



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. This report updates the assessment carried out in September 2011, including amendments in response to points raised by respondents during consultation on the Preliminary Draft Charging Schedule. This consultation ran between October to December 2011.

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 the amount of CIL that **student housing** schemes could absorb is very sensitive to rent levels. Rents for the major student housing schemes recently developed in the Borough range from £165 to £188 on average per week. The existing use of the site is also another critical factor, with the maximum amount of CIL ranging from £152 per sq metre (at lower average rents and an existing office site) to £785 per sq metre (at higher average rents and an existing industrial site). Given this range, the Council might consider setting a CIL rate of £200 per square metre for student housing developments.
- **Hotel developments** could accommodate a CIL of up to a maximum of £295 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** are not a key feature of the development pipeline in Brent, as there is limited demand for new build office accommodation. Conditions will need to be right for developers to bring schemes forward. Setting aside the scenarios above where office development is unviable or marginal (where a scheme would clearly not come forward, regardless of CIL), the other scenarios indicate that a modest level of CIL could be absorbed. The maximum level of CIL would be £100 per sq m, or £40 after allowing a margin to absorb site specific viability issues, plus the Mayoral CIL.
- Residual land values generated by **Retail developments** vary according to rent levels and the existing use of sites coming forward for development. Our appraisals indicate that existing retail sites are unlikely to be redeveloped, as the residual value would be lower than the existing use value. Retail developments would be viable on existing office and industrial sites, generating a range of CIL levels between £15 to £607 per sq metre. The viable levels of CIL increase very steeply with modest increases in rents (from £21 to £23 per sq ft). In arriving at a balance between the two ends of the range, the Council might consider adopting a CIL of £80 per sq metre, exclusive of the Mayoral CIL. This rate of CIL would be at the lower end of the range and have a minimal impact on viability across the area as a whole.
- **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 and often constitute infrastructure in themselves (e.g. schools). 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 modest 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.

2 Introduction

- 2.1 This study has been commissioned to provide an evidence base to inform London Borough of Brent's CIL draft Charging Schedule, as required by Regulation 14 of the CIL Regulations April 2010 (as amended). The aims of the study are summarised as follows:
- a to test the impact upon the economics of residential development of a range of levels of CIL;
 - b to test the ability of commercial schemes to make a contribution towards infrastructure; and
 - c for residential schemes, to test CIL alongside the Council's pre-existing requirements for affordable housing, which were previously tested by BNP Paribas Real Estate¹.
- 2.2 In terms of methodology, we adopted standard residual valuation approaches to make appropriate comparisons and evaluations. However, due to the extent and range of financial variables involved in residual valuations, they can only ever serve as a guide. Individual site characteristics (which are unique), mean that blanket requirements and conclusions must always be tempered by a level of flexibility in application of policy requirements on a site by site basis. It is therefore essential that levels of CIL allow a sufficient margin to allow for these variations.

Policy Context

2.3 The Policy Context

The CIL regulations state that in setting a charge, local authorities must “*aim to strike what appears to the charging authority to be an appropriate balance*” between revenue maximisation on the one hand and the potentially adverse impact upon the viability of development across the whole area on the other. The regulations also state that local authorities should take account of other sources of available funding for infrastructure when setting CIL rates. This report deals with viability only and does not consider other sources of funding (this is considered elsewhere within the Council's evidence base).

Local authorities must consult relevant stakeholders on the nature and amount of any proposed CIL. Following consultation, a charging schedule must be submitted for independent examination.

The regulations allow a number of exemptions from CIL. Firstly, affordable housing and buildings with other charitable uses (if controlled by a charity and serve a purpose that is consistent with their charitable objects) are subject to relief. Secondly, local authorities may, if they chose, elect to offer an exemption on proven viability grounds. The exemption would be available for 12 months, after which time viability of the scheme concerned would need to be reviewed. To be eligible for exemption, regulation 55 states that the Applicant must enter into a Section 106 agreement (and the costs of complying with the agreement must exceed the amount of CIL that would have been payable); and that the Authority must be satisfied that granting relief would not constitute state aid.

¹ *London Borough of Brent: Affordability Housing Viability Study (September 2009)*

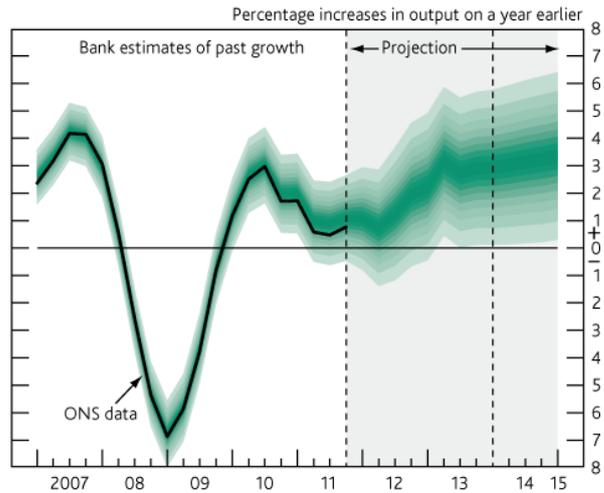
The CIL regulations enable local authorities to set differential rates for different zones within which development would take place and also for different types of development.

The 2010 regulations set out clear timescales for payment of CIL, which varied according to the size of the payment, which by implication is linked to the size of the scheme. The 2011 amendments to the regulations allow local authorities to set their own timescales for the payment of CIL if they chose to do so. This is an important issue that the Council will need to consider, as the timing of payment of CIL can have an impact on an Applicant's cashflow (the earlier the payment of CIL, the more interest the Applicant will bear before the development is completed and sold).

Several local authorities have undertaken viability assessments and have drafted a CIL charging schedule, which they have submitted for independent examination. To date, six charging authorities (Newark and Sherwood Council, Shropshire Council, Portsmouth, the Mayor of London, Redbridge Borough Council and Wandsworth Borough Council) have been through the examination process and are at various stages of adoption and implementation..

Economic and housing market context

- 2.4 The historic highs achieved in the UK housing market by mid 2007 followed a prolonged period of real house price growth. However, a period of 'readjustment' began in the second half of 2007, triggered initially by rising interest rates and the emergence of the US sub prime lending problems in the last quarter of 2007. The subsequent reduction in inter-bank lending led to a general "credit crunch" including a tightening of mortgage availability. The real crisis of confidence, however, followed the collapse of Lehman Brothers in September 2008, which forced the government and the Bank of England to intervene in the market to relieve a liquidity crisis.
- 2.5 The combination of successive shocks to consumer confidence and the difficulties in obtaining finance led to a sharp reduction in transactions and a significant correction in house prices in the UK, which fell to a level some 21% lower than at their peak in August 2007 according to the Halifax House Price Index. Consequently, residential land values fell by some 50% from peak levels. One element of government intervention involved successive interest rate cuts and as the cost of servicing many people's mortgages is linked to the base rate, this financial burden has progressively eased for those still in employment. This, together with a return to economic growth early 2010 (see February 2012 Bank of England GDP fan chart below, showing the range of the Bank's predictions for GDP growth to 2014) has meant that consumer confidence has started to improve to some extent.



Source: Bank of England

- 2.6 Throughout the first half of 2010 there were some tentative indications that improved consumer confidence was feeding through into more positive interest from potential house purchasers. Against the background of a much reduced supply of new housing, this would lead one to expect some recovery in prices. However it is evident that this brief resurgence has abated, with the Nationwide and Halifax House Price Indices showing annual house price falls of 0.1% and 2.8% retrospectively in February 2011.
- 2.7 The balance of opinion is that house prices will remain flat in the short term, with continuing high levels of unemployment likely to result in increased repossessions and increased supply of homes into the market. At the same time, demand is expected to remain subdued, due to the continuing difficulties consumers face in securing mortgages.

House price and sales volume - Brent London borough



Source: Land Registry

- 2.8 According to Land Registry data, residential sales values in Brent have recovered since the lowest point in the cycle in April 2009. Prices have increased by 16.47% between April 2009 and February 2012 and are now 1.56% higher than their March 2008 peak level.
- 2.9 The future trajectory of house prices is currently uncertain, although Savills' current prediction is that values are expected to increase over the next five years. Medium term predictions are that properties in regional mainstream markets (i.e. non-prime) will return to growth in 2013². Savills predict that values in London will fall by 1% in 2012, but increase by 1% in 2013, 5% in 2014, 6% in 2015 and 6.5% in 2016. This equates to cumulative growth of 19.1% between 2012-2016 inclusive, compared to a UK average of 6% cumulative growth over the same period.
- 2.10 After the adoption of the CIL charging schedule, the Council could explore the possibility of indexing the levels of CIL or undertake a review after a period of time to reflect any future improvements in market conditions.

Local Policy context

- 2.11 The Council has calculated its infrastructure requirements, indicating a requirement for funding of circa £406.8 million over the next 15 years³. After sources of anticipated funding have been deducted, the Council estimates a funding gap of £224.8 million to be funded from other sources. The Council recognises that CIL may not fund this full amount and other sources of funding might need to be identified.
- 2.12 In addition to financing infrastructure, the Council expects residential developments to provide a mix of affordable housing tenures, sizes and types to help meet identified housing needs and contribute to the creation of mixed, balanced and inclusive communities. The precise number, tenure, size and type of affordable units will be negotiated to reflect identified needs and economic viability, having regard to Core Strategy Policy CP2 that sets a strategic Borough-wide 50% affordable housing target. In circumstances where site specific or market factors affect scheme viability, developers will be expected to provide viability assessments to demonstrate an alternative affordable housing provision.

