

Financial Viability Review

Riverdale House/Mill House
68 Molesworth Street
London
SE13 7EY

Report Prepared for:

London Borough of Lewisham

November 2015



Private & Confidential

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Smith
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Lambert Smith Hampton Financial Viability Review

Prepared on behalf of the London Borough of Lewisham for the proposed redevelopment of:

Riverdale House/Mill House
68 Molesworth Street
London
SE13 7EY

Written by and on behalf of Lambert Smith Hampton:

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1 Introduction & Background

Purpose of Report

- 1.1 Lambert Smith Hampton (“LSH”) are instructed by the London Borough of Lewisham (“LBL”) to review a site specific Financial Viability Assessment (“FVA”) for the proposed roof extension to Riverdale House and the conversion of the Mill House to provide 25 residential units comprising a mix of 1,2 and 3 bedroom flats and duplex apartments.
- 1.2 We have been provided with information regarding a draft pre-application and we understand that a full planning application has now been submitted.
- 1.3 We are aware that Riverdale House currently benefits from prior approval for the change of use from office (Class B1) to residential (Class C3) and work is currently underway to provide a total of 137 units.
- 1.4 Financial viability is an important material consideration in the consideration of planning applications. The cumulative impact of planning policy obligations should not be such to make proposals incapable of being delivered.

“To ensure viability, the costs of any requirements likely to be applied to development, such as requirements for affordable housing, standards, infrastructure contributions or other requirements should, when taking account of the normal cost of development and mitigation, provide competitive returns to a willing land owner and willing developer to enable the development to be deliverable.”¹

- 1.5 The purpose of this report is to undertake a due diligence review for the proposed development in line with the RICS Financial Viability in Planning Guidance Note (FVIP 94/2012) in order to ascertain;
 - i. Whether it would be viable for a policy compliant scheme to be delivered;
 - ii. If a policy compliant scheme is not viable, advice on the maximum achievable quantum of on site affordable housing which it would be viable to provide;

¹ Paragraph 173, National Planning Policy Framework, DCLG. (2012).

- iii. In the event that a payment in lieu is the only practical or viable option, to assess the maximum achievable payment that can be made.

Planning Policy Context

- 1.6 Core Strategy Policy 1 outlines the Council's approach to the provision of affordable housing, and the policy can be considered in line with the recently published Planning Practice Guidance, which states;

"...viability can be important where planning obligations or other costs are being introduced. In these cases decisions must be underpinned by an understanding of viability, ensuring realistic decisions are made to support development and promote economic growth."²

- 1.7 LBL's Core Strategy Policy 1 states that;

"...The Council will seek the maximum provision of affordable housing with a strategic target of for 50% affordable from all sources. Contributions to affordable will be sought on sites capable of providing 10 or more dwellings. The starting point for negotiations will be a contribution of 50% affordable housing on qualifying sites across the borough."³

- 1.8 The proposed scheme results in the construction of 25 residential dwellings and on the basis of the Council's Core Strategy Policy June 2011, this is understood to generate a requirement of approximately 12 on site affordable housing units. The current proposals make provision for 3 intermediate units or 2 social rented units on-site, meaning there is a shortfall in affordable housing provision.

Confidentiality

- 1.9 Due to the commercially sensitive nature of some of the information contained herein, this report is provided on a strictly private and confidential basis as publication of the document may serve to prejudice the Applicant in any commercial negotiations. The report must not be

² Paragraph 001, Viability – A General Overview, Planning Practice Guidance, DCLG. (2014).

³ Page 82, Lewisham local development framework, Core Strategy. (Adopted June 2011).

recited or referred to in any document, or copied or made available (in whole or in part) to any other person without express prior written consent.

- 1.10 The advice provided herein must only be regarded as an indication of potential value, on the basis that all assumptions are satisfied. The advice does not and cannot be considered to represent a formal valuation in accordance with the Royal Institution of Chartered Surveyors (RICS) Valuation-Professional Standards 2014 (“the Red Book”) and should not be regarded as such.

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2 Methodology

Financial Viability in Planning

- 2.1 The RICS published a first edition guidance note FVIP in August 2012 which identifies best practice for the assessment of area wide and site specific viability as part of the planning process. DCLG have prepared further viability guidance for the National Planning Policy Framework (“NPPF”), which follows this approach.

