1 Introduction

1.1 This is a report on the second draft financial business plan prepared by HACAS Chapman Hendy in support of the South Kilburn masterplan.

1.2 The Business Plan has been prepared using the outputs from the Business Evaluation Model (BEM) dated 9 September 2003, which was developed by Summers Inman, working with MACE and the other members of the masterplanning team. The BEM has been used to produce "zone-by-zone" costs for the proposed redevelopment of South Kilburn, and covers both the costs of refurbishment of those properties intended to remain with the London Borough of Brent under the prospective Arms Length Management Organisation (ALMO), and the demolition and rebuilding of the rest of Brent's stock in South Kilburn.

1.3 For the purposes of this exercise, the costs associated with the refurbished properties have been excluded from the totals produced by the BEM, as these costs will be included in a separate modelling exercise to assess their likely impact on the proposed ALMO.

2 Business Plan

2.1 The model used for this business plan is a version of HACAS Chapman Hendy's Global Financial Model, adapted to produce a transfer valuation in accordance with the requirements of the Office of the Deputy Prime Minister (ODPM).

2.2 The first stage in the modelling process was to profile the works costs produced by the BEM into the timescales established in the masterplan phasing. The assumption for BEM purposes was that all works costs would take place in the same year (year 9 for new-build). This is obviously not a realistic assumption, but was used in the BEM for pragmatic reasons. The phasing is intended to ensure that works progress in a logical order, and that decants of tenants and demolitions of existing properties can be accommodated within the programme on a "just-in-time" basis. This means that properties should not be vacant for too long prior to demolition, thus minimising loss of rental income through voids.

2.3 The phasing of the works costs was previously circulated to all parties on 13 October, and has been incorporated in the business plan as circulated.

2.4 The phased works costs and unit numbers are shown below.

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Table 1 - Phasing of Units

<u>Input Unit Movements</u>	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**	**Year 11**	**Year 12**	**Year 13**	**Year 14**	**Totals**
	2006.07	**2007.08**	**2008.09**	**2009.10**	**2010.11**	**2011.12**	**2012.13**	**2013.14**	**2014.15**	**2015.16**	**2016.17**	**2017.18**	**2018.19**	**2019.20**	
Units Completed															
NB Social Rent	-	300	100	202	150	241	-	172	223	-	237	-	120	(211)	1,534
NB for Sale		33	60	125	150	169	-	306	183	-	85	-	97	211	1,419
Totals	-	333	160	327	300	410	-	478	406	-	322	-	217	-	2,953
Less : Rented Units Vacated (negative)	-	-	(309)	-	-	(300)	(133)	(195)	-	(334)	-	(263)	-	-	(1,534)
Net Unit Loss	-	333	(149)	327	300	110	(133)	283	406	(58)	322	(263)	217	-	1,419
Leasehold Units Vacated (negative)	-	-	(58)	-	-	(23)	-	(53)	-	(16)	-	(9)	-	-	(159)
Freeholders Repurchased and Demolished	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

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Table 2 – phasing of development cashflows