Development context

- 2.13 Sites in the Borough are developed with a range of styles and densities, reflecting the types of land available and public transport accessibility (which varies between different parts of the Borough). Development sites in the Borough range from existing retail; offices; redevelopment of existing residential; and major regeneration sites. Over the past decade, development proposals in the Borough have increased in density, with the densest schemes located in areas with high levels of public transport accessibility.

² *Savills Research: Residential Property Focus, November 2011*

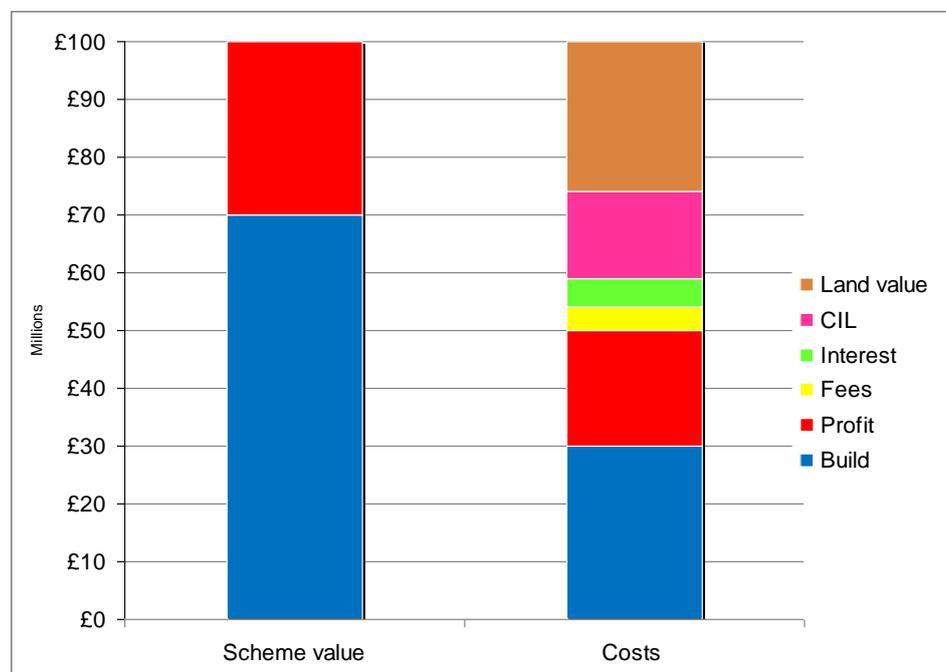
³ *Brent Infrastructure and Investment Framework, October 2011*

3 Methodology

- 3.1 Our methodology follows standard development appraisal conventions, using assumptions that reflect local market and planning policy circumstances. The study is therefore specific to Brent and reflects the policy requirements set out in the Core Strategy.

Approach to testing development viability

- 3.2 Appraisal models can be summarised via the following diagram. The total scheme value is calculated, as represented by the left hand bar. This includes the sales receipts from the private housing and the payment from a Registered Social Landlord ('RSL') for the affordable housing units. The model then deducts the build costs, fees, interest, CIL (at varying levels) and developer's profit. A 'residual' amount is left after all these costs are deducted – this is the land value that the Developer would pay to the landowner. The residual land value is represented by the brown portion of the right hand bar in the diagram.



- 3.3 The Residual Land Value is normally a key variable in determining whether a scheme will proceed. If a proposal generates sufficient positive land value (in excess of existing use value), it will be implemented. If not, the proposal will not go ahead, unless there are alternative funding sources to bridge the 'gap'.
- 3.4 When running a development appraisal, it is necessary to identify the key variables – sales values, costs etc – with some degree of accuracy in advance of implementation of a scheme. Even on the basis of the standard convention that current values and costs are adopted (not values and costs on completion), this can be very difficult. Problems with key appraisal variables can be summarised as follows:
- development costs are subject to national and local monitoring and can be reasonably accurately assessed in 'normal' circumstances. In boroughs like Croydon, many sites will be previously developed. These sites can sometimes encounter 'exceptional' costs such as decontamination. Such

costs can be very difficult to anticipate before detailed site surveys are undertaken;

- development value and costs will also be significantly affected by assumptions about the nature and type of affordable housing provision and other Planning Obligations. In addition, on major projects, assumptions about development phasing; and infrastructure required to facilitate each phase of the development will affect residual values. Where the delivery of the obligations are deferred, the less the real cost to the applicant (and the greater the scope for increased affordable housing and other planning obligations). This is because the interest cost is reduced if the costs are incurred later in the development cashflow; and
 - while Developer's Profit has to be assumed in any appraisal, its level is closely correlated with risk. The greater the risk, the higher the profit level required by lenders. While profit levels were typically up to around 15% of completed development value at the peak of the market in 2007, banks now require schemes to show a higher profit to reflect the current risk. We do not know when and if profit levels may begin to fall back.
- 3.5 Ultimately, the landowner will make a decision on implementing a project on the basis of return and the potential for market change, and whether alternative developments might yield a higher value. The landowner's 'bottom line' will be achieving a residual land value that sufficiently exceeds 'existing use value' or other appropriate benchmark to make development worthwhile. Margins above EUV may be considerably different on individual sites, where there might be particular reasons why the premium to the landowner should be lower or higher than other sites.
- 3.6 Developers will seek to mitigate the impact of 'unknown' development issues through the following strategies:
- When negotiating with the landowner, the developer will either attempt to reflect planning requirements in the offer for the land, or seek to negotiate an option, or complete a deal 'subject to planning' which will enable any additional unknown costs to be passed on to the landowner. It should be noted that such arrangements are not always possible. Ultimately, the landowner meets the cost through reduced land value, providing the basic condition for Residual Land Value to exceed existing use value (plus landowners' margin) or other appropriate benchmark is met; and/or,
 - The developer will seek to build in sufficient tolerance into the development appraisal to offset risks including, for example, design development where costs might be incurred to satisfy planning and design requirements etc. It would also be normal to have a contingency allowance which would generally equate to 2% to 5% of build costs.
 - The extent to which developers can successfully mitigate against all risks depends largely on the degree to which developers have to compete to purchase sites. In a competitive land market, the developer who is prepared to build in less contingency to mitigate against planning and development risks is likely to offer the winning bid.
- 3.7 Clearly, however, landowners have expectations of the value of their land which often exceed the value of the existing use. CIL will be a cost to the scheme and will impact on the residual land value. Ultimately, if landowners' expectations are not met, they will not voluntarily sell their land and (unless a Local Authority is prepared to use its compulsory purchase powers) some may simply hold on to their sites, in the hope that policy may change at some future point with reduced requirements. It is within the scope of those expectations

that developers have to formulate their offers for sites. The task of formulating an offer for a site is complicated further still during buoyant land markets, where developers have to compete with other developers to secure a site, often speculating on continued rises in value.

Viability benchmark

- 3.8 The CIL Regulations provide no specific guidance on how local authorities should test the viability of their proposed charges. However, there is a range of good practice generated by both the Homes and Communities Agency and appeal decisions that assist in guiding planning authorities on how they should approach viability testing for planning policy purposes.
- 3.9 In 2009, the Homes and Communities Agency published a good practice guidance manual 'Investment and Planning Obligations: Responding to the Downturn'. This defines viability as follows: *"a viable development will support a residual land value at level sufficiently above the site's existing use value (EUV) or alternative use value (AUV) to support a land acquisition price acceptable to the landowner"*.
- 3.10 A number of planning appeal decisions provide guidance on the extent to which the residual land value should exceed existing use value to be considered viable:

Barnet & Chase Farm: APP/Q5300/A/07/2043798/NWF

"the appropriate test is that the value generated by the scheme should exceed the value of the site in its current use. The logic is that, if the converse were the case, then sites would not come forward for development"

Bath Road, Bristol: APP/P0119/A/08/2069226

"The difference between the RLV and the existing site value provides a basis for ascertaining the viability of contributing towards affordable housing."

Beckenham: APP/G5180/A/08/2084559

"without an affordable housing contribution, the scheme will only yield less than 12% above the existing use value, 8% below the generally accepted margin necessary to induce such development to proceed."

Oxford Street, Woodstock: APP/D3125/A/09/2104658

"The main parties' valuations of the current existing value of the land are not dissimilar but the Appellant has sought to add a 10% premium. Though the site is owned by the Appellants it must be assumed, for valuation purposes, that the land is being acquired now. It is unreasonable to assume that an existing owner and user of the land would not require a premium over the actual value of the land to offset inconvenience and assist with relocation. The Appellants addition of the 10% premium is not unreasonable in these circumstances."

