

Jack Savin-Taylor MRICS
DS2 LLP
100 Pall Mall
London, SW1Y 5NQ

June 2019

OPDC Viability Review:

1. Introduction

At the request of the client, we were asked to undertake an independent review of the Cargiant Site Allocation Viability, specifically in relation to residential values, future value growth and absorption rates. We are familiar with the scheme having previously advised on the master plan, pricing for the residential units, and estimated sales rates. As such we are well placed to aid in this request.

2. Our Assumptions

In order to conduct our review, we have made a key assumption, on which our analysis is contingent. This assumption is that the Old Oak site will see the delivery of the Crossrail and HS2 stations. We understand that the Hythe Road Overground station is no longer going ahead, reducing the transport access of the site. The Crossrail and HS2 station are key not only in delivering the necessary infrastructure for the regeneration of the site but in improving vital connectivity between the site and central London. Recently there has been doubt cast on whether or not HS2, and by extension, Crossrail will be delivered to the site.

Beyond this, the absence of the HS2 and Crossrail station would have a detrimental impact on the regenerative potential for the site. A significant proportion of the site will be made up of retail and commercial use. Without the improved infrastructure, it is unlikely that large commercial tenants will be attracted to the site. In the absence of commercial tenants, retailers will be hesitant to take up space in the Old Oak Common area. The commercial tenants will be key to driving footfall and business for the retailers during the day whilst creating a dynamic environment and important public realm improvements. The symbiotic relationship of the various uses is therefore highly dependent on the presence of the required infrastructure. It is highly unlikely that existing infrastructure will be capable of supporting planned usage. Furthermore, without the infrastructure, we would anticipate a significant decrease in the estimated sales rates at Old Oak.

T +44 20 7629 8171 F +44 20 7493 4114
55 Baker Street London W1U 8AN

knightfrank.co.uk

Knight Frank LLP is a limited liability partnership registered in England with registered number OC305934.
Our registered office is 55 Baker Street, London, W1U 8AN where you may look at a list of members' names.

The natural extension of all of this would be that in the absence of the above infrastructure many of the most critical assumptions, including but not limited to sales values, velocities, and growth rates would be reduced as a result.

3. Site Information

The site currently has limited access to central London via the London Overground and London Underground. Willesden Junction operates the Bakerloo line. Currently the travel time between Willesden Junction and Bank, Waterloo and Canary Wharf is estimated at 31 minutes, 27 minutes and 37 minutes respectively. This does not include the walk time to the station which we currently estimate as being approximately 15 minutes (0.8 miles). Furthermore, the site does not have sufficient public transport to the southern boundary. All of this highlights how dependent the long term success of this site is on the successful delivery of the HS2 and Crossrail. The PTAL rating of the site currently ranges between 0-3 on a scale of which 0 is the worst and 6 is the best.

4. Key findings from the BNP Paribas Report

The following have been extracted from the BNP report between sections 3.6 and 3.17 as per the clients instructions:

- a. Key comparable schemes.
- b. The argument that the developments units will achieve a premium over and above the sales values of second-hand stock in the area. The existence of a 'new build premium'.
- c. A blended average of £750 psf across the development site in question.
- d. Residential Growth rates between 2020 – 2023 ranging from 1% to 3.67%.
- e. A growth rate of 3% applied thereafter until the completion of the development in 2039.
- f. A cumulative regeneration value of 6.70% applied every year between 2022 and 2027.
- g. Absorption rates.

5. Analysis on the Key Findings

The numbers in bold, e.g. '**3.9**', correspond with the relevant sections in the BNP report.

Based on the key findings observed above we are of the following opinion:

'3.6' – Whilst we accept that the comparable evidence provided by BNP is relevant, they have focused solely on geography and not necessarily the key consideration of scale. Due to the sheer size of the project, we have looked further afield to comparables such as Royal Wharf and Royal Arsenal, which we believe are more comparable in terms of profile and scale. Of BNP's comparables, we believe that Park Royal and Wembley

are the most pertinent. Park Royal is particularly relevant given its location whilst the regeneration of Wembley is more comparable in terms of scale. We note the inclusion of The Television Centre in White City. The Television Centre is a successful scheme. However, since its launch in Q3 2015 the scheme has only sold 400 units, circa 100 per year, despite high profile retailers and the presence of the Soho House Hotel, emphasizing the trade-off between maximizing value and driving sales rates, which we will cover in more detail later in this note. This relatively slow sales rate has contributed to the delay of phase 2 of the scheme, which is still under review.