	Year 1 2006.07	Year 2 2007.08	Year 3 2008.09	Year 4 2009.10	Year 5 2010.11	Year 6 2011.12	Year 7 2012.13	Year 8 2013.14	Year 9 2014.15	Year 10 2015.16	Year 11 2016.17	Year 12 2017.18	Year 13 2018.19	Year 14 2019.20	Totals
Input Redevelopment Cash Flow (2002/03 Prices)															
Build /demolition costs	8,974	35,896	29,918	35,375	56,252	28,126	36,733	29,280	49,561	11,539	33,513	7,436	22,286	-	384,889
Refurbishment costs	-	-	-	-	687	-	-	-	-	-	-	-	-	-	687
Albert Road DC/Health and education facilities	3,500	-	-	-	-	-	7,000	-	-	-	-	-	-	-	10,500
Community facilities and car parking costs	-	3,552	1,707	3,488	3,200	4,374	-	5,099	4,331	-	3,435	-	2,315	-	31,500
Total Works	12,474	39,448	31,625	38,863	60,139	32,500	43,733	34,379	53,892	11,539	36,948	7,436	24,601	-	427,576
Land purchase and legal fees	3,000	3,000	-	-	-	-	-	-	-	-	-	-	-	-	6,000
Homeloss.	-	-	2,275	-	-	2,003	825	1,538	-	2,170	-	1,686	-	-	10,497
Repurchase Costs	-	-	21,961	-	-	8,709	-	20,068	-	6,058	-	3,408	-	-	60,205
Sub-total	15,474	42,448	55,862	38,863	60,139	43,211	44,558	55,985	53,892	19,767	36,948	12,530	24,601	-	504,277
Refurbish borrowed properties	-	-	-	-	-	-	-	-	-	-	-	-	5,000	-	5,000
Total Costs	15,474	42,448	55,862	38,863	60,139	43,211	44,558	55,985	53,892	19,767	36,948	12,530	29,601	-	509,277
Input Funding Cash Flow (2002/03 Prices)															
Proceeds from Sales of NB for Sale Units	-	9,399	17,089	35,602	42,722	48,134	-	87,153	52,121	-	24,209	-	27,627	60,096	404,152
Total Funding	-	9,399	17,089	35,602	42,722	48,134	-	87,153	52,121	-	24,209	-	27,627	60,096	404,152
Net Cash Flow (2002/03 Prices)	15,474	33,049	38,773	3,261	17,417	(4,923)	44,558	(31,169)	1,771	19,767	12,739	12,530	1,974	(60,096)	105,125

2.5 The main assumptions used in the model are set out in Appendix 1.

2.6 The business plan modelling was carried out in stages, commencing with a version of the BP phased exactly as the BEM. This was to ensure firstly that the base position was correct, and secondly to enable the financial impact of any of the changes required to get from this starting point to the first draft outputs to be assessed.

2.7 The base position, or BEM equivalent model produced a valuation of -£17.2m, compared with the (amended) BEM valuation of -£15.3m. We have, however, been asked to illustrate the full net cost of the proposed redevelopment before any contributions are assumed, with any potential contributions being shown "below the line". This is because the contributions cannot be certain at this stage, and it is important to demonstrate the real level of support required for the scheme to proceed. We have therefore removed the contributions from the Council (£10m) and the NDC (£18m) previously assumed. This makes the base business plan position -£40.6m against an amended BEM position of -£39.2m.

2.8 The cashflows from the two models are in line, and the only significant difference between the BP and the BEM relates to how the discount factors are applied to arrive at the Net Present Value of future cash flows (the valuation). The BEM assumes that the full discount factor applies in any given year, i.e. the whole year's income or expenditure are discounted, whereas the HCH model is in line with the ODPM approach, in that the discount rate is assumed to apply to the half year position. This is the principal reason for the difference between the two valuations at this stage.

2.9 The table below summarises the movements in the valuation between the base position, and the position put forward in this report as being the second draft business plan.

Table 3 - Business plan movements

	Valuation
Base position	-£40.6m
Amend works profile to agree with phased works costs circulated 13 October 2003	-£73.3m
Amend start year to 2006/07 – involves:	
Uplift current rents by 7.27% - in line with BEM assumption	
Uplift new build rents by 12.55% - 4 years @ RPI + 0.5%	
Uplift management costs by 15.93% - 5 years @ RPI + 0.5%	
Uplift maintenance costs and new build costs by 22.47% - in line with BEM BCIS indices 2002-2006	
Uplift property prices by 16.99% - 4 years @ RPI + 1.5%	
Total impact of these changes	-£110.8m
Include real increases on Maintenance costs @ RPI + 1% years 1-10	-£111.9m
Include real increases on Earnings @ RPI + 0.5% years 1-30	-£113.6m
Reduce management costs to £1082 per unit (@ 2001/02 prices) New Build management costs reduce by 10% from year 11 onwards	-£104.2m
Increase sales £ per square foot to £400 from £350	-£68.4m
Include real increases on property prices @ RPI + 1% years 1-30	-£49.6m
Set up costs @£3m	-£52.4m
Increase current voids & bad debts to 4% and new build to 2%	-£54.2m
Additional £0.5m set up costs in year 1 for works programme	-£54.7m
Add 1.5% management fee for works programme	-£60.0m

2.10 This then gives a second draft business plan that produces a valuation of -£60.0m, before any contributions to the project are assumed.