- 3.11 It is clear from the planning appeal decisions above and HCA good practice publication that the most appropriate test of viability for planning policy purposes is to consider the residual value of schemes compared to the existing use value plus a premium. As discussed later in this report, our study adopts a premium above EUV as a viability benchmark.
- 3.12 The recent examination on the Mayor of London's CIL charging schedule considered the issue of an appropriate land value benchmark. The Mayor had adopted existing use value, while certain objectors suggested that 'Market Value' was a more appropriate benchmark. The Examiner concluded that:

“The market value approach.... while offering certainty on the price paid for a development site, suffers from being based on prices agreed in an historic policy context.” (para 8) and that “I don’t believe that the EUV approach can be accurately described as fundamentally flawed or that this examination should be adjourned to allow work based on the market approach to be done” (para 9).

3.13 In his concluding remark, the Examiner points out that

*“the price paid for development land may be reduced [so that CIL may be accommodated]. As with profit levels there may be cries that this is unrealistic, but **a reduction in development land value is an inherent part of the CIL concept.** It may be argued that such a reduction may be all very well in the medium to long term but it is impossible in the short term because of the price already paid/agreed for development land. The difficulty with that argument is that if accepted the prospect of raising funds for infrastructure would be forever receding into the future. In any event in some instances it may be possible for contracts and options to be re-negotiated in the light of the changed circumstances arising from the imposition of CIL charges. (para 32 – emphasis added).*

3.14 It is important to stress that there is no single threshold land value at which land will come forward for development. The decision to bring land forward will depend on the type of owner and, in particular, whether the owner occupies the site or holds it as an asset; the strength of demand for the site’s current use in comparison to others; how offers received compare to the owner’s perception of the value of the site, which in turn is influenced by prices achieved by other sites. Given the lack of a single threshold land value, it is difficult for policy makers to determine the minimum land value that sites should achieve.

4 The Appraisal Exercise

Residential development

- 4.1 We have appraised a series of generic developments, reflecting both the range of sales values and also densities of development across the borough. This is similar to the approach adopted in the *Affordable Housing Viability Study* which was examined and found sound by the Inspector during 2010. The appraisal exercise generates a high volume of individual residual appraisals based on a cashflow. A sample appraisal is provided at Appendix 1.

Overview of key residential appraisal variables

- 4.2 The key variables in any residential development appraisal are as follows:
- 4.3 **Sales values:** Sales values will vary between local authority areas (and within local authority areas) and are constantly changing. Developers will try to complete schemes in a rising or stable market, but movements in sales values are a development 'risk'. During times of falling house prices, local authorities may need to apply their policy requirements flexibly, or developers may cease bringing sites forward.
- 4.4 **Density:** Density is an important determinant of development value. Higher density development results in a higher quantum of units than a lower density development on the same site, resulting in an increase in gross development value. However, high density development often results in higher development costs, as a result of the need to develop taller buildings, which are more expensive to build than lower rise buildings and the need to often provide basements for car parking and plant. It should therefore not *automatically* be assumed that higher density development results in higher residual land values; while the gross development value of such schemes may be higher, this can be partially offset by increased build costs.
- 4.5 **Gross to net floor space:** The gross to net ratio measures the ratio of saleable space (i.e. the area inside residential units) compared to the total area of the building (i.e. including the communal spaces, such as entrance lobbies and stair and lift cores). The higher the density, the lower the gross to net floor space ratio; in taller flatted schemes, more floor space is taken up by common areas and stair and lift cores, and thus less space is available for renting or sale.
- 4.6 **Base construction costs:** While base construction costs will be affected by density and may be affected by other factors, such as flood risk, ground conditions etc., they are well documented and can be reasonably accurately determined in advance by the developer.
- 4.7 **Exceptional costs:** Exceptional costs can be an issue for development viability on previously developed land. Exceptional costs relate to works that are 'atypical', such as remediation of sites in former industrial use and that are over and above standard build costs. However, for the purposes of this exercise, it is not possible to provide a reliable estimate of what exceptional costs would be, as they will differ significantly from site to site. Our analysis therefore excludes exceptional costs, as to apply a blanket allowance would generate misleading results. An 'average' level of costs for decontamination, flood risk mitigation and other 'abnormal' costs is already reflected in BCIS data, as such costs are frequently encountered on sites that form the basis of

the BCIS data sample.

- 4.8 **Developer's Profit:** Following standard practice, developer profits are based on an assumed percentage of gross development value. While developer profit ranged from 15% to 17% of private housing gross development value in 2007 (and 6% on the affordable housing), banks currently require a scheme to show higher profits. Higher profits reflect levels of perceived and actual risk. The higher the potential risk, the higher the profit margin in order to offset those risks. At the current time, development risk is perceived by banks as high. This is unlikely to change in the first few years after the adoption of the Charging Schedule but should be kept under review thereafter. If conditions improve, it is possible (but by no means guaranteed) that banks will relax their lending criteria and reduce the amount of profit they require schemes to achieve.

Commercial development

- 4.9 We have appraised a series of generic commercial developments, reflecting a range of use classes at average rent levels achieved on lettings of commercial space in actual developments. The Council has also requested that we consider the provision of 'affordable workspace', i.e. commercial floorspace that is let at sub-market rents and controlled as such through a planning obligation. Reductions in rents will reduce the capital value of such schemes, limiting their capacity to make contributions to CIL.

Existing Use Values

- 4.10 Existing Use Value ("EUV") Alternative Use Value ("AUV") and acquisition costs are key considerations in the assessment of development economics. Clearly, there is a point where the Residual Land Value (what the landowner receives from a developer) that results from a scheme may be less than the land's existing use value. Existing use values can vary significantly, depending on the demand for the type of building relative to other areas. Similarly, subject to planning permission, the potential development site may be capable of being used in different ways – as a hotel rather than residential for example; or at least a different mix of uses. EUV / AUV is effectively a 'bottom line' in a financial sense and a therefore a key factor in this study.
- 4.11 For residential developments, we have arrived at a broad judgement on the likely range of existing use values, having regard to the existing use values provided in the Affordable Housing Viability Study. Our assumptions used for arriving at each EUV are provided in Table 4.11.1, with rents sourced from the Estates Gazette 'EGI' database of lettings over the past three years. In each case, the calculations assume that the landowner has made a judgement that the current use does not yield an optimum use of the site; for example, it has many fewer storeys than neighbouring buildings; or there is a general lack of demand for the type of space, resulting in low rentals, high yields and high vacancies (or in some cases no occupation at all over a lengthy period). We would not expect a building which makes optimum use of a site and that is attracting a reasonable rent to come forward for development, as residual value may not exceed existing use value in these circumstances.

Table 4.11.1: Existing use values per hectare – assumptions

Assumption	Secondary offices	Industrial	Community uses	Distressed land sales
Site coverage	40%	50%	35%	BNPPRE estimate of distressed sale of land without planning permission
Storeys	3	1.35	1	
Rent	£13.25 psf	£9.75 psf	£5	
Yield	8%	9%	9%	
Letting void	2 years	2 years	2 years	
Refurb costs	£50 psf	£25 psf	Nil	

- 4.12 In considering the value of sites in existing commercial use, it is necessary to understand the concept of ‘yields’. Yields form the basis of the calculation of a building’s capital value, based on the net rental income that it generates. Yields are used to calculate the capital value of any building type which is rented, including both commercial and residential uses. Yields are used to calculate the number of times that the annual rental income will be multiplied to arrive at a capital value. Yields reflect the confidence of a potential purchaser of a building in the income stream (i.e. the rent) that the occupant will pay. They also reflect the quality of the building and its location, as well as general demand for property of that type. The lower the covenant strength of the occupier (or potential occupiers if the building is currently vacant), and the poorer the location of the building, the greater the risk that the tenant may not pay the rent. If this risk is perceived as being high, the yield will be high, resulting in a lower number of years rent purchased (i.e. a lower capital value).
- 4.13 Over the past four years, yields for commercial property have ‘moved out’ (i.e. increased), signalling lower confidence in the ability of existing tenants to pay their rent and in future demand for commercial space. This has the effect of depressing the capital value of commercial space. However, as the economy recovers, we would expect yields to improve (i.e. decrease), which will result in increased capital values. Consequently, EUVs might increase, increasing the base value of sites that might come forward, which may have implications for the amounts of CIL that developments can yield.
- 4.14 Redevelopment proposals that generate residual land values below EUV plus an appropriate margin to the landowner are unlikely to be delivered. While any such thresholds are only a guide in ‘normal’ development circumstances, it does not imply that individual landowners, in particular financial circumstances, will not bring sites forward at a lower return or indeed require a higher return. It is simply indicative. If proven existing use value justifies a higher EUV than those assumed, then appropriate adjustments may be necessary. Similarly, the margin above EUV that individual landowners may require will inevitably vary. As such, Existing Use Values should be regarded as benchmarks rather than definitive fixed variables on a site by site basis.
- 4.15 The EUVs used in this study therefore give a broad indication of likely land values across the Borough, but it is important to recognise that other site uses and values may exist on the ground. There can never be a single threshold land value at which we can say definitively that land will come forward for development. The EUVs that result from the assumptions in table 4.11.1 therefore provide an indication of the spread of values across the Borough, with some sites falling between one value and another. The EUVs are

provided in table 4.15.1 below.