“Financial viability has become an increasingly important material consideration in the planning system. While the fundamental purpose of good planning extends well beyond financial viability, the capacity to deliver essential development and associated infrastructure is inextricably linked to the delivery of land and viable development.”⁴

- 2.2 The NPPF emphasises both the delivery of planning obligations and scheme deliverability via the provision of competitive returns to both willing landowners and developers to enable sustainable development to come forward.

Financial Viability Assessments

- 2.3 A FVA allows for a robust testing of the ability of a development project to meet its costs, including the cost of planning obligations, while ensuring an appropriate Site Value (“SV”) for the landowner and a market risk-adjusted return to the developer in delivering that project. FVAs should be sufficiently detailed with evidence supporting the key inputs into the study.
- 2.4 Instances may arise where the project programme of a proposed scheme is such that the costs and values associated with that scheme may span the usually anticipated development cycle, and so may warrant the inclusion of projected cost and value assumptions, with an associated assessment of an appropriate land-owner/developer return on this basis.
- 2.5 When assessing a suitable benchmark SV there are two usual approaches to the valuation of development land;
- Comparison with the sale price of land for comparable development; and

⁴ p.2 RICS Financial Viability in Planning (94/2012).

- Assessment of the value of a proposed scheme as completed and deduction of the costs of development (including developer's profit) to arrive at the underlying Residual Land Value ("RLV").

2.6 In practice both valuation methods may be employed, with the comparable method providing a sense-check against current market conditions and sentiment. The degree to which either, or both, is relevant depends upon the nature of the development being considered and the complexity of the site specific issues at hand.

2.7 Established approaches to the valuation of property and development assets, specifically in a financial viability context, are grounded in numerous pieces of RICS guidance. LSH have had regard to the concepts and standards outlined in these documents in formulating our opinion of site specific financial viability.

- RICS Valuation – Professional Standards (2014)
- RICS Guidance Note – Financial Viability in Planning (2012)
- RICS Information Paper – Comparable Evidence in Property Valuation (2012)
- RICS Guidance Note – Valuation of Land for Affordable Housing (2010)
- RICS Valuation Information Paper 12 - Valuation of Development Land (2008)

2.8 For the purposes of this assessment LSH have tested the scheme viability using Argus Developer which is widely regarded as the industry standard software for property development feasibility studies and facilitates any level of development analysis.

Viability Testing

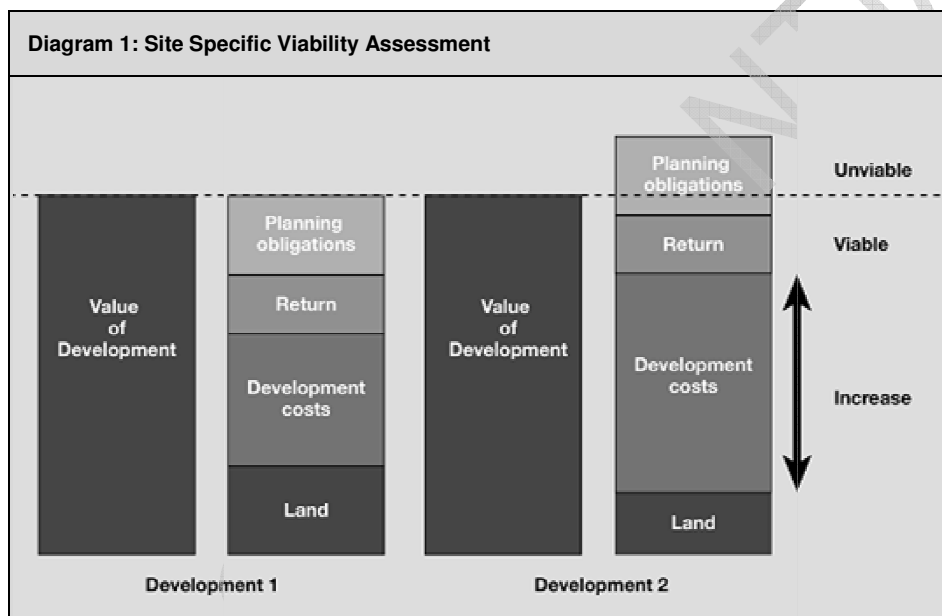
2.9 There are two approaches that can be used to assess the site specific viability of a development proposal;

- Site Value approach (including an allowance for developer's return as a cost of development);
- Developer's Return approach (where site value is a cost of development).

