Appx I Overview and Scrutiny Commission 19th October 2021

MERTON ESTATES REGENERATION PROGRAMME

07 OCTOBER 2021

savills

Executive Summary

savills

- Residential sales market
  - Growth since April 2020 of between 1% and 3%

- Build to Rent investment market
  - Rental growth since April 2020 of between (3.8%) and 0%

- Construction costs
  - Cost inflation since April 2020 of between 3% and 5%

Purpose

savills

- High-level review of revenue and cost factors driving the viability performance of the Merton Estate Regeneration Programme (MERP), comparing assumptions prepared for April 2020 Financial Viability Assessment (FVA) with current day position.

- Three key areas are considered:
  - ➢ Residential sales market; movement from April 2020
  - ➢ Build to Rent investment market; movement from April 2020
  - ➢ Construction costs; movement from April 2020

FVA – April 2020 – Income Assumptions – High Path

savills

Private Sales Values

Unit type	Avg size - sqm	Avg size - sqft	Avg Market Value	£psf MV
1-bed 1-person flat	37	394	£335,000	£851
1-bed 2-person flat	49	532	£435,000	£817
2-bed 3-person flat	62	671	£525,000	£783
2-bed 4-person flat	69	745	£575,000	£772
3-bed 4-person flat	73	788	£585,000	£743
3-bed 5-person flat	85	915	£625,000	£683
3-bed 5-person maisonette	92	990	£650,000	£657
3-bed 5-person house	101	1086	£720,000	£663
4-bed 7-person flat	107	1150	£750,000	£652
4-bed 8-person house	116	1245	£785,000	£630

Private Rental Values

Unit type	Avg Rental Value (£pcm)	Avg Rental Value (£psf)
Studio	£1,300	£39
1-bed flat	£1,500	£33
2-bed flat	£1,875	£32
Average	£1,638	£33

- Sales values applied in the appraisal model reflecting a blended £777 psf across the entire Estate, driven by the proposed mix and size of private dwellings.
- Values vary between phases to reflect the specific development mix coming forward.
- Build to Rent values based upon Market Rents subject to research in Q1 2020. Our investment valuation reflected additional advice provided by Savills' Operational Capital Markets team, who are experienced in transacting large-scale Build to Rent developments.

FVA – April 2020 – Income Assumptions – Ravensbury / Eastfields

savills

Ravensbury

Unit type	Avg size - sqm	Avg size - sqft	Avg Market Value	£psf MV
1-bed 1-person flat	37	398	£245,000	£616
1-bed 2-person flat	50	538	£310,000	£576
2-bed 3-person flat	64	689	£385,000	£559
2-bed 4-person flat	73	786	£415,000	£528
3-bed 4-person flat	77	829	£435,000	£525
3-bed 5-person flat	89	958	£445,000	£465
3-bed 5-person house	102	1098	£485,000	£442
4-bed 8-person house	115	1238	£515,000	£416

Eastfields

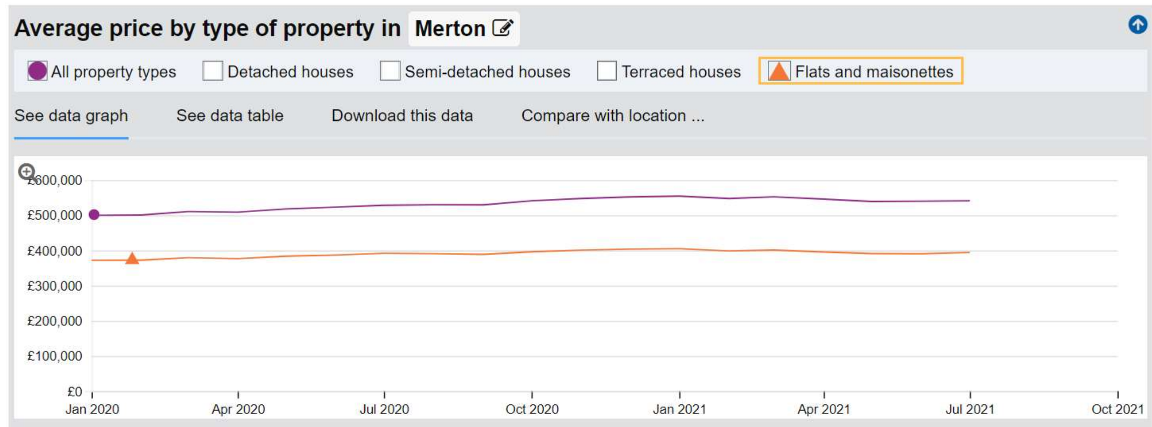
Unit type	Avg size - sqm	Avg size - sqft	Avg Market Value	£psf MV
1-bed 2-person flat	50	538	£260,000	£483
2-bed 4-person flat	73	786	£350,000	£445
2-bed 4-person maisonette	82	883	£390,000	£442
3-bed 5-person flat	89	958	£420,000	£438
3-bed 5-person maisonette	96	1033	£430,000	£416