Table 4.15.1: Existing use values (per hectare)

Use	Existing use value (£ millions)
Secondary offices	11.88
Industrial/warehousing	4.81
Community	2.09
Distressed land sales or public sector land	1.21

- 4.16 For commercial developments, we have adopted an approach that assumes that a development will come forward on a site in the same use as the proposed development, as well as sites in alternative commercial uses. For example, an office building may be developed on a site that accommodates an existing office building. Alternatively, the office might be developed on a site in industrial use. The range of testing is summarised in Table 4.16.1. In each case, the floor area assumed to calculate the site's existing use value is based on the percentage of new floor space found in commercial developments that have been completed in the Borough during the past two years. This data (attached as Appendix 2) indicates that existing floorspace in commercial developments equates to 36% of new floorspace. Conversions and changes of use that would not give rise to a CIL payment have been removed from the analysis.

Table 4.16.1: Commercial appraisal scenarios (new and existing floorspace)

Development type	Existing Floorspace
Office	Office
Office	Industrial
Retail	Retail
Retail	Office
Retail	Industrial
Student	Office
Student	Industrial
Hotel	Office
Hotel	Industrial

Specific Modelling Variables

- 4.17 This section summarises the individual assumptions used in the appraisals. These assumptions are consistent with the variables adopted in the Council's Affordable Housing Viability Study, wherever appropriate (and updated to reflect current conditions). This ensures that the Council's affordable housing and CIL requirements have been tested on a consistent basis.

Residential sales values

- 4.18 Residential values in the Borough reflect national trends in recent years but do of course vary across the Borough. We have examined comparable evidence of transacted properties in the Borough, which indicates that sales values range from £3,856 per sq m (£358 per sq ft) to £7,070 per sq m (£657 per sq ft) – see Table 4.18.1 below.

Table 4.18.1 Comparable evidence: residential sales values achieved

Scheme	Ave achieved value per sq ft	Ave achieved values per sq m	Developer	Sales date
City View, NW10 3NB	£677	£7,287	Ansoll	Qtr 4 2011
Octave HA9 0RB	£398	£4,284	Bouygues/Southern	Qtr 3 2011
Regents Court NW10 5LE	£600	£6,458	Finan Wentworth	Qtr 4 2011
Wembley Central HA9 7AF	£441	£4,767	St Modwen	Qtr 4 2011
Wembley City W04 HA9 0WS	£525	£5,651	Quintain	Qtr 2 2011
White House & Oak Tree NW2 5PN	£431	£4,639	Kamm/Bath Mat	Qtr 3 2011
Zahra House NW10 5NL	£562	£6,049	Crossier	Qtr 2 2011
Barham Park HA0 2NE	£331	£3,563	Countryside and Notting Hill	Qtr 1 2012
Rise HA0 4LU	£419	£4,513	Mount Anvil	Q4 '11 and Q1 '12

- 4.19 As noted earlier in the report, Savills predict that sales values will increase over the medium term. We have therefore widened the range of values included in our appraisals to reflect the prospects of real growth of 10% and 25%. However, the appraisals use current values only; we refer to Savills' predictions merely to underline the likely prospects of further future improvements in viability over the medium term.

Commercial rents and yields

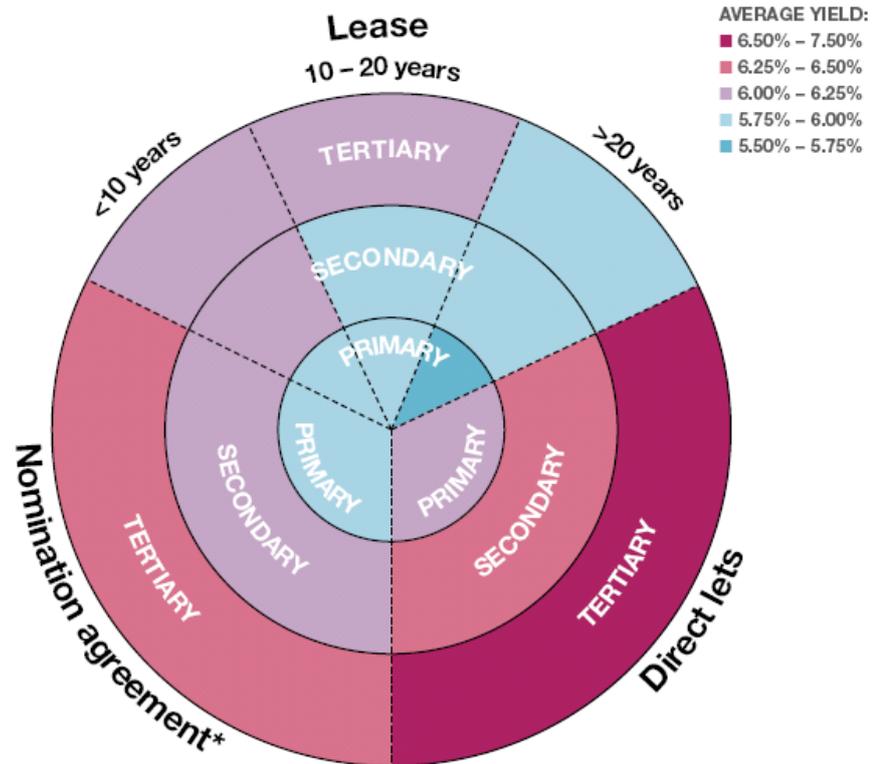
- 4.20 Our research on lettings of commercial floorspace indicates a range of rents achieved, as summarised in table 4.20.1 and Appendix 3. This table also includes our assumptions on appropriate yields to arrive at a capital value of the commercial space. We have assumed a student housing yield of 6.25%, although research by Savills⁴ indicates that yields could be as low as 5.5%, depending on the ownership structure (see figure 4.20.2).

Table 4.20.1: Commercial rents and yields

Commercial use	Rent (£s per sq ft)	Yield
Office	£20 - £24	7%
Industrial	£12	8%
Retail	£20 - £25	6.75%
Student rents	£165 - £176 per week	6.25%
Hotel	Capital values of £110,000 to £130,000 per room	N/A

⁴ 'Spotlight on Student Housing' (Autumn 2011)

Figure 4.20.2: Savills research on yields by location and type



*NA's must be hard core, ie. 15 – 20 years with a high % occupancy guarantee

Source: Savills Research

- 4.21 As noted in paragraph 4.16, for each commercial use type, we have assumed that the site currently accommodates the same or differing use classes and the development involves intensification of that use. The amount of increase in floorspace is determined by analysis of the completions data (attached as Appendix 2). We have assumed lower rents and higher yields for existing space than the planned new floorspace, informed by the EGI database of second hand lettings to reflect the lower quality and lower demand for second hand space, as well as the poorer covenant strength of the likely occupier of second hand space. A modest refurbishment cost of £50 per sq ft for existing office and retail floorspace and £25 for industrial floorspace is allowed to reflect costs that would be incurred to secure a letting. A 20% landowner premium is added to the resulting existing use value as an incentive for the site to come forward for development.

Residential density and mix

- 4.22 We have run appraisals using the range of densities that are typically encountered in the Borough. Densities are assumed to range from 100 units per hectare – a modest inner urban density – to 450 units per hectare – a high central urban density.

A consistent unit mix has been adopted for both private and affordable tenures, as follows. The mix reflects the Core Strategy requirement that 25% of the units be provided with three or more bedrooms.

- One bed: 35%
- Two bed: 40%
- Three bed: 25%

Gross to Net Floor space

- 4.23 The higher the density, the greater the loss of net lettable/ saleable space. This is because flatted schemes require common areas and stair cores, whereas houses provide 100% 'saleable space'. In our model, as a greater quantum of flats is incorporated into the hypothetical development, the build costs increase, to reflect the cost of building the communal space in the blocks of flats.
- 4.24 In our model, we have adopted a gross to net ratio for flats of 85%. This reflects a high volume of schemes that BNP Paribas Real Estate has valued or appraised on behalf of developers, banks and local authorities. The gross to net ratio is reflected in the build cost when measured on the total saleable area (i.e. the area that excludes common areas). For example, if a building is comprised of 10 flats each with a net internal area (i.e. the floorspace inside the flat itself) of 100 square metres, the total net area of the building is 1,000 square metres. However, when the entrance lobbies, corridors and stair cores are taken into account, the total floor area (what is known as the gross internal area) is 1,200 square metres. The net area is 83% of the gross area. If the build cost is £1,500 per square metre, this equates to £1,800 per square metre per net square metre. This is an important distinction when considering whether a build cost is reasonable – the unit of measurement (i.e. gross or net) needs to be consistent.

Base Construction Costs

Residential build costs

- 4.25 The modelling exercise plots a range of base construction costs reflecting density considerations ranging from £1,561 per square metre to £2,852 per square metre (net), incorporating the costs of meeting Lifetime Homes requirements, but excluding infrastructure costs. These costs are drawn from the RICS Building Cost Information Service (BCIS). The costs could increase further should 'exceptional costs' arise, that is the variety of above average costs which include contamination and remediation. As a result, costs need to be treated with caution and where exceeded, will inevitably affect the capacity of schemes to carry obligations and affordable housing.
- 4.26 Our base construction costs assume that housing is provided to Code for Sustainable Homes level 4 and an additional allowance averaging £6,800 per unit has been added to achieve level 4. This reflects the findings of Cyril Sweet's 2008 study⁵ (published by CLG) on the cost of achieving the various CSH levels. Our assumptions therefore reflect these future requirements. The cost of moving to level 5 or 6 is currently prohibitive and technological solutions are required to bring costs down. The current timescale for moving to Code for Sustainable Homes levels 5 and 6 is uncertain. The Inspector's report on the Newark and Sherwood CIL Charging Schedule indicates that CIL viability should be based on current requirements only.

