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Community Infrastructure Levy: Viability Study

Prepared for

London Borough of Brent

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1 Executive Summary

1.1 This report tests the ability of a range of development types throughout the London Borough of Brent to yield contributions to infrastructure requirements through a Community Infrastructure Levy ('CIL'). For residential development, due regard has also been given to the Borough's policy requirement that such developments should contribute towards the provision of affordable housing.

Methodology

1.2 The study methodology compares the residual land values of a range of generic developments to the sites' current use values, plus a margin to incentivise landowners to release their sites for development. If a development incorporating a given level of CIL generates a higher value than the current use value (plus appropriate landowner's margin), then it can be judged that the proposed level of CIL will be viable.

1.3 The study utilises the residual land value method of calculating the value of each development. This method is used by developers when determining how much to bid for land and involves calculating the value of the completed scheme and deducting development costs (construction, fees, finance and CIL) and developer's profit. The residual amount is the sum left after these costs have been deducted from the value of the development, and equates to the amount that a developer would normally pay for the site.

1.4 The housing and commercial property markets are inherently cyclical and the Council is testing its proposed rates of CIL at a time when values have fallen slightly below their peak. We have controlled for this factor by running a series of sensitivity analyses which inflate sales values in real terms by 10% and 25% This analysis will enable the Council to determine levels of CIL that might become viable both in today's terms but also whether a system of indexation should be applied to the CIL rates (providing this is permissible within the regulations).

Key findings

1.5 The key findings of the study are as follows:

- The results of this study are reflective of current market conditions, which are likely to improve over the medium term. It is therefore important that the Council keeps the viability situation under review so that levels of CIL can be adjusted to reflect any future improvements. It might be possible to achieve through indexation, using a combination of changes in house prices (as measured by the Land Registry House Price Index) and build costs (as measured by BCIS or other appropriate index).
- A majority of **residential schemes** should be able to absorb a CIL rate of up to £300 per sq m, including the Mayoral CIL of £35 per sq m. However, our results indicate that a CIL of this level would prevent some developments at the margins of viability from coming forward. We therefore recommend a lower starting rate of around £200 per sq m, exclusive of the Mayor CIL.
- Our appraisals indicate that student housing schemes could comfortably accommodate a CIL of around £300 per sq metre (exclusive of the Mayoral CIL).
- Hotel developments could accommodate a CIL of up to a maximum of £320 per sq metre. We would suggest a starting rate of £200 per sq metre to allow a buffer and for the Mayoral CIL.

- **Office developments** range in value, with rents typically between £21 per sq ft (or £215 per sq m) to £22 per sq ft (£269 per sq m). Our appraisals indicate that a CIL of up to £147 per sq m could be levied based on the upper end of the rental range, but this would result in many office developments that attract lower rents from coming forward. Given that there are no other significant planning obligations that could be 'flexed' to absorb viability issues on lower value schemes, we recommend that the Council sets a CIL for offices at the lower end of the range. This would suggest a maximum CIL of around £40 per sq m, exclusive of the Mayoral CIL after allowing a margin to absorb site specific viability issues.
- Values generated by **Retail developments** vary between high street and small retail developments and retail parks, with the latter attracting higher rents and generating higher capital values. At the lower end of the range, our results indicate that a maximum CIL of £83 per sq m could be achieved. However, schemes with slightly higher rents could absorb a CIL of £138 per sq m. Balancing the two ends of the range and considering the risk to lower value schemes of a higher rate, a CIL of £80 plus Mayoral CIL appears reasonable and should have a limited impact on viability.
- D1 uses often do not generate sufficient income streams to cover their costs. Consequently, they require some form of subsidy to operate. This type of facility is very unlikely to be built by the private sector. We therefore suggest that a nil rate of CIL be set for D1 uses. In contrast, D2 uses (excluding public swimming pools) frequently generate positive land values and a model CIL of £5 exclusive of the Mayor CIL could be secured.
- Our appraisals of developments of **industrial and warehousing** floorspace (including use classes B1b & c, B2 and B8) indicate that these uses are unlikely to generate positive residual land values. Even when positive land values are achieved, they fall short of existing use values. We recommend that zero rates are set for these use classes, although it is unlikely that development would come forward in any case.