2.10 In adopting the SV approach the RLV of the proposed scheme, assuming a market level of developer return as a cost of development, is compared to an appropriate SV. The Developer's Return approach adopts a fixed land value and compares a Residual Profit to an

appropriate hurdle profit rate. LSH have adopted the Site Value approach for the purposes of this assessment, in the line with the methodology adopted by the Applicant.

2.11 If the proposed scheme RLV is greater than that of the SV, the scheme is considered viable at that level of planning obligations, generating a financial surplus. If the RLV of the proposal is less than the SV the scheme is not viable. The development economics of the scenarios in the below diagram illustrates how the extent of planning obligations or other requirements can render a scheme unviable when compared to an appropriate SV benchmark.



Source: RICS Financial Viability in Planning GN 94/2012

2.12 In looking at diagram 1 above, the development economics of “Development 1” are such that policy can be met in delivering all planning obligations while meeting a Site Value for the land, all other development costs and a market risk adjusted return for the development. With “Development 2” the cumulative impact of policy requirements, development costs and a market risk adjusted return are such that a viability assessment is required to establish what could viably deliver the development while meeting the viability definition.

3 Proposed Scheme

Site Description

- 3.1 The broadly rectangular site occupies a prominent position fronting Molesworth Street within close proximity to Lewisham Shopping Centre and the Ravensbourne River. The subject site ("the Site") currently comprises two vacant office buildings in the form of Riverdale House extending to approximately 16,673ft² GIA and the Mill House extending to approximately 8,498ft² GIA. We understand that the Mill House is considered to be an undesignated heritage asset.
- 3.2 Riverdale House comprises an office building arranged over 5 floors and was constructed in the 1980's. The property is currently vacant and benefits from prior approval for the change of use from office (Use Class B1) to residential (Use Class C3) to provide a total of 137 units. Construction work is underway to convert the building.
- 3.3 The Mill House comprises a brick built building arranged over ground, first, second and third floors and was constructed in the 1800's. The building is mainly used as office accommodation together with kitchen and WC facilities and it's current existing lawful use is A3.
- 3.4 Transport links are excellent with Lewisham DLR and Lewisham mainline rail station a little under a 10 minute walk away (offering access to Stratford, Bank, London Cannon Street and London Bridge). The site has a PTAL rating of 6b.
- 3.5 The immediate area is characterised by a wide range of different commercial land uses to include office and retail accommodation. To the north of the Site there are various new build residential schemes along and around Loampit Vale, recently completed or under construction. Lewisham Shopping Centre is located directly opposite the Site.
- 3.6 The Site is understood to benefit from a level topography and is broadly rectangular in shape. It measures approximately 0.22 acres (0.54 hectares) and vehicular access is currently offered from Molesworth Street, a publicly adopted highway.
- 3.7 This assessment assumes that the freehold interest in the Site is held, and it is free from any onerous easements or restrictions.

Development Proposal

3.8 The Applicant proposes the following development to take place;

“Development of the roof space of Riverdale House and the conversion of the Mill House to provide a total of 25 residential apartments.”

3.9 In terms of design the residential units proposed at Riverdale House will be arranged as penthouse apartments over part fourth, fifth, sixth and seventh floors with each benefitting from outside space and associated views.

3.10 The proposed redevelopment the Mill House includes the conversion of the existing building to comprise a mix 1, 2 and 3 bedroom flats and duplex apartments arranged over ground, first, second, third and fourth floors. The units will benefit from differing levels outdoor amenity space.

Accommodation

3.11 We have been provided with a schedule of areas by Alan Camp Architects and summarise these in tables 1 and 2 overleaf:

Table 1: Riverdale Accommodation Schedule			
Apartment	No. Bedrooms	Floor	Size (ft² NSA)
1	2	Fourth	926
2	2	Fourth	883
3	1	Fifth	538
4	1	Fifth	538
5	1	Fifth	538
6	1	Fifth	543
7	1	Sixth	621
8	1	Sixth	582
9	1	Sixth	538
10	1	Sixth	759
11	2	Sixth	658
12	1	Sixth	545
13	1	Sixth	559
14	1	Sixth	801
15	1	Seventh	556
16	1	Seventh	577

