



24 August 2011

Welwyn Hatfield Borough Council
Council Offices
The Campus
Welwyn Garden City
Hertfordshire
AL8 6AE
F.A.O : R Aston Esq

Dear Sirs

**LAND AT BROADWATER ROAD WEST, WELWYN GARDEN CITY
REPORT ON GL HEARN FINANCIAL JUSTIFICATION DATED JULY 2011**

1. This report relates to a planning application submitted by Spenhill Regeneration Limited at Broadwater Road West, Welwyn Garden City. Colliers International is appointed to advise the Council on viability issues.
2. On 14th June 2011 Colliers International provided the Council with a report on the 'viability assessment of the SPD submitted by GL Hearn on behalf of the applicant.
3. On 19th July 2011, GL Hearn submitted a report on the financial justification in respect of the viability of the supplementary planning document (SPD) compliant development scheme. This document, submitted with a development appraisal and pdf print out from their Three Dragons toolkit appraisal, aimed to consider how the property market had changed since September 2010 and also to provide detailed responses to the points raised by Colliers International.
4. Following receipt of the GL Hearn report dated 19th July 2011 the Council has requested that Colliers International provides a report considering the GL Hearn response and drawing attention to any shortcomings.
5. In order to keep our considerations in as simple a form a possible we have set out our thoughts by reference to the paragraph numbering adopted in the GL Hearn report.
6. We set out our considerations below:
 - 3.1: The SPD is not a fixed object that dictates a specific development with a specific schedule of accommodation. There are various possible developments that would comply with the SPD to a plausible degree and some would surely be more viable



than others. That is what Colliers meant when writing that "a more robust approach would be to consider whether a viable scheme that complies with the SPD can be devised". G L Hearn's reply, "to devise a viable scheme would involve moving away from the SPD", is rather disingenuous and effectively proves what Colliers originally wrote: "this implies a preconceived conclusion". It indicates an initial objective to devise an example of an SPD-compliant and non-viable development and to hold it up as "proof" that no SPD-compliant development can be viable. It remains merely one example.

3.2: As we have only pdf printouts to work from, we set out to reproduce G L Hearn's Three Dragons appraisal, so we can see how it varies from the appraisals prepared by Colliers (see Appendix I). However, G L Hearn have not used the Welwyn Hatfield model of the toolkit – they have used the GLA (London) version, which is not approved by Welwyn Hatfield BC. Many of the assumptions are different and the inputs are structured differently.

One major difference is in the build costs. G L Hearn's basic per-m² build costs, *excluding* £25.363m of allegedly "exceptional" development costs, are £1,791/m² for flats and £1,195/m² for houses (including professional fees). These figures are much higher than the Three Dragons default assumptions in the GLA toolkit and are even higher than the default assumptions in the Welwyn Hatfield toolkit.

It is not possible to scrutinise the actual figures for build costs in the G L Hearn's Three Dragons toolkit, because they have not provided a printout of the "Costs Analysis" report. However, here is a schedule of the comparative net per-m² build costs. G L Hearn's figures include professional fees and the Three Dragons figures exclude professional fees, so we have shown both:

BUILD COSTS PER M²			
	Welwyn Three Dragons	GLA Three Dragons	G L Hearn
INCLUDING PROFESSIONAL FEES @ 12%			
Flats	1,450	1,612	1,791
Houses <=75m ²	1,210	1,198	1,195
Houses >75m ²	1,187	1,051	1,195
Average for all unit types (based on unit type floor areas)	1,382	1,475	1,631
EXCLUDING PROFESSIONAL FEES @ 12%			
Flats	1,295	1,439	1,599
Houses <=75m ²	1,080	1,070	1,067
Houses >75m ²	1,060	938	1,067
Average for all unit types (based on unit type floor areas)	1,234	1,317	1,456

Based on G L Hearn's schedule of accommodation, the total basic build costs, including professional fees @ 12%, that correspond to those per-m² figures are as follows:



- Welwyn Three Dragons default figures: £88,689,093
- GLA Three Dragons default figures: £94,682,323
- G L Hearn figures: £104,680,867

That represents a difference of £15.99m between the Welwyn figures and the G L Hearn figures. The G L Hearn figures are 18.03% higher than the Welwyn figures, before one takes into account the £25.363m of “exceptional development costs”.