'3.9' – We agree that the blended average of £750 per sq. ft. is reasonable for the scheme. Taking into consideration the different micro-locations within the proposed development, which are impacted by factors such as the height of the building, proximity to canals or railways, we could see a range of £700 - £850 psf. The figures provided fall within Knight Frank's expectations. The premium units are made up of those centrally located, with closer proximity to transport, and with canal views. Some of the proposed units on higher floors in towers would be capable of achieving the higher end of the range. Across the site, however, the £750 per sq. ft. reflects the scale of the project and the requirement for competitive pricing in order to drive sales rates.

'3.10' – Producing values regarding growth rates over an investment horizon is a complicated task. As such we agree with the approach taken by BNP. Using an average of growth forecasts by market-leading firms is a reasonable approach for dealing with the inherent uncertainty.

'3.11' – Current challenging conditions highlight that past performance is no guarantee of future performance and the shifting dynamics of the residential market create greater uncertainties in using previous periods to suggest future performance. 3% growth of capital values from the year 2024 does, however, seem optimistic. Given the length of the period and the resulting uncertainty, we suggest that a growth rate of 2%, in line with the Bank of England's target inflation rate, would be a better base assumption. This means that the houses neither lose nor gain in real terms over this period. A more objective assumption rather than assuming 15 years of potentially real, cumulative, growth in values. Furthermore, linking growth rates on an almost 1 to 1 basis with the growth in UK household disposable income is not considered a sound basis for market forecasting as it assumes that households do not spend disposable income anywhere other than on residential property.

'3.12 & 3.14' – The industry, including Knight Frank, has accepted the existence of a new build premium and has been exploring betterment and regeneration values. The only cause for consideration we have here is the potential for 'double counting'. Taking the difference between the average local authority growth and price growth in regeneration areas cannot be put down entirely to regeneration value. Some of that has to be the new build premium, which we assume, has been integrated into the £750 psf blended average. A review of surrounding second-hand transactions indicates a value range of £506 - £685 psf. As such, any increase attributed to regeneration should be decreased to account for double counting. The report has reiterated in

this section the importance of infrastructure, the same infrastructure which has had doubt cast on it at Old Oak Common. Furthermore, we feel there are limitations on King's Cross as a regeneration comparable. King's Cross location in central London means that it naturally has a higher capital value ceiling than Old Oak Common given its proximity to the West End and International transport links. As a result of its central position, the redevelopment at King's Cross is inherently less dependent on the delivery of infrastructure than Old Oak Common. We are also aware that the highest annual absorption rate achieved at King's Cross during the 2011 – 2017 period was 130 units. The highest transaction levels were achieved in the 2011 - 2014 market, a fundamentally different market than we have today. All of this reinforces our belief that the Old Oak Common scheme is better compared to larger schemes such as Royal Wharf, Royal Arsenal and Wembley.

'3.15' – Based upon the work conducted by CBRE in their research into regeneration effect, BNP have applied a regeneration value of 6.7% per annum on top of the 'normal market growth per annum'. This regeneration value of 6.7% has been applied evenly between 2022 – 2027. We have a few concerns regarding this. We are of the opinion that a premium of 6.7% is not in keeping with comparable schemes which have come to the market. We also believe that to apply any regeneration premium evenly across the time period would not be in keeping with the market. Early adopters of the scheme will have to be incentivized partly by paying a lower regeneration premium than those who follow, to compensate for the increased risks they have assumed. This lower regeneration value in the early years can be offset by higher values in later years. We will demonstrate these point in the betterment and regeneration case study below. If we take a value of £750 per sq. ft. in 2019 and compound the values provided in the report the 2027 value would be approximately £1,364 per sq. ft. an annual growth rate of 6.87% - values which we are of the opinion are unrealistic given the scale of the scheme. Furthermore, the uncertainty in the political and economic arena, the changes in SDLT, amongst other considerations, mean that making estimates based on past performance become increasingly less reliable.