17	2	Seventh	731
		Total	10,892

Table 2: Mill House Accommodation Schedule					
Apartment	No. Bedrooms	Floor	Type	Size (ft² NSA)	Outside Space
1	3	Ground	Lateral	797	Patio
2	3	Ground/First	Duplex	958	Garden
3	3	Ground/First	Duplex	958	Garden/Terrace
4	3	First	Lateral	947	Terrace
5	1	Second	Lateral	538	Terrace
6	2	Second	Lateral	1,076	Terrace
7	2	Third/Fourth	Duplex	850	N/A
8	2	Third/Fourth	Duplex	840	Terrace
Total				6,964	

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4 Market Information Summary

Gross Development Value

- 4.1 A scheme Gross Development Value (“GDV”) has been assessed through reference to private residential sales values, capitalised ground rent income and estimated capital receipts for affordable housing units.

Private Residential Values

- 4.2 The private residential units have been individually priced, primarily with reference to the new build apartments currently on the market from across the Lewisham Gateway development.
- 4.3 LSH are aware of a number of new build schemes within the area reflecting the following prices and unit sizes;

	Net Sales Area Range	Unit Price Range	£/ft² Range
1 Bedrooms	492 ft ² - 532 ft ²	£303,000 – £328,000	£570/ft ² - £661/ft ²
2 Bedrooms	618 ft ² - 694 ft ²	£355,000 – £405,000	£517/ft ² - £601/ft ²

- 4.4 A number of second hand units are currently on the market within the SE13 postcode and have also been considered with regards to the Mill House. A single 1 bedroom asking price is quoted, 6 x 2 bedroom prices, and a single 3 bedroom duplex unit. The asking prices reflect the following;

	Net Sales Area Range	Unit Price Range	£/ft² Range
1 Bedrooms	488 ft ²	£320,000	£655/ft ²
2 Bedrooms	645 ft ² - 1144 ft ²	£325,000 – £399,000	£284/ft ² - £616/ft ²
3 Bedrooms	877 ft ²	£399,950	£456/ft ²

- 4.5 LSH have been provided with a sales schedule by Galliard Homes for existing apartments within Riverdale House which indicated that as at January 2015 last year approximately 75% of the apartments being sold off plan. It would appear that all units have now sold and LSH have therefore reflected an off plan sales rate of 100%.

Car Parking

- 4.6 LSH have assumed that any unallocated car parking will be offered with the new units.

Ground Rents

- 4.7 A ground rent income equivalent to for the 1 bedroom flats, for the 2 bedroom flats and for the 3 bedroom flats has been assumed, capitalised at a net all risks yield of with subsequent purchaser's costs deducted. The income is assumed as receivable at the end of the sales period following disposal of all the residential units.
- 4.8 For the purposes of this review LSH have adopted the same ground rent assumptions.

Affordable Housing Revenue

- 4.9 We understand that the Council's position on tenure split is 70% affordable rent (at 60% of open market rent) and 30% intermediate and would request that the Applicant reflects this within their FVA so that these assumptions can be accurately valued and modelled.
- 4.10 LBL have confirmed that a rate of £125/ft² for the affordable rented units and £264/ft² for the intermediate units are acceptable. LSH have therefore reflected these values within our assessment.

Construction Costs & Project Programme

- 4.11 LSH have been provided an elemental cost plan in relation to the proposed development of Riverdale House and conversion of The Mill House and have assessed the base build cost including demolition, external works and contingency at £3.920 and £1.505m respectively.

- 4.12 We have referred the scheme to our in-house Cost and Project Management team who have commented upon the assumptions and scheme within a separate report.
- 4.13 LSH have been advised by LBL that the proposed development will be of standard construction and not pre-fabricated.
- 4.14 A project programme reflecting an 8 month lead-in period and month 12 construction period has been assumed, with no justification set out for these assumptions. LSH have adopted a 3 lead-in period.
- 4.15 For the purposes of our report LSH have adopted the build base rate contained within the RLB cost schedule and present our conclusions against a sensitivity analysis reflecting increased and reduced construction costs.

Planning Obligations

- 4.16 Further to discussions with LBL we are aware also that the following planning obligations will apply;
- Employment and training £20,000
 - Town Centre Management £3,648
 - Public Realm £25,000

- 4.17 LSH have therefore reflected the above obligations within our appraisal.