Other factors that differ between the two regional toolkits include:

- Internal overheads @ 6% in the GLA version and @ 5% in the Welwyn version; this accounts for a difference in the residual land value of £0.737m.
- Developer's return @ 17% in the GLA version and @ 15% in the Welwyn version; this accounts for a difference in the residual land value of £2.562m.
- Car parking build costs are calculated separately and automatically in the Welwyn toolkit. G L Hearn have provided £9.1195m. The Welwyn toolkit assumes zero car parking costs for houses; assuming that the 794 flats have 50% undercroft parking and 50% underground parking (the only available options), the Welwyn Three Dragons toolkit generates £9.028m of car parking costs; this accounts for a difference in the residual land value of £0.0915m.
- Thus, even assuming that we accept G L Hearn's build costs, the G L Hearn appraisal appears to underestimate the land value by £3.4m, solely as a result of using the incorrect regional model for the toolkit.

G L Hearn argue that they have used ProVal to appraise the affordable housing as it is the “industry standard”, which it is not, although it is one of several recognised applications for the purpose of appraising affordable housing. ProVal is not, however, *Welwyn Hatfield BC's* recognised appraisal system. That is the Three Dragons toolkit. We have not seen Appendix 5 to G L Hearn's report, which comprises their ProVal appraisals, but we assume that the sales receipts of £26.206m for the affordable housing units derive from these appraisals, as G L Hearn have selected the “payment ... to developer is fixed...” option in the Three Dragons appraisal.

ProVal arrives at a much lower figure than the Three Dragons appraisal itself. If we select the options “payment ... to developer is calculated by the Toolkit” and “grant is not available”, the Welwyn toolkit calculates receipts of £31.412m – a difference of £5.206m.

- To summarise our initial audit of G L Hearn's Three Dragons appraisal:
- They have overstated the Internal Overheads by £0.737m;
- They have overstated the Developer's Return £2.562m;



- They have overstated the car parking costs by £0.0915m;
- They have understated the affordable housing sales receipts by £5.206m.
- That is a total difference of £8.5965m, as is reflected in the reduction of the negative residual land value from -£17.682m to -£9.087m.
- And this is before we have even tackled the £25.363m of alleged “exceptional development costs” and the unusually high build costs per m².

- 3.5: 'G L Hearn have now provided a proposed mix of units, which is helpful. There are 991 units of housing in their proposed “SPD-compliant” scheme, This is more than Colliers or the Council had originally estimated, when assessing how much accommodation could be provided within the SPD. It is a clear indication that a variety of layouts and combinations of property types could be “SPD compliant”. Despite G L Hearn's rigid sense of the term (see point 3.1).
- 3.7: The ProVal appraisal produces a much smaller sale value for the affordable housing than the Welwyn model Three Dragons toolkit. The council's approved viability package is the Three Dragons, not ProVal. See detailed figures under 3.2 above. Both appraisals are assuming zero grant.
- 3.8: Following discussions with officers of the Borough Council, Colliers International received guidance that 80% of market rents was the correct input for the Three Dragons Appraisal. Either G L Hearn have been given different advice or they have misunderstood the advice they received.
- 3.9: The comments on the council's requirements are broadly consistent with what the council told Colliers. However, the G L Hearn scheme provides a far smaller percentage of houses, as opposed to flats, than Colliers and the Council's planning officers and housing department would expect – further evidence that an SPD-compliant scheme can take many forms, some more profitable and more viable than others.

The council and Colliers estimate that, in an SPD-compliant scheme, up to 44% of the units could be houses. In G L Hearn's scheme of 991 units, only 20% of the units are houses. This has a material effect on the profitability of the scheme. Using G L Hearn's figures for OMV, the houses sell at an average price of £259/ft² and the flats sell at an average price of £266/ft², a difference of £7/ft². However, the basic per-m² build cost of the houses is quoted by G L Hearn @ £1,195/m² (£111/ft²) and the basic per-m² build cost of the flats is quoted by G L Hearn @ £1,791/m² (£166/ft²), a difference of £55/ft².

Clearly, if one disregards the relatively minor and temporary marketing considerations mentioned by G L Hearn in respect of sales of houses, the houses are more profitable than the flats per ft². The schedule of accommodation chosen



by G L Hearn is therefore suffering, in terms of profitability, by comparison to the schedule of accommodation that Colliers agreed with the local planning authority.

