the cost implications of planning obligations are not set at a level at which the developer's return (after allowing for all development costs including Site Value) falls below that which is acceptable in the market for the risk in undertaking the development scheme. If the cost implications of the obligations erode a developer's return below an acceptable market level for the scheme being assessed, the extent of those obligations will be deemed to make a development unviable as the developer would not proceed on that basis. (RICS GN Para 3.3.1)

3.14 In this case, we need to determine whether the scheme as applied for generates a developer's profit in line with market and funder requirements.

Benchmark Developer's Profit

3.15 The NPPG defines the developers return as follows:

"For the purpose of plan making an assumption of 15-20% of gross development value (GDV) may be considered a suitable return to developers in order to establish the viability of plan policies. Plan makers may choose to

apply alternative figures where there is evidence to support this according to the type, scale and risk profile of planned development. A lower figure may be more appropriate in consideration of delivery of affordable housing in circumstances where this guarantees an end sale at a known value and reduces risk."

3.16 In arriving at a benchmark return I have considered the risk profile of the scheme. The property is previously developed land that comprises a dilapidated hotel in need of demolition. There will be unknowns in respect of ground conditions that cannot be fully explored until demolition has occurred.

3.17 The site sits in what is an undeniably fantastic location. This does however bring with it complexities of construction such as lorry movements along small roads.

3.18 It is well known in the development and construction market that there is a general labour shortage; this is most heightened in rural and remote locations away from major population centres. We are in regular contact with developers, some of whom will not build in North Devon given the difficulties they face in attracting labour to their sites. There also remains uncertainty surrounding the longer term impacts of Brexit and the continued construction cost inflation experienced and forecast due to labour, skills and material shortages.

3.19 Recent changes to the stamp duty payable on second homes and amends to the tax relief available for buy-to-let landlords has had a detrimental impact on the market for luxury homes in the south west. Whilst Lee Bay will appeal to second home owners and relocaters, we attach caution to this market as they are either:

- Reluctant to commit to an expensive second home and pay an additional 3% of stamp duty on what is already a high fee
- Needing to dispose of their current home to purchase a new home to relocate to. The second hand market is weak at present, particularly for larger homes

3.20 Lee Bay is also reasonably remote with no local services and this will also, in our opinion, add sales risk to the project.

3.21 The NPPG guides a profit level between 15 and 20%. We have recently agreed a viability for a green field site in Bideford using a blended profit margin of 20% on GDV for the open market units and 6% on the affordable units. The subject site is far more risky than a green field house builder site and should arguably attract a higher profit margin than 20%.

3.22 It should be noted that the draft PPG (and previous guidance) referred to 20 per cent and this has, until now, been the accepted level of return. The PPG recognises that a lower figure 'may be more appropriate in consideration of delivery of affordable housing in circumstances where this guarantees an end sale at a known value and reduces the risk'. It also acknowledges that different figures may be appropriate for different development types. We believe that a figure lower than 20% is the result of a scheme delivering affordable housing where the target profit on GDV for the affordable is 6% and 20% on the open market units.

3.23 For the reasons stated above it is my opinion that an appropriate benchmark developer's return for this scheme is a profit of 20% of GDV.

4 Development Value

4.1 The Gross Development Value (GDV) of the scheme has previously been debated between AK and LS. They agreed at a GDV for all units of £9,995,000.

4.2 The scheme has been amended since the first viability report was submitted and is now smaller; being reduced by 2 no. units.

4.3 Acorn Blue has liaised with local agents and have used their significant experience of selling high quality coastal developments in reaching their predicted sales prices.

4.4 Given the lack of comparable evidence in the immediate vicinity we are of the opinion that the agreed GDV remains valid, albeit that there has been some growth since the process began that has been reflected in our assumed GDV of £9,845,000.

The GDV breakdown is as follows:

Type	Description	Internal SqFt.	Internal SqM.	Price/SqFt	Resale Value
2 bed	Lower Ground apartment	861	80	£494	£425,000
2 bed	Lower Ground apartment	840	78	£482	£405,000
2 bed	Ground floor apartment	635	59	£520	£330,000
2 bed	Ground floor apartment	721	67	£485	£350,000
3 bed	Penthouse	1,023	95	£489	£500,000
3 bed	Penthouse	1,152	107	£412	£475,000
4 bed	Maisonette	1,292	120	£368	£475,000
4 bed	Maisonette	1,292	120	£368	£475,000
4 bed	Maisonette	1,292	120	£368	£475,000
2 bed	Maisonette	1,012	94	£440	£445,000
2 bed	Maisonette	1,076	100	£418	£450,000
3 bed	Penthouse	1,012	94	£489	£495,000
3 bed	Penthouse	1,023	95	£489	£500,000
4 Bed	end terrace house 2 storey	1,528	142	£373	£570,000
3 bed	mid terrace house 2 storey	1,195	111	£385	£460,000
3 bed	mid terrace house 2 storey	1,195	111	£385	£460,000
4 Bed	end terrace house 2 storey	1,528	142	£373	£570,000
3 Bed	GF apartment	990	92	£465	£460,000
3 Bed	FF apartment	1,227	114	£408	£500,000
4 Bed	mid terrace house 2 storey	1,324	123	£378	£500,000
4 Bed	end terrace house 2 storey	1,324	123	£397	£525,000

4.5 LS has included a value of £102,000 as a ground rent investment income in addition to sales GDV. The Government announced a consultation to reform the residential leasehold system on 21st December 2017. The likely outcome of this consultation will be legislation that will remove the ability to obtain ground rents on any new development. As a result many valuers and lenders will no longer make any allowance for ground rents when calculating a value of a scheme. We therefore believe it incorrect to attribute any ground rent income or investment value to the proposed scheme.