Other Assumptions

4.18 Various other market based assumptions inform the financial model that in turn informs the RLV of the proposed scheme, and a summary of the main appraisal inputs is set out in the following table;

Input	LSH Assumption
Residential Agent Fees	1.5% of GDV
Marketing Fees	1.75% of GDV
Professional Fees	12%
Finance Rate	7% blended rate
Profit	20% on Cost
Legal Fees	£500/unit

5 Site Value

Definition

- 5.1 The definition of SV, sometimes referred to as the Benchmark Land Value (“BLV”), is stated in the RICS FVIP guidance note, where;

“Site value should equate to 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”.⁵

- 5.2 To more fully understand the above definition it is necessary to define Market Value (“MV”), which can be found in the RICS “Red Book” as;

“The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion”.⁶

Valuation Parameters

- 5.3 To determine the SV for a development asset there are a number of considerations and different bases of value that form the parameters within which a reasoned assessment of MV can be made;

- Existing Use Value (“EUV”) / Current Use Value (“CUV”);
- Alternative Use Value (“AUV”);
- Purchase Price.

- 5.4 EUV and CUV have come to be used interchangeably, although subtle differences exist between the two bases of value. The over-riding assumption with both is that the asset is valued in its current or existing planning use-class, and possible more valuable alternative uses are not reflected.

- 5.5 The RICS Red Book comments on the relationship between AUV and MV, stating;

⁵ Page 17, RICS Financial Viability in Planning (94/2012)

⁶ Page 53, RICS Valuation – Professional Standards (2014)

“Where it is clear that a purchaser in the market would acquire the property for an alternative use of the land because that use can be readily identified as generating a higher value than the current use and is both commercially and legally feasible, the value for this alternative use would be the market value...”⁷

- 5.6 In establishing the MV of an asset it is therefore necessary to understand the EUV/CUV of the asset in conjunction with possible alternative uses, which will be adjusted for risk. Where development potential can be realised, i.e. is considered both commercially and legally feasible, the MV will include an element of hope value over and above the EUV/CUV.
- 5.7 The site purchase price should, when the conditions of the sale can be considered to accord with the definition of MV, and the level of consideration can be supported with other comparable market transactions, reflect a deliverable scheme from a planning perspective whilst maintaining a reasonable anticipation of return for a developer.

Adopted Site Value

- 5.8 LSH have adopted a SV equating to £0.580 within our FVA.

Existing Use Value

- 5.9 To substantiate the EUV the property has been assessed on an investment basis with reference to 5 comparable lease transactions that in turn inform an estimate of an achievable Market Rent (“MR”).
- 5.10 A rent of has been applied to the existing Mill House Net Internal Area (“NIA”) of 6,308ft², which has then in turn been capitalised at into perpetuity with purchaser’s costs deducted. No evidence has been supplied in support of the adopted yield assumption.
- 5.11 It has been established that the existing lawful use of the Mill House is A3 and the Applicant has stated that this does not reduce their opinion of value and believe that this results an increase of the SVB. This is on the basis that an A3 use class (whereupon changes to A1 or A2 would be permitted) would command a premium over B1 use.

⁷ Page 141, RICS Valuation - Professional Standards (2014)

5.12 LSH have been provided with additional comparable transactions as follows;

- **191-193 Lewisham High St, SE13;** A 1,512 ft² A2 retail unit was let in December 2014 at a passing rent of per annum equating to. This comparable is situated within a superior location and benefits from a high level of footfall;
- **75 Springbank, SE13;** A 1,200 ft² retail unit was let in December 2014 at a passing rent of per annum equating to. This comparable is situated within a superior location and forms part of parade of retail units approximately 0.2 miles south of Hither Green mainline station.

5.13 LSH would consider the Mill House to be located within tertiary location given the lack of frontage, footfall and occupiers within the immediate area. We are of the opinion that there would be very limited demand from retail occupiers for the property as a whole given the position adjacent to a dual carriage way.

5.14 LSH have not been provided with a valuation for the Mill House on the basis of the existing lawful use with appropriate voids or rent free incentives and would request that this is provided and more fully commented upon.

5.15 A refurbishment cost of £10/ft² has been assumed, with no void period or letting incentives accounted for.

5.16 The Applicant has applied a value to the roof space at Riverdale House based on the installation of a telecommunication mast. Further to discussions with LBL we are advised that Council records do not reveal any consent for the installation of telecommunication devices and no devices are currently present on the roof of Riverdale House.