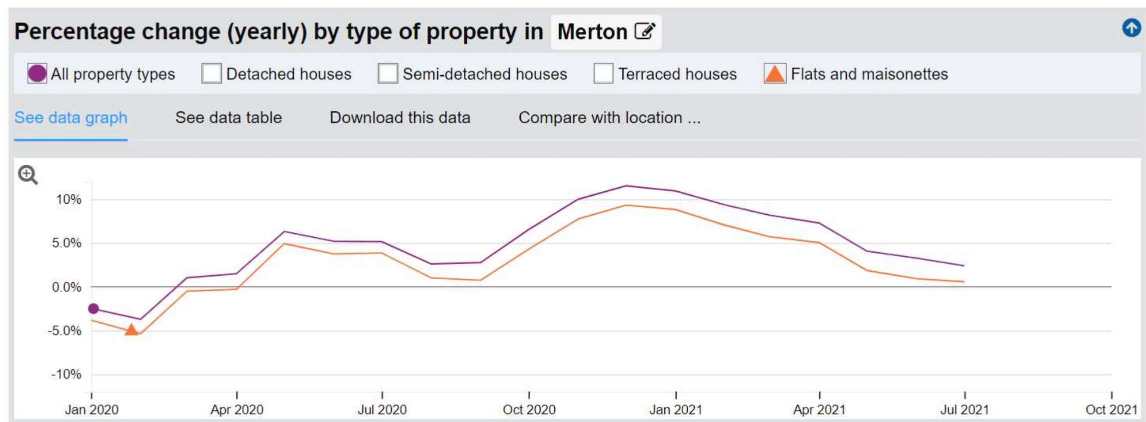
- Sales values considerably lower across Ravensbury & Eastfields estates compared to High Path estate.
- Blended values of £500 psf applied across private residential tenures (slightly in excess of the findings of property market research into local sales undertaken at the time).

Private Sales Market – Market Trends (Jan 2020 – Jul 2021)

savills

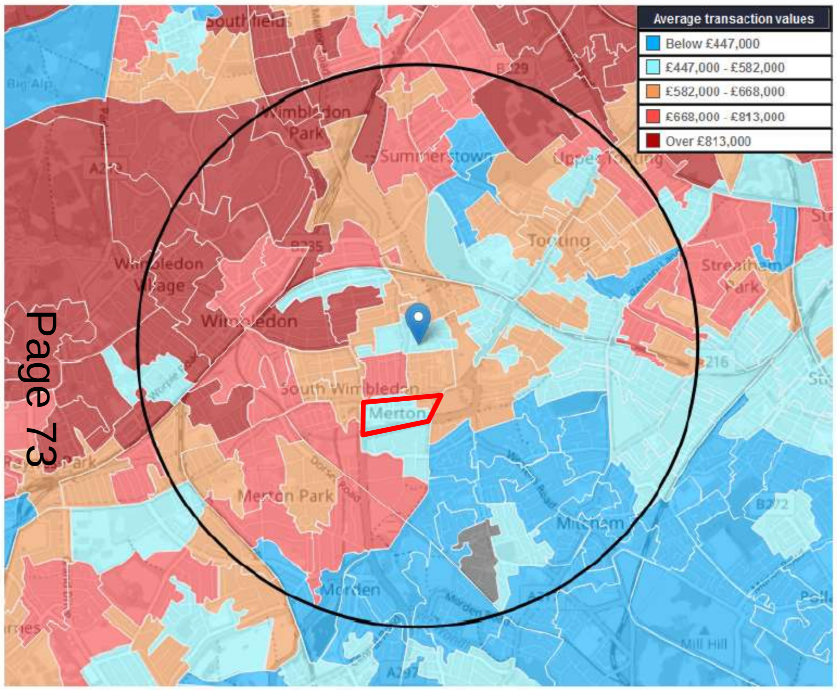
- Land Registry House Price Index suggests modest improvement in average sales values over the last 18 months in Merton's mainstream market, with average values increasing by 6% (to £540k) across all property types / 4% (to £394k) for flatted unit sales since Q1 2020 (i.e. value of flats has grown at a slower rate than property prices generally in Merton).
- Value growth fuelled by SDLT holiday (now closed) which underpinned a strong return for sales rates following the first Covid-19 lockdown in Q2 2020. Year-on-year growth in values peaked in December 2020 (11.5%) since returning to far more sustainable levels as per July 2021 (3.0%).
- It is vital to distinguish between trends in the mainstream resale market and the new build market. Implicitly the latter already reflects a form of value premium which restricts further upwards movement compared to resale properties.