2.11 In order to improve the valuation, it will be necessary to re-evaluate the assumptions and assess whether it is reasonable to amend one or more of them to achieve a favourable result. Two possible areas for consideration could be in respect of the “double” homeloss payments provided for and the repurchase costs included, which allow for both the cost of repurchase and the loss in revenue caused by the “equity swap”.

2.12 Assuming that the decants programme could be managed to minimise the number of double decants (say 30%), the valuation would be improved by £2.8m. Removing the equity swap assumption would improve the valuation by £28.5m.

3 Conclusions

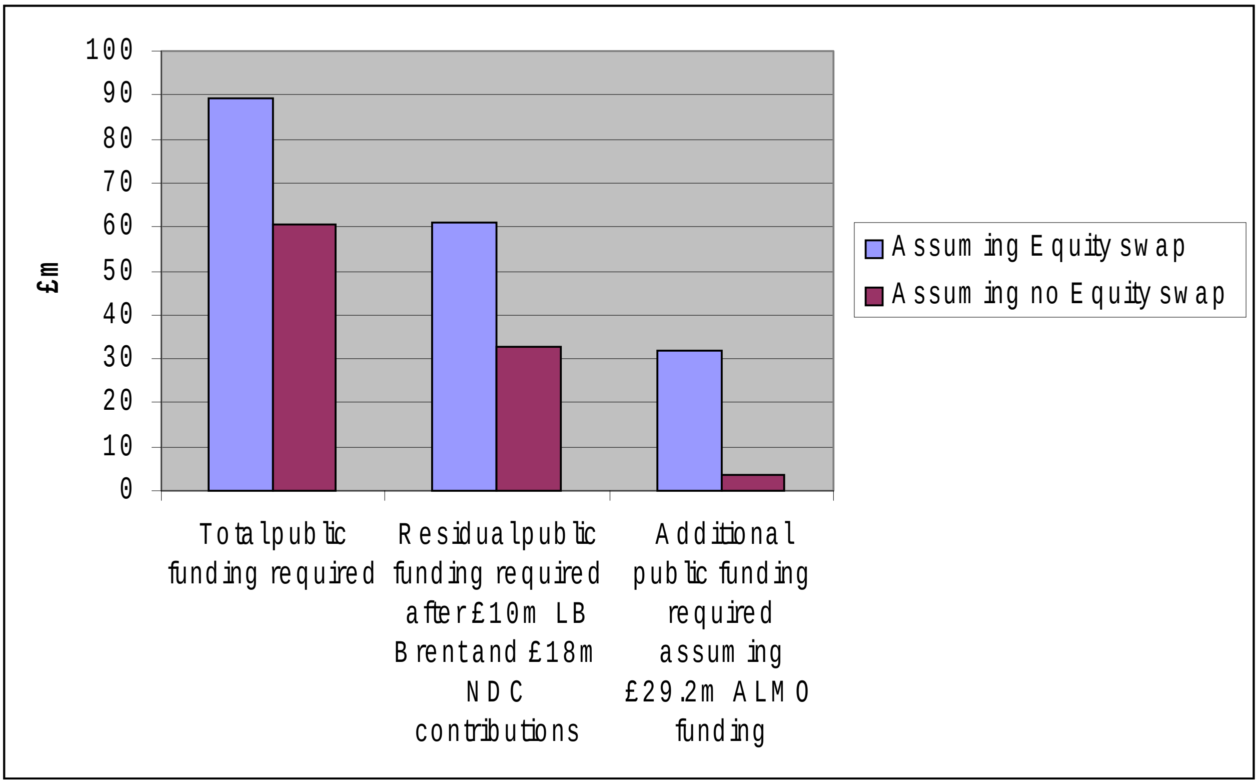
3.1 We have prepared the first draft business plan on the bases set out above and in Appendix 1.