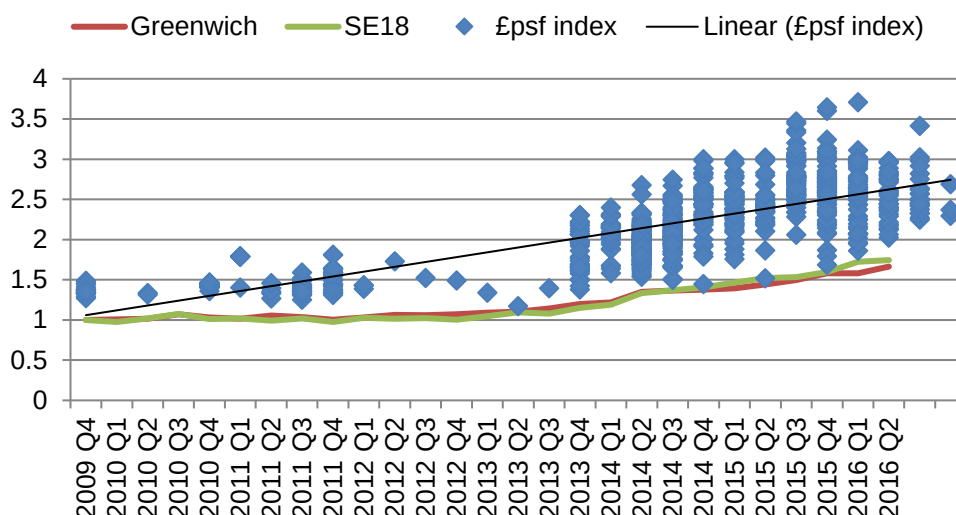
'3.16' - One cannot view prices in isolation, they are intrinsically linked with the sales rate, a key variable in the viability of the Old Oak scheme. On this, we have undertaken research of key schemes around London. However, we do note that a regeneration scheme on the scale of Old Oak is unprecedented, particularly in west London. Our research has shown that regeneration schemes such as Royal Wharf and Royal Arsenal have seen maximum absorption rates on a yearly basis of 308 and 258 units. These two schemes have seen an average absorptions rate of approximately 132 and 91 units. We note that both of the schemes in question achieved their best years in 2014, the strongest year of the past cycle. As such we would not anticipate seeing absorption rates of this level in the current market. Over the course of its sales period is averaged approximately 151 exchanges a year. We have also had reference to the Tottenham Hale regeneration, of which we understand that in its three months since launch has sold 46 units, roughly 25% of the first phase, or 184 units per annum if extrapolated, although in our experience most schemes struggle to sustain the initial sales velocity achieved at launch.

If the scheme has two phases operating at any one time each selling 6 units that is an estimate of approximately 144 units a year. If the units do not sell at this rate the scheme may either be forced to take lower values or could see phases which were not intended to overlap, begin to overlap. If at any time three phases were attempting to sell at the same time the expected absorption rate would reach 216 units a year. Which given the current market conditions we do not believe this to be a reasonable assumption and therefore compromises the viability of the project.

6. Betterment & Regeneration

Whilst betterment can be analyzed, its prevalence requires a review on a case-by-case basis. Below we provide examples and analysis of comparable regenerations schemes:

Case Study (1): Royal Arsenal Riverside



Source: Knight Frank, Land Registry, Berkeley

The above graph highlights how £psf values at Royal Arsenal have comfortably outperformed the local area, although this is in part a reflection of the most desirable stock being brought forward towards the end of the development process.

That said the SE18 re-sales index has outperformed the wider Land Registry Index for Greenwich as the local area benefits from the improved public realm resulting from the scheme.

Date	Greenwich Change	Scheme Change
Q1 2009	£196,146 (flats only)	£400psf
Q2 2018	£340,924	£850psf
% Change	74%	113%

Source: Knight Frank, Land Registry, Berkeley

The above table provides an indication of the percentage increase attributed to place making throughout the build programs of the scheme. Taking the sales data from Q1 2009 the scheme was initially marketed at £400psf and has since increased by 113% to £850psf in Q2 2018. Over the same timescale, the London Borough of Greenwich land registry index has shown 74% growth over the same period. The regeneration growth factor is 39% above market inflation.