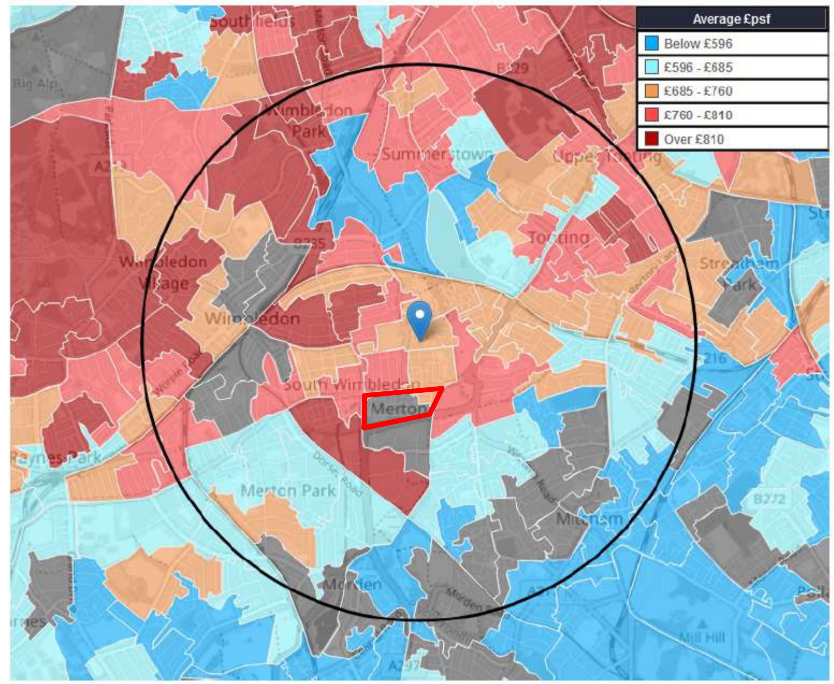
Private Sales Market – Value Heat Maps (High Path)

Average house prices within 1.5 miles of SW19 1DS, 12 months to July 2021



Source: HM Land Registry

Average £psf within 1.5 miles of SW19 1DS, 12 months to July 2021



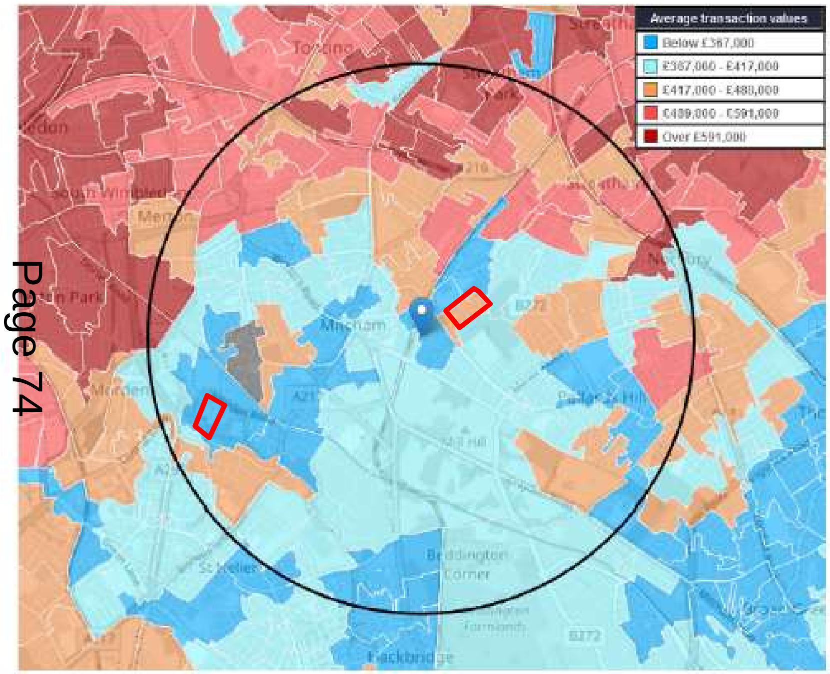
Source: Savills Research. HM Land Registry. EPC