A very rough calculation would suggest that an increase in houses from 20% to 44% of the residential floor area of the development ($690,818 \text{ ft}^2 \times 24\% = 165,796 \text{ ft}^2$) multiplied by the net difference in profitability ($\text{£}55/\text{ft}^2$ less $\text{£}7/\text{ft}^2 = \text{£}48/\text{ft}^2$) could increase the profitability of the development and thus the residual land value by $\text{£}7.958\text{m}$, say $\text{£}8\text{m}$.

We have gone into detail with this example to illustrate further the point that an "SPD-compliant" scheme is not an inflexible concept and that, with some value-engineering, dramatic differences in profitability can be achieved, all within the concept of an SPD-compliant scheme.

- 3.10: Although G L Hearn have sourced their OMVs from precisely the same information that Colliers used, nearly all of their valuations are lower than Colliers'. The one bedroom units and the houses are significantly lower. Nevertheless, their average OMV/ft² appears to come out higher. From the schedule, it doesn't appear that their unit floor areas are smaller. The reason for this is not clear. Note that their OMVs include car parking space sales receipts; Colliers' previous report accounted for these as extra receipts. For the purposes of this report, Colliers have accepted G L Hearn's OMVs.
- 3.12: G L Hearn have responded to estimated car parking costs that have been superseded in Colliers' subsequent work – we are now using the Welwyn Hatfield Three Dragons toolkit's automatically-inserted figures of $\text{£}15\text{k}/\text{space}$ for underground parking and $\text{£}5\text{k}/\text{space}$ for undercroft parking. The Three Dragons toolkit is the council's approved package. See detailed analysis of car parking costs in point 3.2 above.

Also see the extensive comments under 3.2 above re build costs.

- 3.13: G L Hearn have missed Colliers' point here, although Colliers' paragraph 5.20 could have been clearer. The reason the non-residential element is too expensive in G L Hearn's version is because it treats the build cost as if these structures are separate from the residential buildings. Colliers have proposed that the non-residential element should be provided as the ground floor of otherwise residential buildings, which would produce substantial build cost savings, especially in respect of shared roofs and foundations. Colliers' proposed build cost of $\text{£}646/\text{m}^2$ for non-residential elements of the development is reasonable if it is designed in this manner.

If one reduces the G L Hearn assumption that non-residential units will cost $\text{£}1,130/\text{m}^2$ to build to Colliers' marginal build cost of $\text{£}646/\text{m}^2$, then this one amendment increases the residual land value of G L Hearn's scheme in the Three Dragons appraisal by $\text{£}8.524\text{m}$.



3.14: We are unable to tie up the itemised schedule of costs in this paragraph with the totals in G L Hearn's Three Dragons appraisal printouts. Here are two schedules:

EXCEPTIONAL DEVELOPMENT COSTS AS PER G L HEARN REPORT		
Site clearance/preparation	250,000	
Demolition	1,018,000	
Disconnecting services	404,000	
Roadwork preparation	314,640	
Japanese knotweed removal	25,000	
Contingency	1,000,000	
Site demolition & remediation		3,011,640
Energy & recycling		3,964,000
Water treatment/pumping station	750,000	
Soft landscaping	400,000	
Street furniture/play areas	250,000	
Hard landscaping	2,770,000	
Prelims, OH&P	520,000	
Tender price inflation	-190,000	
Landscaping/Road/Site works		4,500,000
Heritage centre within silos	1,240,000	
Silo building structure	1,350,000	
Listed building works		2,590,000
S.278 works		3,225,000
S.106 costs		3,567,600
Bridge		1,440,720
Statutory authorities		4,240,000
TOTAL		26,538,960

EXCEPTIONAL DEVELOPMENT COSTS AS PER THREE DRAGONS APPRAISAL		
Energy, roads, site works, listed buildings, Statutory Authorities, S.278		19,959,720
Contingency, demolition, remediation		5,403,120
S.106 contributions		3,567,600
TOTAL		28,930,440



Where has the extra £2,391,480 come from? We cannot reconcile the two sets of figures.