The compound annual growth rates for the regeneration area and wider local area are 8.49% and 6.16% respectively. As such the average annualized regeneration premium over the period in question is estimated at 2.33%. What we find particularly interesting, and would like to point out is how the regeneration premium increased over the time period in question. Between Q4 2009 and Q3 2013, despite the indicative linear line of best fit, the delta between the regeneration zone and the wider area remained smaller and closer to constant. This aligns with our earlier stated opinion that regeneration values cannot be applied equally at the mean value over the period in question. Furthermore, the impact of phased schemes on regeneration value must be considered. New build premium has been widely accepted in London. What this means is that when a new phase of the scheme is launched there are more units in the market benefiting from the new build premium. This changes the average value of the units within the regeneration area, not because of the regeneration premium, but due to the well-accepted and demonstrable new build premium. As such, a regeneration premium such as the one we have calculated above must be adjusted to mitigate the potential for double counting. A report by the National Audit Office estimates that the new build premium is worth somewhere between 15-20% higher than comparable second-hand property in the area.¹ If we were, therefore, to adjust the regeneration premium by 15% to account for new build premiums in phased schemes, we would estimate a regeneration premium at Royal Arsenal at 1.98%, or say, **2.00%**.

Linking this back to the subject scheme, this illustrates in our opinion that a flat rate of 6.7% for regeneration value is not only a crude application method, but an optimistic figure compared to comparable regeneration premiums and one which may be double counting new build premiums on phased schemes. As we stated at the outset of this section the case for betterment must be considered on a case-by-case basis. An important factor of Royal Arsenal is the way in which Berkeley Homes sold the residential which is very much focused on extracting maximum value above sales velocity. This is only possible due to their large balance sheet approach to development and must be seriously considered when analyzing the £ psf they were capable of

¹ 'Help to Buy poses big 'market risk' for government'- The Financial Times, George Hammond – 13th June 2019 - <https://www.ft.com/content/08205aae-8d2e-11e9-a1c1-51bf8f989972>

achieving in this development. We have previously noted the importance of sales velocities at Old Oak Common, and the sensitive relationship between sales rates and price growth. Indeed, even if the development is capable of selling 200 units a year, roughly 16 a month, or one every two days, it would still take the development 26.5 years to sell all of the units. This is unlikely to be a satisfactory time frame. As such we would expect this to be subsidized with large transactions to alternative uses such as PRS, student and retirement operators. While these sales will help to boost the sales velocity, sales to the PRS, retirement and student providers will not help to fuel future growth. This could impact the £ psf achieved across the development and by extension, any regeneration premium may be called further into consideration.

As such we would conservatively suggest that any regeneration premium should average at the max 3% over the period in which it is applied, with a larger value in the later years compared to the earlier ones.

7. Conclusions

Based on the above we have come to the following conclusions regarding the Cargiant site:

- Given the scale of the project, we highlight the relationship between sales velocity and price growth, and the likelihood that the price growth will be inhibited in order to sustain a reasonable sales rate.
- The development is highly contingent on the delivery of HS2 and Crossrail of which there is currently uncertainty. The delivery of this infrastructure is vital to its fundamental regeneration potential, and also the sales values and sales rates, both of which are key to the success of this project.
- If HS2 and Crossrail are not delivered, many of the key assumptions regarding the project would be subject to significant downward revisions.
- We are of the opinion that a regeneration premium of 6.70% per annum is inconsistent with the market for comparable regeneration projects.
- We are of the opinion that applying the regeneration premium evenly over the five year period does not best reflect the realities of the market; and that in reality it should be applied with smaller values in the early years and larger values in the later years.
- We are aware of the potential for 'double counting'. Phased regeneration schemes will introduce new units with the new build premium attached at different times. As such the analysis of regeneration value cannot simply be the result of the difference between values in the regeneration area compared to those in the wider local area.
- We are of the opinion that given the increased market uncertainty, time period in question, and changes to the market that a base growth rate of 3% from 2028 onwards is an optimistic value. Rather we feel a value closer to 2%, representing neither a real gain or loss in value assuming the Bank of England's 2% inflation target, represents a more conservative value to reflect the current state of the market.

Kind regards,

A handwritten signature in black ink, appearing to read "Tom Dailey".

Tom Dailey, MRICS

Partner

Residential Development Consultancy

T: +44 20 7861 5145

M: +44 7827 978722

tom.dailey@knightfrank.com