7 Conclusions and recommendations

7.1 The results of our analysis indicate a degree of variation in viability of development in terms of use classes. In light of these variations, two options are available to the Council under the CIL regulations. Firstly, the Council could set a single CIL rate across the Borough, having regard to the least viable use classes and least viable locations. This option would suggest the adoption of the ‘lowest common denominator’, with sites that could have provided a greater contribution towards infrastructure requirements not doing so. Secondly, the Council has the option of setting different rates for different use classes. The results of our study point firmly towards the second option as our recommended route.

7.2 We have also referred to the results of development appraisals as being highly dependent upon the inputs, which will vary significantly between individual developments. In the main, the imposition of CIL is not a critical factor in determining whether a scheme is viable or not (with the relationship between scheme value, costs and existing use value benchmarks being far more important). This is evidenced by the very marginal differences between the ‘pre’ and ‘post’ CIL residential appraisals shown in the table in Section 6.

7.3 Given CIL’s nature as a fixed tariff, it is important that the Council selects rates that are not on the limit of viability. This is particularly important for commercial floorspace, where the Council does not have the ability to ‘flex’ other planning obligations to absorb site-specific viability issues. In contrast, the Council could in principle set higher rates for residential schemes as the level of affordable housing could be adjusted in the case of marginally viable schemes. However, this approach runs the risk of frustrating one of the Council’s other key objectives of delivering affordable housing. Consequently, sensitive CIL rate setting for residential schemes is also vital.

7.4 Our core recommendations on levels are CIL are therefore summarised as follows:

- The results of this study are reflective of current market conditions, which are likely to improve over the medium term. It is therefore important that the Council keeps the viability situation under review so that levels of CIL can be adjusted to reflect any future improvements. This could be achieved through indexation, using a combination of changes in house prices (as measured by the Land Registry House Price Index) and build costs (as measured by BCIS or other appropriate index).

- A majority of **residential schemes** should be able to absorb a CIL rate of up to £300 per sq m, including the Mayoral CIL of £35 per sq m. However, our results indicate that a CIL of this level would prevent some developments at the margins of viability from coming forward. We therefore recommend a lower starting rate of around £200 per sq m, plus the Mayoral CIL.

- Our appraisals indicate that student housing schemes could comfortably accommodate a CIL of around £300 per sq metre (exclusive of the Mayoral CIL).

- Hotel developments could accommodate a CIL of up to a maximum of £320 per sq metre. We would suggest a starting rate of £200 per sq metre to allow a buffer and the Mayoral CIL.

- **Office developments** range in value, with rents typically around £21 per sq ft to £22 per sq ft. Our appraisals indicate that a CIL of up to £147 per sq m could be levied, but this would result in many office developments that attract lower rents from coming forward. Given that there are no other significant planning obligations that could be 'flexed' to absorb viability issues on lower value schemes, we recommend that the Council sets a CIL for offices that strikes a balance between the upper and lower end of the rental range. This would suggest a maximum CIL of up to £110 per sq m, or £40 after allowing a margin to absorb site specific viability issues, plus the Mayoral CIL.
- Values generated by **Retail developments** vary between high street and small retail developments and retail parks, with the latter attracting higher rents and generating higher capital values. At the lower end of the range, our results indicate that a maximum CIL of £66 per sq m could be achieved. However, the viable levels of CIL increase very steeply with modest increases in rents (from £21 to £23 per sq ft) to £341 per sq m. In arriving at a balance between the two ends of the range, the Council might consider adopting a CIL of £80 per sq m plus the Mayoral CIL.
- Our appraisals of developments of **industrial and warehousing floorspace** indicate that these uses are unlikely to generate positive residual land values. Even when positive land values are achieved, they fall short of existing use values. We recommend that zero rates are set for these use classes, although it is unlikely that development would come forward in any case.

For residential schemes, the application of CIL of £200 per sq m does not appear to be a critical factor in determining whether or not a scheme is viable. Some schemes would be unviable even if a zero CIL were adopted. We therefore recommend that the Council pays limited regard to these sites. However, the Council should also consider the potential CIL that could be secured from other viable sites when determining an appropriate balance between revenue maximisation and viability.