- High Path estate located on fringe of higher values within the borough, moving towards north / west (£700+ psf) in the past 12 months.

Private Sales Market – Value Heat Maps (Ravensbury / Eastfields)

savills

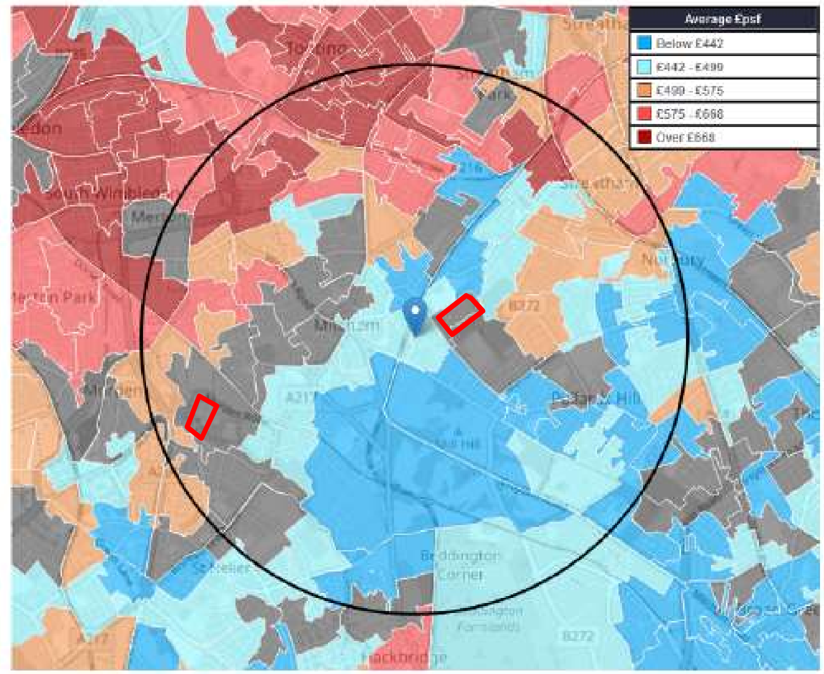
Average house prices within 1.5 miles of CR4 1SJ, 12 months to July 2021



Source: HM Land Registry

Page 74

Average £psf within 1.5 miles of CR4 1SJ, 12 months to July 2021



Source: Savills Research, HM Land Registry, EPC

- Ravensbury (shown to the west, above) and Eastfields (shown to the east) estates located in lower value areas within the borough.
- Surrounding areas demonstrating lower capital values / £psf values, sub-£500 psf in the past 12 months.

Private Sales Market – Conclusions

savills

- General market trends across all property types support some upwards movement on sales values in Merton cross period since Q1 2020. Value growth fuelled by Stamp Duty Land Tax (SDLT) holiday (now closed) with year-on-year growth in values as per July 2021 at 3.0% (latest available data).

- Recorded sales evidence in last 12 months presented through heat maps suggests £psf values will be broadly aligned with the previous FVA, but scope for some upwards movement. Always important to consider the location, specification and size of comparable sales evidence in relation to the subject site.

- It is vital to distinguish between trends in the mainstream resale market and the new build market, and between different types of housing. For example, we have seen the value of larger family homes in Merton increase at a faster rate than for flats. A blanket approach to value uplift cannot be applied to all residential development.

- Reflecting market trends and local market evidence, a modest uplift in sales values would be supported. The specific scale of adjustment remains subject to further more detailed assessment but likely to be similar to that reported by Land Registry over the same period.