5.17 Furthermore, written consent from Council for the installation of a mast would be required under Part 16 Condition A(i) subparagraph (2) of The Town and Country Planning (General Permitted Development) (England) Order 2015. While a definitive assessment of a potential proposal against the GDPO cannot be carried out without details of a proposed scheme, it is clear that an application for Prior Approval under Condition A.3 would be required to be submitted to Council. As part of the Prior Approval process the Council are required to assess the position and design of a telecommunication device.

5.18 In accordance with the above we have not reflected any value attributed to the telecommunication mast within our appraisal.

Alternative Use Value

5.19 An AUV of the Site has been assessed with reference to comparable transactions that reflect residential redevelopment opportunities. A total of 8 comparable transactions have been supplied in support of the Applicant's SV. The comparables are located across SE4, SE13, SE1, SE14, SE8, and SE23.

5.20 The Mill House is currently a vacant building allocated for A3 use and the Applicant has approached assessing a possible AUV by comparing other comparable residential land transactions reflecting differing land uses including a care home, former pub, MOT centre and a mews workshop which benefits from prior approval and existing income. These indicate a range of asking prices between and summarised as follows:

- **2 Church Rise, SE23;** A Victorian Villa which has been converted to 12 bed care home extending to approximately 4,100 sq ft with proposals for 5 x 2 bedroom flats, 1 x 3 bedroom flat and 2 x 1 bedroom flats.
- **209-210 Grange Road, SE1;** A former pub extending to approximately 3,812 sq ft with B1 (office) on the ground and first and C3 (residential) on the second and third floor. The property previously benefitted from planning permission for the conversion of the first floor office to a one bedroom apartment however was not implemented.
- **1 Creekside, SE8;** An M.O.T centre extending to approximately 8,000 sq ft available with vacant possession and situated within a predominately residential location.
- **Hatcham Mews, Hatcham Park Road, SE14;** A mews workshop subject to 3 leases outside the 1954 L&T Act and benefits from prior approval.
- **62 Campshill Road, SE13;** A former pub comprising a mix of retail over ground and basement and residential accommodation on the upper floors. The property extends to approximately 4,700 sq ft.
- **10-14 Mercy Terrace, SE13;** A vacant industrial unit extending to approximately 13,700 sq ft. The property is situated within a predominately residential location and was sold for redevelopment potential.

- **1-5 Ashy Road, SE4;** A vacant office building arranged over ground and first floor extending to approximately 5,600 sq ft was purchased in 2013 for redevelopment purposes.
- **289 Lewisham Way, SE4;** A former church building arranged over 4 floors extending to approximately 8,210 sq ft on a site of 0.28 acres. The property was purchased in 2013 for redevelopment purposes.

5.21 The sale of Hatcham Mews, SE14 has been highlighted as the lead comparable and comprises two let workshops extending to approximately 13,199 sq ft and benefits from prior approval for the conversion to 3 x 3 bedroom houses, 1 x 4 bedroom houses, 2 x 2 bedroom flats on a site of approximately 0.42 acres. The property is situated within a far superior residential location within the Hatcham Park Conservation Area.

6 Results & Viability Conclusions

Outputs & Results

6.1 The proposed 100% market unit scheme has been modelled by LSH due to the uncertainties surrounding the valuation assumptions underpinning the affordable units. Revisions have been made to the Applicant's assumptions where evidence has not been supplied in support of major appraisal assumptions;

- Sales rate altered to reflect increased off plan sales;
- all-in finance rate adopted;
- Project programme reduced;
- Residential agency and legal fees reduced.

Scheme Viability

6.2 In summary, LSH have reviewed the proposed scheme inputs and benchmark Site Value provided by the Applicant, checking the assumptions and evidence base that underpins the FVA.

6.3 Based on the planning obligations contained within this report we are of the opinion that the proposed development could support approximately 16% affordable housing in the form of 3 affordable rented units and 1 intermediate unit. The surplus generated equates to approximately £490,352 and LSH have assessed the value of the affordable accommodation in accordance with values acceptable to the LBL stated previously.

Appendix 1

Construction Cost Review

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Appendix 2

Development Appraisal

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