⁵ Communities and Local Government 'Cost Analysis of the Code for Sustainable Homes, 2008'

- 4.27 It is important to note that build costs could increase further should additional 'exceptional costs' arise. As a result, costs need to be treated with caution and where normal levels are exceeded, the capacity of the site concerned to meet the Council's requirements for CIL and affordable housing will be affected. However, with many sites coming forward on previously developed sites, the build costs (which are based on BCIS tender price data) includes an 'average' cost for decontamination and site clearance, with some sites in the sample including such costs.

Commercial build costs

- 4.28 We have relied upon BCIS data for commercial build costs. BCIS reports that the mean average build cost for retail space as at the 3rd quarter of 2011 is £1,033 per sq m; £758 for industrial floorspace; and £1,184 per sq m for office floorspace.

Developer's profit

- 4.29 Developer's profit is closely correlated with the perceived risk of residential development. The greater the risk, the greater the required profit level, which helps to mitigate against the risk, but also to ensure that the potential rewards are sufficiently attractive for a bank and other equity providers to fund a scheme. In 2007, profit levels were at around 15-17% of Gross Development Value. However, following the impact of the credit crunch and the collapse in interbank lending and the various government bailouts of the banking sector, profit margins have increased. It is important to emphasise that the level of minimum profit is not necessarily determined by developers (although they will have their own view and the Boards of the major housebuilders will set targets for minimum profit).
- 4.30 The views of the banks which fund development are more important; if the banks decline an application by a developer to borrow to fund a development, it is very unlikely to proceed, as developers rarely carry sufficient cash to fund it themselves. Consequently, future movements in profit levels will largely be determined by the attitudes of the banks towards development proposals.
- 4.31 The near collapse of the global banking system in the final quarter of 2008 is resulting in a much tighter regulatory system, with UK banks having to take a much more cautious approach to all lending. In this context, the banks may not allow profit levels to decrease much lower than their current level, if at all.
- 4.32 The minimum generally acceptable profit level is currently around 20% of private housing GDV. Our assumed return on the affordable housing GDV is 6%. A lower return on the affordable housing is appropriate as there is very limited sales risk on these units for the developer; there is often a pre-sale of the units to an RSL prior to commencement. Any risk associated with take up of intermediate housing is borne by the acquiring RSL, not by the developer. A reduced profit level on the affordable housing reflects the Homes and Communities Agency's guidelines in its Economic Appraisal Tool.

Affordable housing tenure and values

- 4.33 The Council's policy position is 70% rented housing and 30% shared ownership. The Affordable Rent tenure is accepted, subject to the RSL setting rent levels that are accessible to households in receipt of Housing Benefit. This requirement caps the rent levels, particularly for larger units, at the following percentages of market rent:

- One bed unit: 80%;
 - Two bed unit: 70%;
 - Three bed unit: 60%; and
 - Four bed unit: 50%.
- 4.34 We have calculated the value of the Affordable Rent units housing by capitalising the net rents (inclusive of service charges), before deductions for management and maintenance, having regard to financing arrangements of Registered Social Landlords. This exercise results in a blended rate of £2,411 per square metre (£224 per sq ft).
- 4.35 As intermediate housing is linked to market values, the values will be determined in part by varying market values. The values adopted for this tenure are based on the assumption that 50% of the equity is sold to the occupier and the RSL charges a rent of 2.75% on the retained equity. This is a cautious approach as the price paid will in reality move with the market changes and also RSL ability to fund acquisitions and their business plan assumptions.
- 4.36 The CLG/HCA '2011-2015 Affordable Homes Programme – Framework' (February 2011) document clearly states that RSLs will not receive grant funding for any affordable housing provided through planning obligations. Consequently, all our appraisals assume nil grant.

Other Influential Factors

- 4.37 Variability of landowner attitudes: Land markets need time to adapt to changing policy circumstances and landowners may have the choice to hold sites back and hope that policies change. Up until the recent housing market recession, a more common circumstance in areas of sharp price inflation has been fierce competition between developers. This resulted in some developers buying sites without consent on the expectation that rising capital values would offset risk. When the market turns, these developers find that they are unable to implement their schemes and cannot afford their infrastructure and affordable housing obligations.
- 4.38 Site specific circumstances may arise where the authority is obliged to weigh up perhaps conflicting policy requirements. On sites with an extensive requirement for decontamination (i.e. above average levels), not all the Council's planning requirements may be affordable. For example, an employment protection policy may require commercial space to be provided in a predominantly residential scheme. The commercial space is likely to have a negative or low value, which requires a cross subsidy from the private housing. This is likely to reduce the amount of subsidy available to provide CIL and affordable housing.

Net additional floorspace calculations

- 4.39 The Council has supplied details of all completed schemes over the past two years (attached as Appendix 2). We have analysed the amount of existing and new floorspace to calculate an average rate of net additional floorspace across all developments. This analysis indicates that existing floorspace equates to 36% of planned replacement space. This net additional floorspace calculation is used to consider appropriate levels of CIL in the next section.

5 Appraisal outputs

Residential appraisals

- 5.1 The full outputs from our appraisals of residential development are attached as Appendix 3. For each development scenario, we have tested the following levels of affordable housing (all assumed to be 70% rented and 30% Shared Ownership, in line with the Core Strategy):
- 10% affordable housing;
 - 20% affordable housing;
 - 30% affordable housing;
 - 40% affordable housing; and
 - 50% affordable housing;
- 5.2 For each affordable housing level, we have tested the rented housing with social rents and with 'affordable rents' at the following percentages of market rent:
- One bed flats: 80%;
 - Two bed flats: 70%;
 - Three bed flats: 60%; and
 - Four bed flats: 50%.
- 5.3 The residual land values from each of the scenarios above are then compared to four existing use value benchmarks to determine whether the imposition of CIL would have an impact on development viability. In some cases, the equation RLV less EUV (including landowner premium) results in a negative number, so the development would not proceed, whether or not CIL was imposed. We therefore focus on situations where the RLV is greater than EUV and where (all other things being equal) the development would proceed. In these situations, CIL has the potential to 'tip the balance' of viability into a negative position. We return to this point later in this report.

Commercial appraisals

- 5.4 Our research on rents achieved on commercial lettings indicates a range of rents within each main use class. Our commercial appraisals therefore model the whole range of rents and capital values to test the impact the different rent levels have on viability and the ability of commercial schemes to contribute towards CIL. For each use class tested (B1, B2/B8 and retail), we have run four appraisals of a quantum of floorspace, each with rent levels reflecting the range identified by our research.

Presentation of data

Residential appraisals results

- 5.5 For each affordable housing percentage, there are 112 appraisals of generic developments, each on a hectare of land, using a range of sales values and development densities. Each set of appraisals is compared to four EUV benchmarks.

- 5.6 The existing use value benchmark (including a landowner premium of 20%) is then deducted from each residual land value to determine whether or not, in each of the specific circumstances, the imposition of CIL at varying levels would impact on scheme viability. A sample table, corresponding to the residual land values above, is provided below.

Density - units/ha ->	100 uph	150 uph	200 uph	250 uph	300 uph	350 uph	400 uph	450 uph
Build costs ->	£1561 per sqm	£1615 per sqm	£1722 per sqm	£1938 per sqm	£2153 per sqm	£2260 per sqm	£2314 per sqm	£2368 per sqm
Sales value per sq m								
£3,875	1,532,412	1,808,313	1,103,605	- 1,904,204	- 6,265,633	- 9,631,915	- 12,334,765	- 15,369,331
£4,198	2,326,309	3,005,864	2,708,524	116,958	- 3,821,232	- 6,780,114	- 9,075,563	- 11,702,729
£4,521	3,119,591	4,195,788	4,304,787	2,123,105	- 1,376,831	- 3,928,313	- 5,816,363	- 8,036,128
£4,844	3,912,873	5,385,711	5,891,352	4,129,253	1,032,667	- 1,083,310	- 2,557,162	- 4,369,527
£5,167	4,699,759	6,566,040	7,465,124	6,107,414	3,420,571	1,702,578	638,324	- 752,798
£5,490	5,312,233	7,484,751	8,690,071	7,638,599	5,277,433	3,868,917	3,114,141	2,032,495
£5,920	6,128,864	8,709,698	10,323,334	9,680,177	7,747,424	6,757,370	6,415,229	5,746,219
£6,458	7,149,654	10,240,883	12,364,913	12,232,150	10,809,792	10,354,630	10,541,590	10,388,374
£6,997	8,170,443	11,772,066	14,406,492	14,784,125	13,872,161	13,927,393	14,627,425	15,005,057
£7,535	9,191,233	13,303,251	16,448,071	17,336,098	16,934,529	17,500,156	18,710,583	19,598,610
£8,073	10,212,022	14,834,434	18,489,650	19,888,071	19,996,897	21,072,919	22,793,740	24,192,163
£8,611	11,232,812	16,365,619	20,531,229	22,440,046	23,059,265	24,645,682	26,876,898	28,785,714
£9,149	12,253,601	17,896,803	22,572,808	24,992,019	26,121,633	28,218,445	30,960,056	33,379,267
£9,688	13,274,391	19,427,987	24,614,387	27,543,992	29,184,002	31,791,208	35,043,214	37,972,820