5 Development Costs

Site Value

5.1 Site value is defined in the RICS GN as follows (para 2.8):-

"Site Value should equate to the Market Value subject to the following assumption; that the value has regard to the development plan policies and all other material considerations and disregards that which is contrary to the development plan"

5.2 The RICS GN goes on to say practitioners should have regard to current and alternative use value, market/transactional evidence, and all material considerations including planning policy in deriving the Site Value. Site Value must be, by definition, at a level at which a landowner would be willing to sell at a competitive return, as recognised by the NPPF.

5.3 A bench mark land value of £375,000. was used for the land value in the previous viability assessments from both Alder King and Lionel Shelley.

5.4 We have discussed the property with JLL's Leisure and Hotels team based in Exeter. They are of the opinion that if they were instructed to dispose of the property today in its current condition they would achieve a sales price in excess of the Benchmark Land Value.

5.5 Given that the figure of £375,000 has previously been agreed and although we feel it to be too low we have continued to use this as the benchmark site value for the purposes of this report.

Acquisition Costs

5.6 We have made an allowance for acquisition costs in accordance with HMRC rates with 1.5% for agent fees and £10,000 for legal fees plus Stamp Duty at the prevailing rate.

Construction Costs

5.7 The Alder King report submitted in February 2018 relied on a summary quantity surveyor costing for the scheme that covered both build and abnormal costs.

5.8 The review of that report undertaken by LS used BCIS costings as a benchmark. LS accepted as the proposed scheme was to be of a high quality build and design that the upper quartile range of costs should be attributed to this project.

5.9 In our initial review of the 23 no. unit scheme, undertaken in November 2018, we applied BCIS upper quartile range, re-based to North Devon. However, we were unable to agree the appropriate level of external/abnormal costs with LS so it was decided that a costs summary obtained, updated where necessary and that this be made available for review by LS and a 3rd party quantity surveyor if required.

5.10 The cost summary has been prepared by Acorn Blue using uplifted Taylor Lewis (cost consultant) figures with input from contractors Classic Builders.

5.11 The cost summary includes all sub and super structures, abnormals and external build costs.

The cost summary has been updated to reflect BCIS build cost inflation to today's date.

Preliminaries are included at £6,000 per week that the project is on site.

Contractor Overheads and Profits are allowed at 7.5% of build cost, which we believe is reasonable.

Demolition has been allowed at £140,000.

The total build cost for the 21 unit scheme is **£6,089,077.** The cost for the 17 unit scheme is £5,132,370.

5.15 We have allowed a contingency of 5% on build and externals. This is a standard input for a challenging brownfield site.

Professional Fees

5.16 We would normally expect to see a range of 8 – 12% on cost for professional fees, with 12% being for the restoration of listed buildings. Given the challenges of this site, including constrained access and demolition we have attributed a figure of 10% across build and external costs.

Planning Obligations

5.17 We have included Section 106 contributions as per the previous reports, being £184,491 for education and £85,477 for public open space.

5.18 CIL is not adopted in North Devon.

Marketing, legal and disposal fees

5.19 We have allowed for marketing, legal (conveyancing) and disposal (agency) costs of 3.5% of the open market GDV in this assessment to cover show homes, sales office, advertising, agent fees and brochures. In our opinion, this level of marketing will be required if the Applicant is to achieve its target sales prices.

Finance Costs

5.20 The interest rate applied in the appraisal represents a total cost of capital in financing the scheme. This reflects both debt and equity financing. The RICS GN suggests that in assessing such matters as the rate of finance, that this should not be specific to the developer in question but be the benchmark rate that any developer capable of undertaking the scheme would be able to access finance at. JLL regularly undertake loan security valuations on behalf of lenders for development sites of this size and scale and in our experience a rate of 6% is low, but is within the range we are currently seeing in the market.

Development Programme

5.21 The previous FVA and subsequent analysis allowed a 24 month build and sales programme. We believe that this assumption is far too optimistic and does not reflect reality. We have liaised with Acorn Blue and have used our own development knowledge to arrive at the following programme:

- pre-commencement and site clearance – 5 months
- construction period – 24 months
- sales period – 14 months (commencing 18 months into the construction process)

6 Appraisals and Conclusion

6.1 We have run our viability assessment appraisals in ARGUS Developer, which is an established real estate software program used by the property industry to model development projects.

6.2 We have undertaken an appraisal of the scheme as proposed by the Acorn Blue planning application. We have used a fixed land value of £375,000 and have a target profit margin of 20% of gross development value.

6.3 In line with the previous FVA we have also appraised a smaller hypothetical scheme; this time of 17 units (removing the upper building). We have maintained all inputs as per the larger scheme however we have reduced S106 contributions to reflect the lower amount of units.

6.4 The results of the two appraisals are shown in the table below:

No. of units	GDV	Land	Profit on GDV
21	£9,845,000	£375,000	14.94%
17	£7,860,000	£375,000	6.85%

6.5 The appraisals clearly demonstrate that the 17 unit scheme does not make the requisite profit to show that it is viable. This is the same position faced by the 18 unit scheme previously tested.

6.6 The 23 unit scheme previously tested showed a return of c. 20% on GDV. As discussed earlier in this report this is the minimum level that we believe a developer would look to achieve before embarking on this scheme.

6.7 The 21 unit scheme is proposed as a compromise by Acorn Blue. It reduces the number of units and the height of the buildings proposed. Ultimately, however, it creates less revenue whilst still being affected by the same abnormal development costs. It does not achieve what we consider to be a market level of developers profit.

6.8 Acorn Blue are committed to delivering a residential scheme of the highest quality at Lee Bay. In order to reach a compromise in respect of the form of scheme they are willing to take a lower margin in order to bring the development forward.

7 Appendices

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