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Dear Duncan,

### **Acquisition by Southwark Council of the Freehold of 160 Tooley Street**

The Council is considering the purchase of 160 Tooley Street and has been advised externally by GVA in relation to property issues. GVA have developed a detailed financial model which evaluates the potential costs and benefits to the Council of the acquisition and the GVA model and the associated analysis forms the basis of the Council's business case for the proposed acquisition.

We have been requested by the Council to review the analysis undertaken by GVA and reflected in the Cabinet Report dated 11th December and provide comment as we feel appropriate.

Our analysis is based solely upon the GVA model as distributed by Neil Dovey of GVA on 28th November and the Cabinet report dated 11th December. We have not undertaken a formal model audit in relation to the GVA model.

#### **GVA Model**

The GVA model has the following inputs and outputs:

##### **Inputs**

- Purchase price £170m
- Purchase costs 5.8% of purchase price
- Building value in 2052 at 2012 price base - £115m
- Initial rent £7,693,370 pa
- Interest received on Council cash balances 0.77%pa in 2012 rising to 3.5% by 2022
- Interest paid on additional debt 3.55% to 3.75%
- Internal and external borrowing repaid on equal instalments over a 40 year period
- Refurbishment/dilapidation costs in year 20 at 2012 cost base - £15.0m
- Rental and residual value growth - three scenarios: low growth, higher growth and in line with RPI which is assumed as 3.19% for the first 5 years and 2.8% thereafter
- Discount rate for NPV calculation 6.09%
- Three scenarios are modelled: 100% internally funded, 100% externally funded and 50% internally 50% externally funded
- It is assumed implicitly within the model that the current lease could be renewed on similar terms in 2033 for a further 20 years.

**Outputs**

- Undiscounted and discounted financial assessment over 10.5 years and 40.5 years for both the acquisition of the freehold and remaining on a leasehold basis.
- For both options sensitivity testing is included to show the results reflecting assumptions relating to future rental growth and debt and equity financing mixes.
- For both options an economic appraisal, in line with Treasury Green Book requirements, is included to test the overall value generated in all scenarios.

**Analysis and Conclusions**

The methodology adopted by GVA is consistent with best practice for investment analysis and forms an appropriate basis for the Council to determine the costs and benefits to support a decision on the purchase of the freehold.

The Council has within the Cabinet report accurately reflected the GVA analysis and has not distorted the analysis through the omission of any material output of the GVA model.

The assumptions made in relation to interest rates, value and cost changes over a 40 year period are within parameters which are reasonable for an exercise of this nature and do not lead to a distortion of the analysis in favour any particular outcome.

In summary the approach taken by the Council in assessing the costs and benefits of the purchase of the freehold of 160 Tooley Street is in line with best practice and the analysis within the Cabinet report is appropriate for a project of this nature and reflects the outputs from the GVA model.

Our analysis to date has been focused on the business case and supporting analysis as set out above. In due course, as part of the statutory audit, we may review additional issues, for instance the accounting and balance sheet treatments.

Yours sincerely,



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