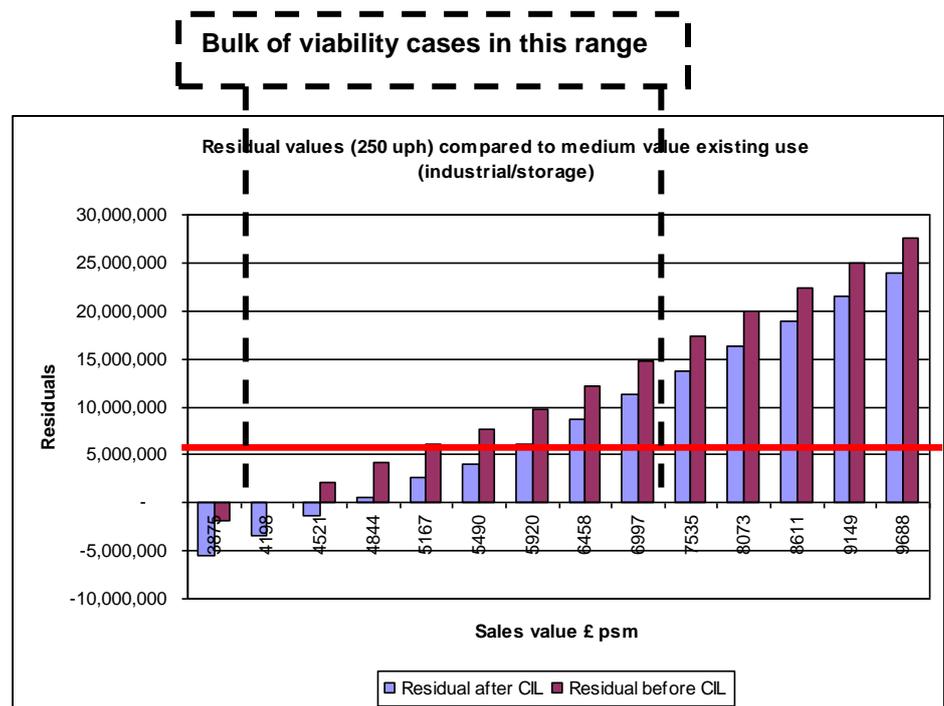
RLVs less existing use value £4,843,800 per hectare Industrial/Storage/Distribution
£1,961,053 per acre

Density - units/ha ->	100 uph	150 uph	200 uph	250 uph	300 uph	350 uph	400 uph	450 uph	Sales value per sq m
Build costs ->	£1561 per sqm	£1615 per sqm	£1722 per sqm	£1938 per sqm	£2153 per sqm	£2260 per sqm	£2314 per sqm	£2368 per sqm	
Sales value per sq m									
£3,875	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£3,875
£4,198	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£4,198
£4,521	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£4,521
£4,844	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£4,844
£5,167	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£5,167
£5,490	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£5,490
£5,920	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£5,920
£6,458	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£6,458
£6,997	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£6,997
£7,535	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£7,535
£8,073	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£8,073
£8,611	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£8,611
£9,149	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£9,149
£9,688	⊗	⊗	⊗	⊗	⊗	⊗	⊗	⊗	£9,688

- 5.7 If the RLV less EUV calculation is shown as a green, this indicates a positive result and a viable development scenario. However, where the RLV less EUV calculation is shown using a red symbol, the development would be unviable at the given level of CIL.

- 5.8 We then chart the results (as illustrated below) to test whether the impact of CIL would reduce the RLV below the EUV benchmark (shown as a red line on each chart). In this example of a 250 unit per hectare scheme on a site currently in industrial/storage use, the purple bars correspond to the RLVs of the scheme at varying sales values (in the range of £3,875 to £9,688 per sq m). The blue bars shows the RLV after the imposition of a CIL, levied on the net additional floor space.

- 5.9 In the example below, where sales values are at £4,844 per sq m or lower, a scheme would generate a RLV that is lower than the EUV (shown by the red line). These sites would not come forward unless another variable were to change (e.g. a reduction in the affordable housing percentage below 50%). However, at sales values of £5,167 per sq m or more, the RLV would exceed the EUV benchmark. The level of CIL is then a critical factor for the schemes that meet the basic viability test. The level of CIL will affect the schemes at the margins of viability. On a scheme with sales values of £5,167 per sqm, the RLV of the scheme after CIL is deducted would fall below the EUV benchmark and in this situation, CIL would prevent the development from proceeding. When sales values exceed £5,920 per sq m, the imposition of CIL would have no impact on the decision to proceed, as the “after CIL” RLV exceeds the EUV benchmark in all cases.



Commercial appraisal results

- 5.10 The commercial appraisal results are more straightforward, due to the narrower range of variables that need to be considered in comparison to residential development. The appraisals are presented in the form of a traditional residual valuation, with the residual land value compared to an existing use value. The ‘surplus’ arising from development is then divided by the total floor area of the new scheme to show the level of CIL that the scheme could viably provide. We also divide the surplus by the net additional floorspace only to provide an indication of the level of CIL per sq m that schemes could yield when the existing space is netted off.

6 Assessment of the results

- 6.1 This section should be read in conjunction with the full results attached at Appendices 3 and 4. In these results, the residual land values are calculated for scenarios with sales values reflective of market conditions across the Borough. These RLVs are then compared to existing use value benchmarks, which include a 20% landowner premium. The graphs in the sections below show the outputs of our appraisals using the variables set out in Section 4.
- 6.2 Charging authorities are required to strike “*what appears to [them] to be an appropriate balance*” between the need to raise funding to provide infrastructure to ensure development is sustainable and the potential impact of CIL on the economic viability of development. Our recommendations are that:
- Firstly, councils should take a strategic view of viability. There will always be variations in viability between individual sites, but viability testing should establish the most typical viability position; not the exceptional situations.
 - Secondly, they should take a balanced view of viability – residual valuations are just one factor influencing a developer’s decision making – the same applies to local authorities.
 - Thirdly, while a single charge is attractive, it may not be appropriate for all authorities.
 - Fourthly, markets are cyclical and subject to change over short periods of time. Sensitivity testing to ‘stress test’ levels of CIL to ensure they are robust in the most likely of market conditions over the life of a Charging Schedule is essential.
 - Fifthly, local authorities should not set their rates of CIL at the limits of viability. They should leave a margin or contingency to allow for change and site specific viability issues.
- 6.3 The early examinations have seen a debate on how viability evidence should translate into CIL rates. It has now been accepted that there is no requirement for a proposed rate to slavishly follow the outputs of residual valuations. At Shropshire Council’s examination in public, Newark & Sherwood Council argued that rates of CIL should be set at the level dictated by viability evidence which would (if followed literally) have resulted in a Charging Schedule with around thirty different charging zones across the Shropshire area. Clearly this would have resulted in a level of complexity that CIL is intended to avoid. The conclusion of this debate was that CIL rates should not necessarily be determined solely by viability evidence, but *should not be logically contrary* to the evidence. Councils should not follow a mechanistic process when setting rates – appraisals are just a guide to viability and are widely understood to be a less than precise tool.

Assessment – residential development

- 6.4 As CIL is intended to operate as a fixed charge, the Council will need to consider the impact on two key factors. Firstly, the need to strike a balance between maximising revenue to invest in infrastructure and the need to minimise the impact upon development viability. Secondly, as CIL will effectively take a ‘top-slice’ of development value, there is a potential impact on the percentage or tenure mix of affordable housing that can be secured. This is a change from the current system of negotiated financial contributions, where the planning officer could weigh the need for contributions against the

requirement that schemes need to contribute towards affordable housing provision.

- 6.5 In assessing the results, it is important to clearly distinguish between two scenarios; namely, schemes that are unviable *regardless of the level of CIL* and schemes that are viable *prior* to the imposition of CIL at certain levels. If a scheme is unviable before CIL is levied, it is unlikely to come forward and CIL would not be a critical factor. We have therefore disregarded the ‘unviable’ schemes in recommending an appropriate level of CIL.
- 6.6 Charts 6.6.1 to 6.6.4 show the impact upon development viability of a CIL charge of £300 per sqm (including the Mayoral CIL of £35 per sqm) levied on the entire development (i.e. no discount for existing floorspace). Each chart compares the results to each of the four EUV benchmarks (shown as a horizontal red line on each chart). All the development scenarios assume 50% affordable housing, with the rented housing provided as Affordable Rent.