Here are comments on the individual items in paragraph 3.14:

- All of the costs in "Site Demolition and Remediation" should be included in the Three Dragons overall build cost, except Japanese Knotweed removal and the £1m contingency. It is arguable that a contingency is inappropriate – there is no provision in the Three Dragons toolkit for a contingency. G L Hearn have shown all of these costs separately as "exceptional development costs" in their Three Dragons appraisal. There is nothing remotely "exceptional" about general site clearance, demolitions, disconnecting services and roadwork preparation - they are part of a *normal* building programme and should be included in the Three Dragons per-m² default costs, not added on to already-very-high per-m² figures, as G L Hearn have done.
- The Energy & Recycling costs figure has been greatly inflated since G L Hearn's earlier report. There is no justification for this; it is merely stated in the report, but its inclusion as an exceptional development cost is acceptable in principle. A proper justification of these costs is still required in due course.
- None of the Landscaping/Road/Site works costs totalling £4.5m are "exceptional" in any way, but they have all been shown as exceptional development costs on the Three Dragons appraisal. Any competent quantity surveyor could have anticipated all of these costs after a single visit to the site and after reading the SPD.
- The same principle applies to the listed building costs, to the S.278 costs and to the cost of Statutory Authorities. They are all foreseeable and not in any way exceptional. It was plain to any prospective buyer that the site contained listed buildings and that the local authority was keen to retain them. However, for the time being, we have retained the listed building costs in our own figures, pending further justification regarding why they should be considered as exceptional.
- G L Hearn have not calculated the planning contributions precisely, despite the ease of doing so using the matrix in the council's policy document. They have increased the costs to an estimated £3,600/unit. Colliers' calculation, which is based on the specific levels of contributions shown in the council's policy document, when applied to G L Hearn's 991 unit scheme, produces S.106 contributions of £1,940,683, plus contributions in respect of sustainable transport of £865,701 (it is not clear whether the sustainable transport costs are included in G L Hearn's schedules of exceptional development costs). Those figures correspond to £1,958/unit excluding the sustainable transport contribution and to £2,832/unit including it.



- G L Hearn have allowed £1.45m for the bridge improvement works. The council's instructions to Colliers were that these costs would be £0.5m and that they would take the form of a fixed contribution to the local authority, not open-ended costs incurred directly by the developer.

Colliers have asked for justifications of these figures and why they should be considered "exceptional". G L Hearn's report does not provide these justifications, merely additional detail and updated, usually steeply increased figures. A justification requires a statement regarding why each cost should be considered as an exceptional addition to the standard Three Dragons build costs and these statements have not been provided.

Here is a schedule of what Colliers consider to be allowable exceptional development costs. Despite doubts, we have retained the contingency and the listed buildings costs.

ADMISSIBLE DEVELOPMENT COSTS INCLUDED IN G L HEARN REPORT		
Site clearance/preparation	0	
Demolition	0	
Disconnecting services	0	
Roadwork preparation	0	
JK removal	25,000	
Contingency	1,000,000	
Site demolition & remediation		1,025,000
Energy & recycling		3,964,000
Water treatment/pumping station	0	
Soft landscaping	0	
Street furniture/play areas	0	
Hard landscaping	0	
Prelims, OH&P	0	
Tender price inflation	0	
Landscaping/Road/Site works		0
Heritage centre within silos	1,240,000	
Silo building structure	1,350,000	
Listed building works		2,590,000
S.278 works		0
S.106 costs		1,940,683
Bridge		500,000
Statutory authorities		0
TOTAL		10,019,683



- 3.15: In their Argus appraisal, G L Hearn have increased most of their marketing and sale costs from their already-very-high level, without actually justifying why these costs are so much higher than those shown in the council's approved viability package. However, they have used the Three Dragons figure in the toolkit itself.
- 3.20: G L Hearn have reduced the contingency percentage, but have applied it to a wider range of costs. There is no provision in the Three Dragons toolkit for a contingency.
- 3.21: We agree that 7% is a reasonable interest rate. It is the default rate shown in the Welwyn version of the Three Dragons toolkit, as G L Hearn would have known, had they used the right model.

SUMMARY AND CONCLUSIONS

There are major inconsistencies in the G L Hearn Three Dragons appraisal, as well as ample evidence of systematic selectiveness of individual assumptions and of choices of which appraisal system to use for which specific purpose, in order to arrive at the foregone conclusion that an SPD-compliant scheme cannot be viable. Every identifiable cost has been amplified to the greatest degree, valuations have been depressed, normal costs have been treated as "exceptional", a very high net-to-gross has been adopted for the flats (25%, as opposed to a more typical 15%), a more pessimistic version of an affordable housing appraisal has been substituted for the Three Dragons toolkit and the GLA toolkit has been used instead of the Welwyn version, leading to certain cost assumptions being higher than they would be in Welwyn.