Build to Rent Market

savills

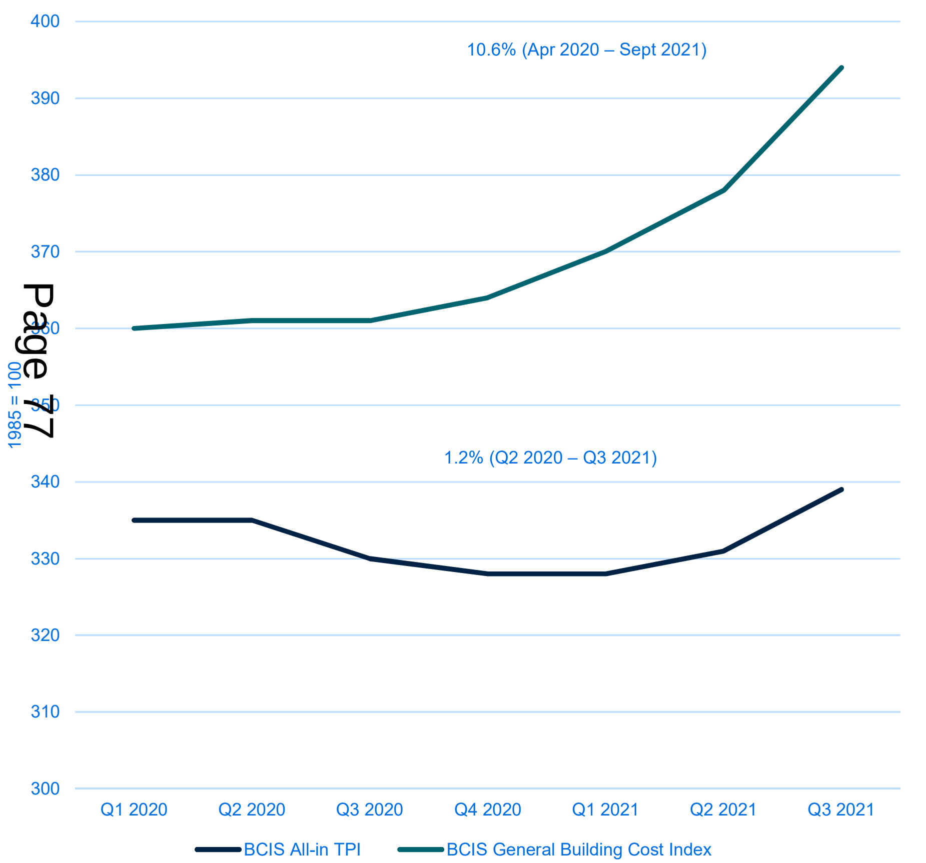
- Previous Market Rent assumptions considered appropriate for current day assessment. Hometrack recently reported an annual 3.8% reduction in rents across London for the year up to August 2021 (in contrast to 5.0% increase in rents across the UK excluding London). Positive growth is expected Q4 2021 into 2022. On balance we would retain the previous Market Rent assumptions adopted.

- Savills' Capital Markets team advises previously used investment metrics remain appropriate – 3.75%-4.0% Net Initial Yield / 20% discount from Market Value subject to Vacant Possession. Valuation should be maintained around £600-£620 psf (£609 psf in April 2020 FVA) assuming forward-fund disposal model (i.e. deal based upon investor cashflowing the construction of the units).

- Recent investment transactions provided below:

Date	Asset Name	Location	Transaction Type	Price	Yield	Units	Net £psf	Vendor	Purchaser	Agent
May-21	The Wiltern	Perivale	Forward Fund	£90,000,000	4.00%	278	£600	Amro	PIC	Savills
Oct-20	Wembley Link	Wembley	Forward Fund	£82,500,000	4.20%	256	£540	HUB	Realstar	Savills
Sep-19	Colindale Gardens	Colindale	Forward Fund	£119,500,000	4.06%	347	£500	Redrow	Realstar	-
Mar-18	St Andrew's Park	Uxbridge	Forward Fund	£75,000,000	4.00%	207	£500	St Modwen	Annington Homes	Savills