Chart 6.6.1: Viability of CIL charge of £300 – High EUV benchmark

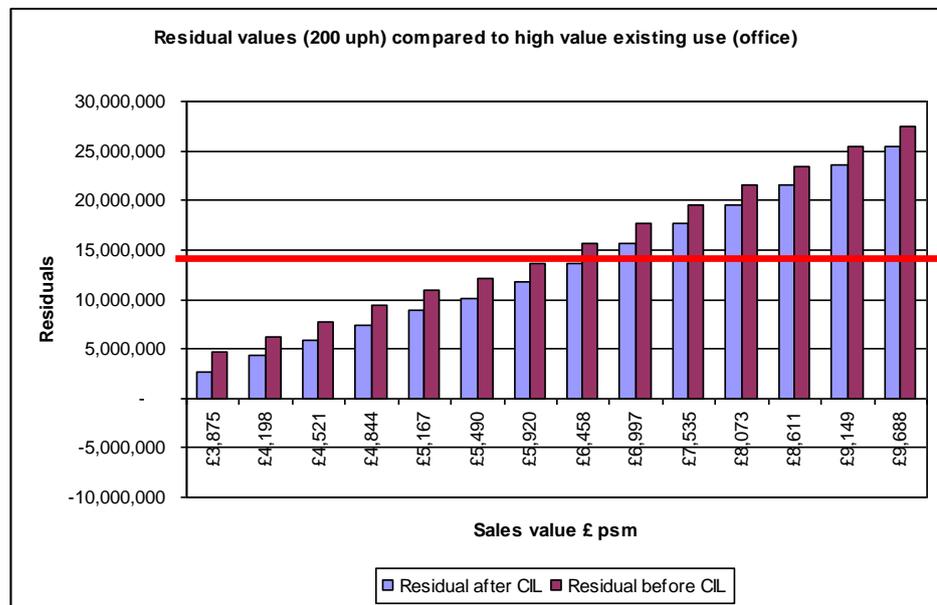


Chart 6.6.2: Viability of CIL charge of £300 – Medium EUV benchmark

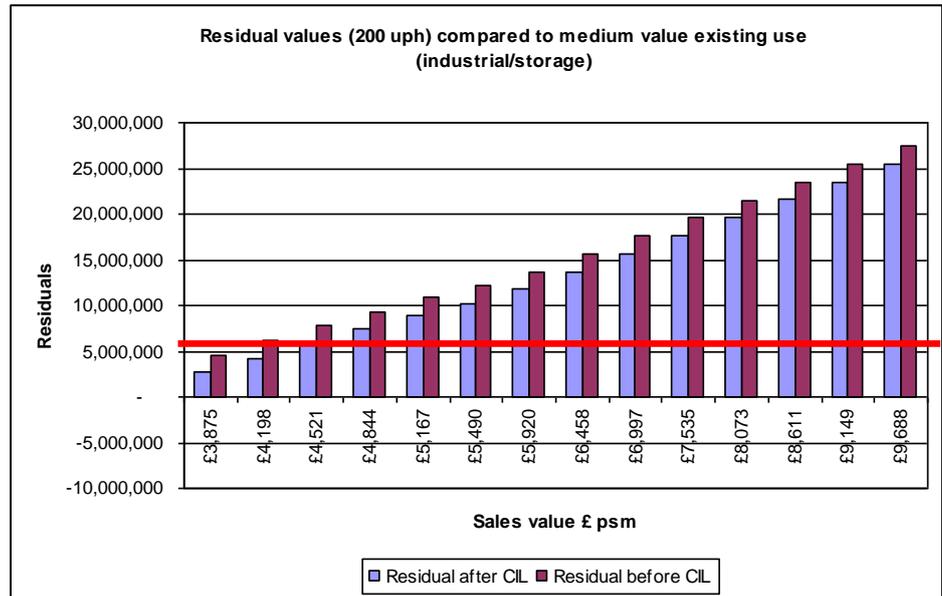


Chart 6.6.3: Viability of CIL charge of £300 – Med-Low EUV benchmark

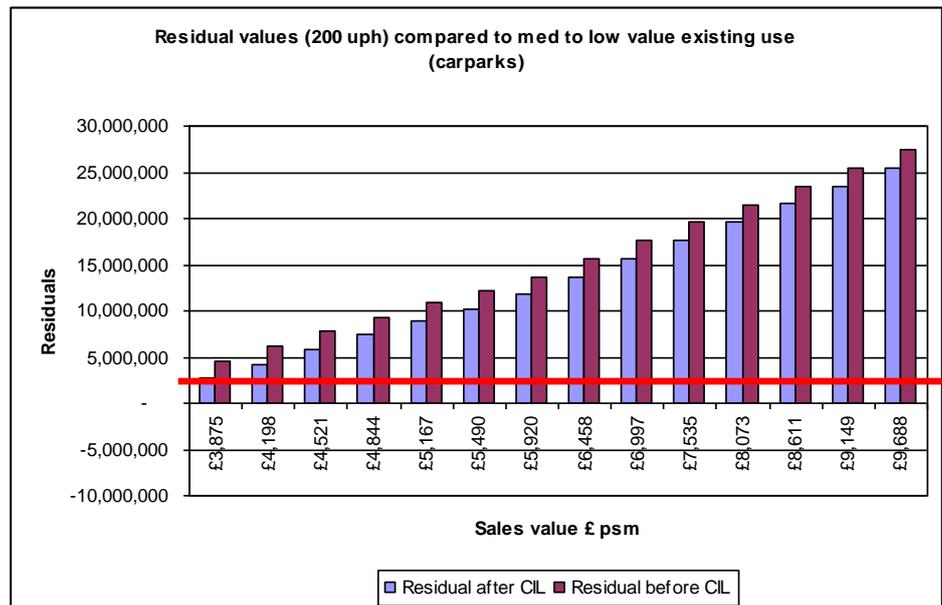
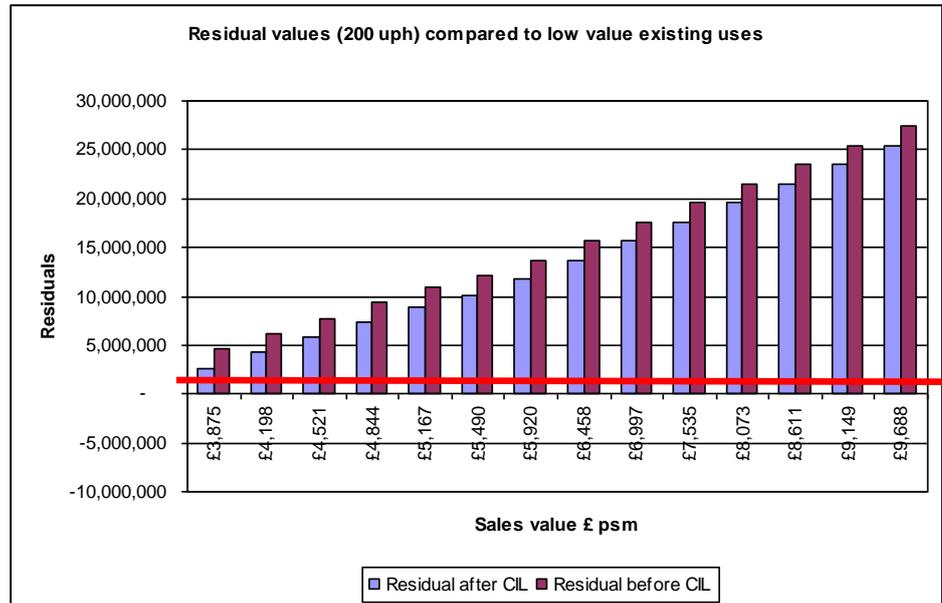


Chart 6.6.4: Viability of CIL charge of £300 – Lowest EUV benchmark



6.7 Charts 6.6.1, 6.6.2 and 6.6.3 indicate that a number of development scenarios would be rendered unviable by a CIL levied at a rate of £300 per sqm across the development. However, as noted previously, CIL will be levied on net additional floorspace only. Our analysis of schemes completed over the past two years indicates that, on average, existing floorspace equates to 36% of new floorspace. In the next set of charts (6.7.1 to 6.7.4), we consider the viability of the same charge (£300 per sqm) but levied on the net additional floorspace **only**.