3.2 The business plan as it currently stands would in all probability not fall within “normal” funding parameters, but we have demonstrated how certain assumptions could be amended to make the plan appear more attractive to prospective funders.

3.3 Once we have worked through the assumptions used, we will then be in a position to do some scenario modelling, to assess the sensitivity of the plan to fluctuations in assumptions.

3.4 On the basis of this second draft business plan and the indicative work previously undertaken to assess the additional level of support required by an extended ALMO to undertake refurbishment works, the total level of public funding would be as follows:

	Assuming Equity Swap	**Assuming no Equity Swap**
Negative valuation	-£60.0m	-£31.5m
Additional ALMO funding (option G – 751 units)	-£29.2m	-£29.2m
Total public funding required	**-£89.2m**	**-£60.7m**
Possible funding:		
LB Brent	£10m	£10m
South Kilburn NDC	£18m	£18m
Residual public funding requirement	**-£61.2m**	**-£32.7m**
ALMO support for refurbishment	£29.2m	£29.2m
Additional public funding required	**-£32.0m**	**-£3.5m**



3.5 The table and chart shown above illustrate the levels of public funding likely to be required to enable the South Kilburn scheme to proceed. The overall public subsidy required is in the region of £89m (assuming equity swaps will form part of the scheme), and possible funding from both the Council and the NDC could reduce this amount to £61m.

3.6 If the Council was successful in its bid to extend its existing ALMO to encompass the additional properties to be refurbished at South Kilburn, this could generate £29.2m of supported borrowing, which would leave a requirement for an additional £32m of public funding. This could possibly be provided through a commitment by the Housing Corporation to provide social housing grant to the partner RSL's or by the Government Office for London making resources available to the Council from the Regional Housing Pot of capital resources.

3.7 However the funds are committed, the way in which payments are phased will have a great bearing on the proposed project. The valuation produced by the second draft business plan is a discounted cashflow, with income and expenditure streams in future years being discounted back to prices at the start of the plan to take account of the cost of money. On this basis, money is worth less in the future than it is now. If potential sources of funds are phased so that they occur in later years, then the sums will need to be greater than if they were received at the start of the process, to allow for the necessary discounting adjustments.

3.8 All of the resources in the table above, with the exception of the ALMO funding, are assumed to be received at the start of year 1. If any of these contributions were delayed and paid in later years, then, as mentioned above, additional sums would be required to achieve the same level of financial benefit.

Appendix 2

Main assumptions used in the financial modelling:

Start year	2006/07
Number of units	1,534
Start rents *	As BEM uplifted by 7.27% Real deflation in line with BEM
New build rents *	As BEM uplifted by 12.55% Real inflation in line with BEM
Maintenance costs	As BEM unit costs – uplifted by 22.47% to point of transfer in line with BCIS indices in BEM Then real inflation of 1% pa years 1-10
New build costs	As BEM – profiled in line with phasing schedule – uplifted by 22.47% in line with BCIS indices in BEM
Average unit sales price	Based on £400 per square foot Real inflation at 1% pa throughout
RPI	2.5%
Earnings inflation	Real inflation of 0.5% throughout
Management costs *	£1082 per unit (2001/02 prices) uplifted by 15.93% to point of transfer – all units New build management costs reduce by 10% from year 11 onwards
Current voids and bad debts	4% pa
New build voids and bad debts	2% pa
Homeloss allowance	£6,200 per property
Leaseholder repurchase price	£378,645 (average, incl equity swap allowance) £165,019 repurchase only with no equity swap
Interest rate	4.5% real (i.e. 7% overall – long term)
Discount rate	7%

* Rents are inclusive of an element of service charges based on current levels of service. Management costs include the cost of providing these services.