Build Cost Price Inflation

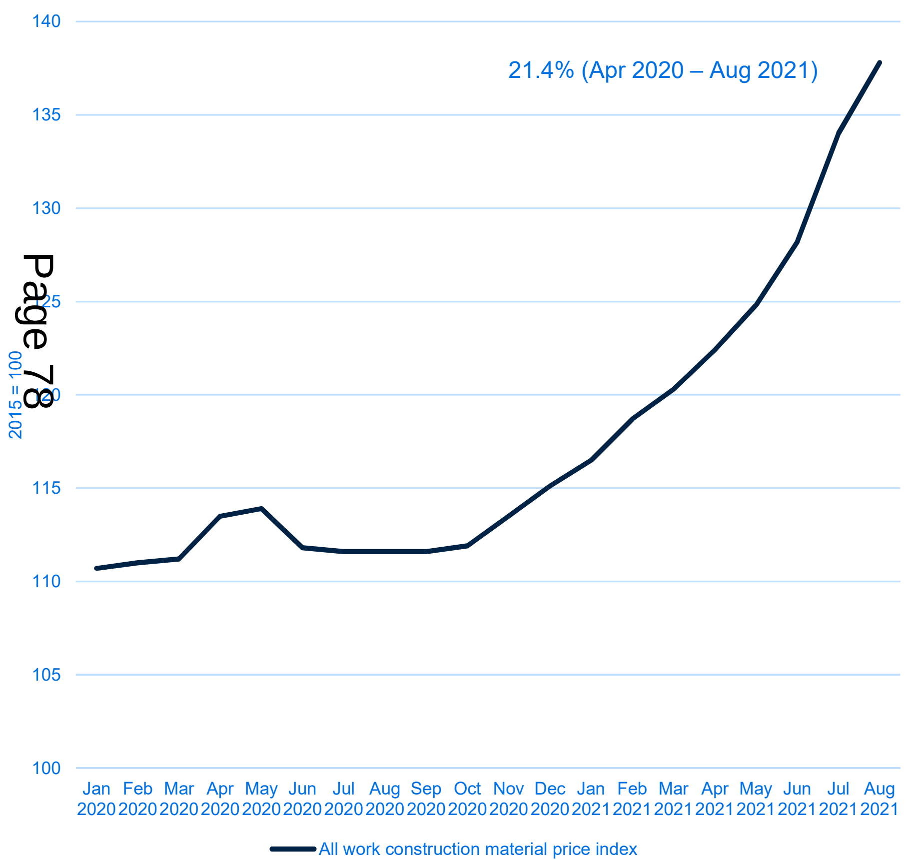


Source: BCIS

- Over the past 18 months, build costs have risen substantially more than tender prices
- Material prices are the primary driver behind higher build costs
- Tender prices fell after the start of the pandemic as contractors focused on winning work and tender opportunities reduced
- Tender prices are now rising as contractors are responding to higher input cots and as demand increases