The issue of the greatest magnitude is that of build costs. To try to cut through the fog of individual figures and look at the bottom line, we have prepared an overall summary of G L Hearn's build costs per m² and per unit for the entire development. This is based on the schedule of accommodation and the build cost per m² figures in their Three Dragons appraisal – summarising this is more straightforward than tackling the complexities of net-to-gross floor areas, different blocks, etc., in the summary of the Argus appraisal. Also, the Three Dragons toolkit is the council's approved viability assessment tool.



G L HEARN SCHEME - TOTAL BUILD COSTS PER M² AND PER UNIT		
BUILD COSTS PER M² INCLUDING PROFESSIONAL FEES		
Flats		1,791
Houses <=75m ²		1,195
Houses >75m ²		1,195
NET FLOOR AREA		
Flats		46,962
Houses <=75m ²		6,150
Houses >75m ²		11,065
TOTAL		64,177
BASIC BUILD COSTS		
Flats		84,108,942
Houses <=75m ²		7,349,250
Houses >75m ²		13,222,675
TOTAL		104,680,867
PROPOSED EXCEPTIONAL DEVELOPMENT COSTS		
Energy, roads, site works, listed buildings, Statutory Authorities, S.278		19,959,720
Contingency, demolition, remediation		5,403,120
TOTAL BUILD COSTS		130,043,707
NET LETTABLE RESIDENTIAL FLOOR AREA		64,177
TOTAL BUILD COSTS PER M²		2,026
TOTAL BUILD COSTS PER UNIT		
Flats		131,596
Houses <=75m ²		111,340
Houses >75m ²		142,838
TOTAL		131,225

This site is not a tightly-constrained, small-scale piece of urban land, fraught with the kind of technical problems typical of difficult inner city locations. It is a suburban, large-scale, highly-accessible and largely cleared site situated immediately adjacent to a main line railway. A development of nearly 1,000 residential units should benefit from significant economies of scale: through procurement of materials in bulk and at the opportune time, through management of labour and through standardisation of unit types and layouts.

There are no signs in G L Hearn's cost estimates that any of these advantages have been taken into account. Quite the contrary: a total build cost of more than £2,000/m² and more than £130,000/unit would be exceptionally high even for a small, difficult urban site – and it is more typical of luxury housing, not a high volume regeneration scheme including 30% affordable housing. A large scale house-builder, looking at this site, would expect to produce this type of housing at a build cost of £1,300/m², including all normal costs such as site preparation works, demolition, prelims, statutory authorities, S.278 works and landscaping.



After setting up a direct emulation of the G L Hearn Three Dragons appraisal on the Welwyn Hatfield model, we have prepared a second Three Dragons appraisal (see Appendix II), also using the Welwyn Hatfield model: we have taken G L Hearn's proposed SPD-compliant schedule of accommodation on its own merits, but we have adopted the Three Dragons standard assumptions and have retained only those of the "exceptional" development costs that Colliers consider to be genuinely exceptional. This appraisal shows a residual land value of £36,746,051, a figure intended to represent the opposite extreme to that proposed by G L Hearn, although it is based on exactly the same development.

Our Three Dragons appraisal shows a gross build cost that works out at £97.626m (including professional fees), which corresponds to £1,521/m² (G L Hearn = £2,026/m²) and £98,513/unit (G L Hearn = £131,225/unit).

Finally, here is a schedule that lists all of the significant adjustments that we have made to G L Hearn's figures, as described above. In our Three Dragons appraisal, we have not altered the schedule of accommodation, so the potential improvement in profitability arising from increasing the percentage of houses from 20% to 44% of the units is listed separately.

The intention is not to claim that every single one of these improvements can actually be made, pound-for-pound, at the listed figures. However, the total of £44m of potential improvements that we have identified utterly dwarfs the negative valuation being proposed by G L Hearn. The revised figures show that it is, after all, possible to design a development that complies with the SPD and is financially viable. It just requires a positive approach.

ADJUSTMENTS TO G L HEARN THREE DRAGONS APPRAISAL COSTS/RECEIPTS		
Internal overheads		737,000
Developer's return		2,562,000
Car parking		91,500
Sale of affordable housing units (increased receipt)		5,206,000
Reduction in build cost of non-residential development		8,524,000
Reduction in exceptional development costs		18,923,757
SUBTOTAL		36,044,257
Improved profitability by increasing houses from 20% to 44% of units		7,958,000
TOTAL		44,002,257

Yours faithfully



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