Material Prices

savills

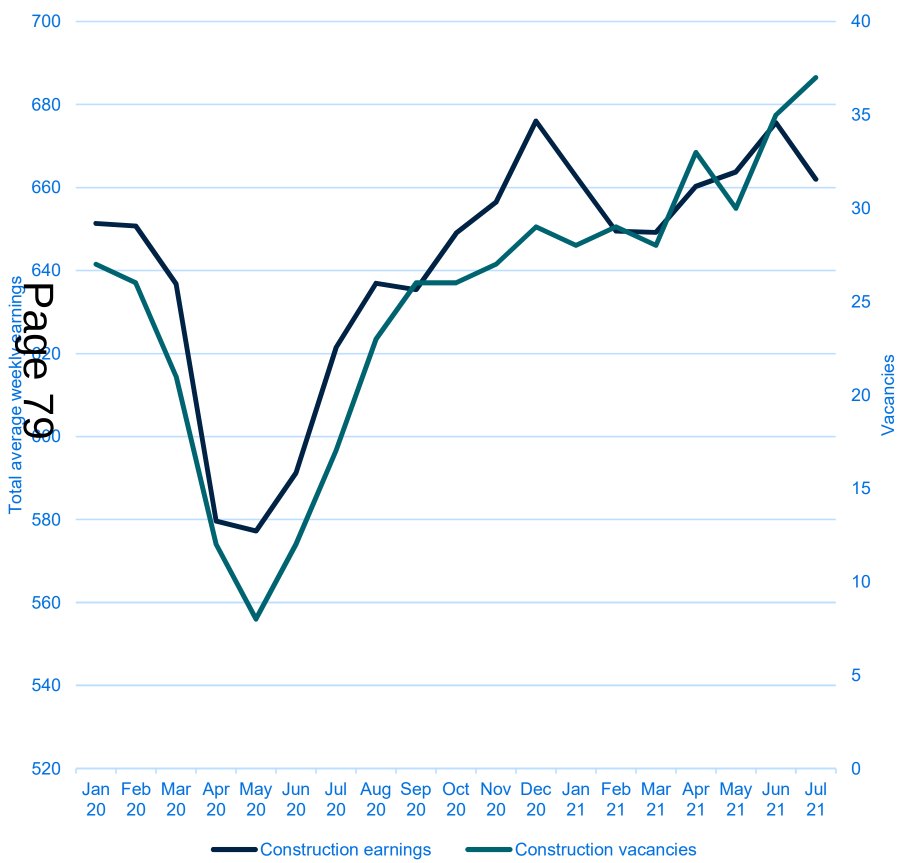


Source: BEIS

- Global supply-demand imbalances have pushed up the costs of many different products
- Steel and timber have seen exceptionally large increases
- Other problems include higher shipping costs and longer lead times
- Whilst it is possible that inflation will prove transitory, recent energy price rises will add to pressures

Labour Costs

savills



Source: ONS

- With the pandemic starting to have an effect in March, wages are only 1.6% higher than in January 2020
- Construction vacancies are significantly higher than at any point since records began
- So far, has not fed through into higher weekly earnings but this is a significant risk
- In June, bonuses were sharply up, and it may be that, for the moment, one-off payments will be enough to incentivise staff

Cost Conclusions

savills

- Construction cost increase at 10.6%, vs Tender Price Inflation of 1.2%
- Differential represents the steps that Tier 1 and Tier 2 supply chains have taken to continue during lower demand in the Covid period, however, demand is now increasing
- Material cost inflation deemed to represent a post-Covid ‘hotspot’ as manufacturing and delivery resource levels return to normal. This is effecting both finished materials and the base cost of key materials such as steel and timber
- Resource levels are in flux post-Covid and as impacts of Brexit are crystalised. Once demand is established, supply of resource will likely adjust to reflect opportunities for individuals and companies
- Therefore, forecast cost change from April 2020 to September 2021 is in the order of 3% to 5%
- It is anticipated that the high-end of this range may reduce over time for projects not required to procure construction works immediately, however, it does represent a current day position

Source: ONS

MERP

SQW Review of Savills Updated Costs and Value Guide

SQW has reviewed the updated cost and value guide produced by Savills comparing assumptions prepared for the April 2020 Financial Viability Assessment (FVA) with the current day position.

Item	SQW Comment
Residential sales market; movement from April 2020	Savills has cited the Land Registry House Price Index, which suggests a modest improvement in average sales values over the period from Jan 2020 to July 2021 in Merton's mainstream market, with average values increasing by 6% (to £540k) across all property types and by 4% (to £394k) for flatted unit sales, noting that the value of flats has grown at a slower rate than property prices generally in Merton. Savills makes the point that it is important to distinguish between different types of housing, but conclude that a modest uplift in sales values would be supported by the evidence cited. We have reviewed HM Land Registry data and consider the approach and conclusions to be sound and reasonable.
Build to Rent Market	Savills cites an annual 3.8% reduction in rents across London for the year up to August 2021 which contrasts with the national picture beyond London where rents have increased by 5% according to Hometrack as well as recent investment transactions handled by Savills' Capital Markets team. They conclude that the previous Market Rent assumptions should be retained on the basis of this evidence balanced

	against expected positive growth in Q4 2021 and 2022. This is a reasonable approach and we agree that based on this evidence, on balance assumptions on rents and yields for the Build to Rent element should be retained.
Build Cost Price Inflation	Savills cites BCIS All-in-TPI and BCIS General Building Cost Index for the period Q1 2020 to Q3 2021 which show build costs have risen substantially more than tender prices as the latter fell during the pandemic as contractors focussed on winning work, and that the data shows tender prices are now rising. Data is also cited from ONS show a substantial increase in construction material prices with steel and timber having seen exceptionally large increases. ONS data is cited on construction earnings and construction vacancies which shows that while construction earnings fell in March 2020 they have now returned to a similar level, 1.6% higher than in January 2020, with the extremely high construction vacancies figure not currently having led to an increase in construction wages, despite being higher than at any point since records began. Savills concludes that this is a significant risk. Overall, it is suggested that the forecast cost change from April 2020 to September 2021 is 3%-5%. We have reviewed the data cited and consider Savills approach and reasoning to be sound, and would emphasise the current high level of uncertainty surrounding construction costs.