Chart 6.7.1: Viability of CIL charge of £300 levied on net additional floorspace only – High EUV benchmark

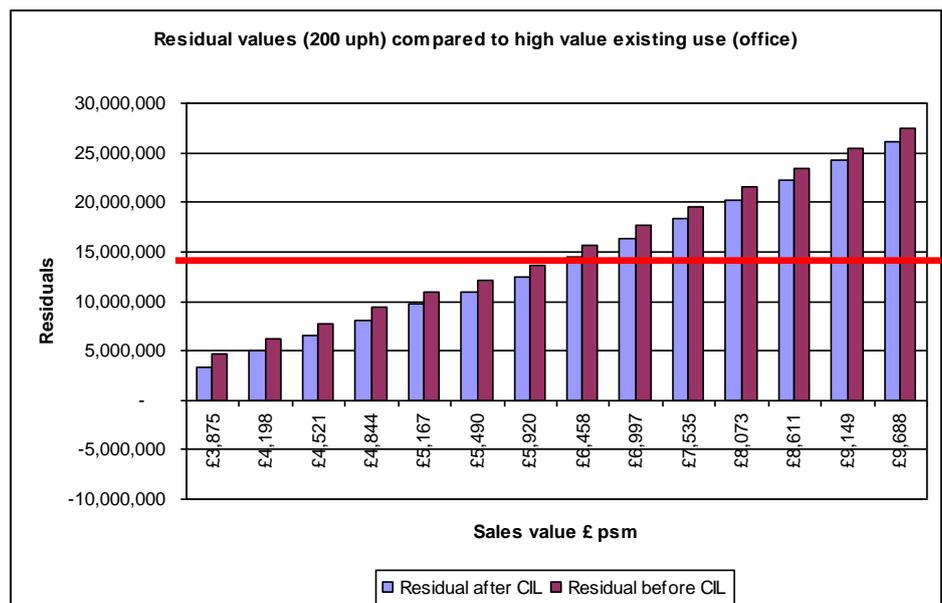


Chart 6.7.2: Viability of CIL charge of £300 levied on net additional floorspace only – Medium EUV benchmark

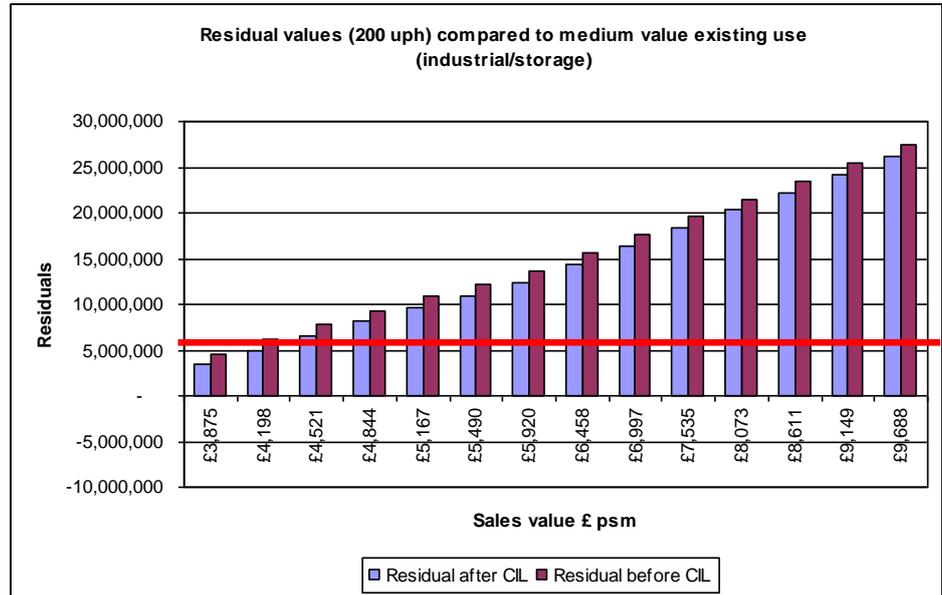


Chart 6.7.3: Viability of CIL charge of £300 levied on net additional floorspace only – Med-Low EUV benchmark

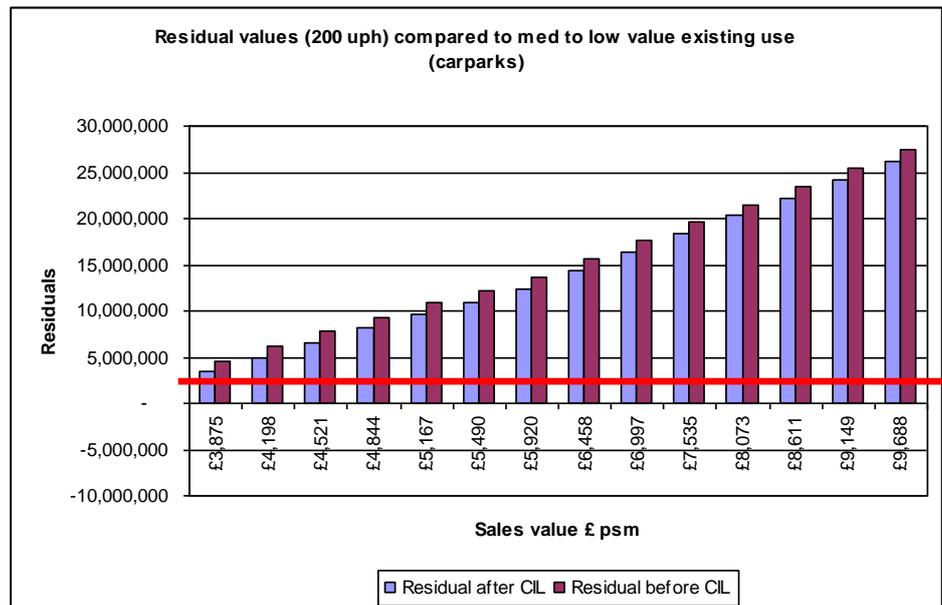
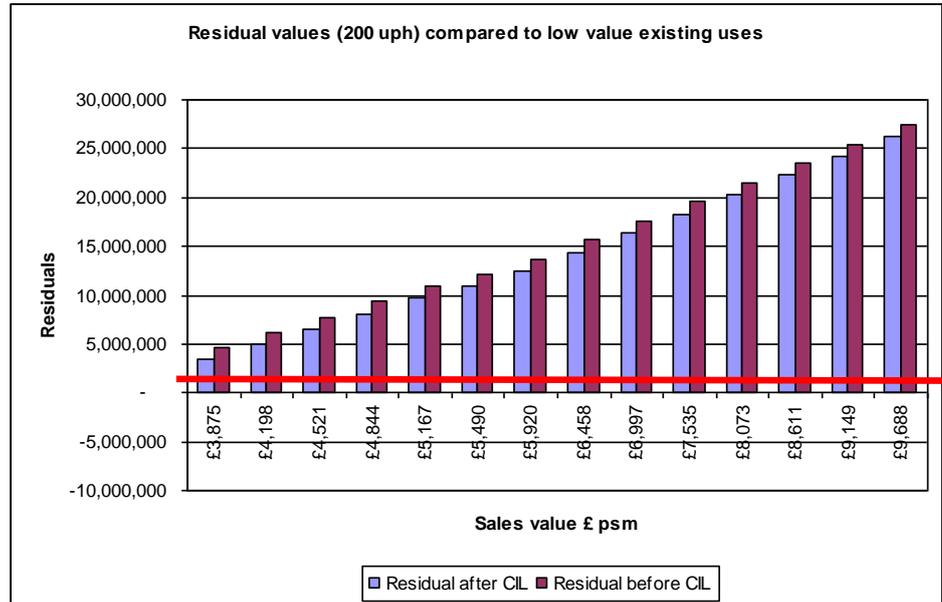


Chart 6.7.4: Viability of CIL charge of £300 levied on net additional floorspace only –Low EUV benchmark



- 6.8 Given that many schemes will fall into the £3,875 to £5,920 per sq m sales value bands (as indicated by table 4.18.1, in which more schemes sit within this range than in excess of £5,920 per sqm), a CIL rate of £300 per sqm appears to be the very highest level that could be set without a significant impact on the viability of residential development. At a reduced rate of CIL of £235 per sqm (Borough CIL of £200 plus Mayoral CIL of £35 per sqm), schemes at sales values of £4,198 per sqm (that were rendered unviable by the higher CIL charge on medium value industrial sites) would become viable (see Charts 6.8.1 to 6.8.4).

Chart 6.8.1: Viability of CIL charge of £235 levied on net additional floorspace only – High EUV benchmark

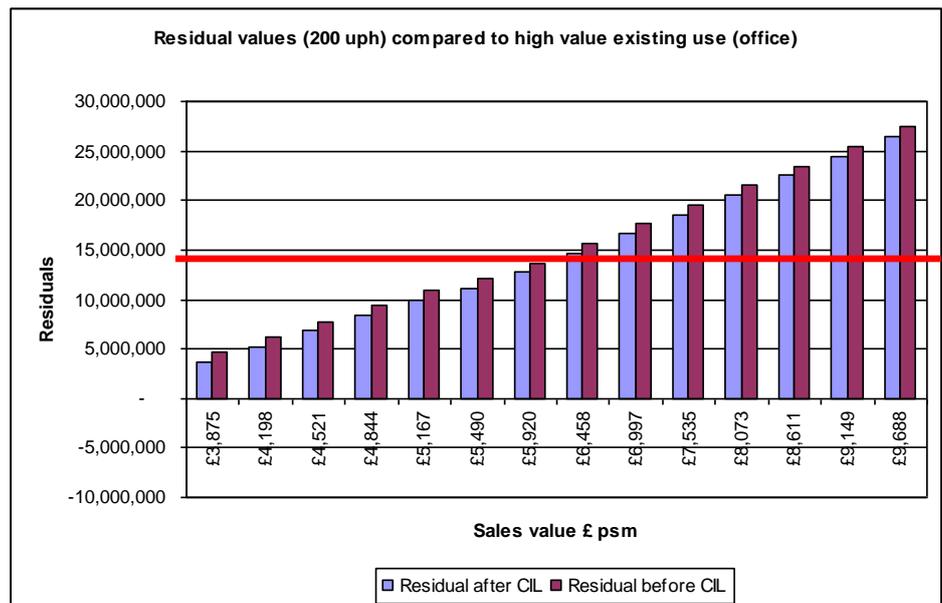


Chart 6.8.2: Viability of CIL charge of £235 levied on net additional floorspace only – Medium EUV benchmark

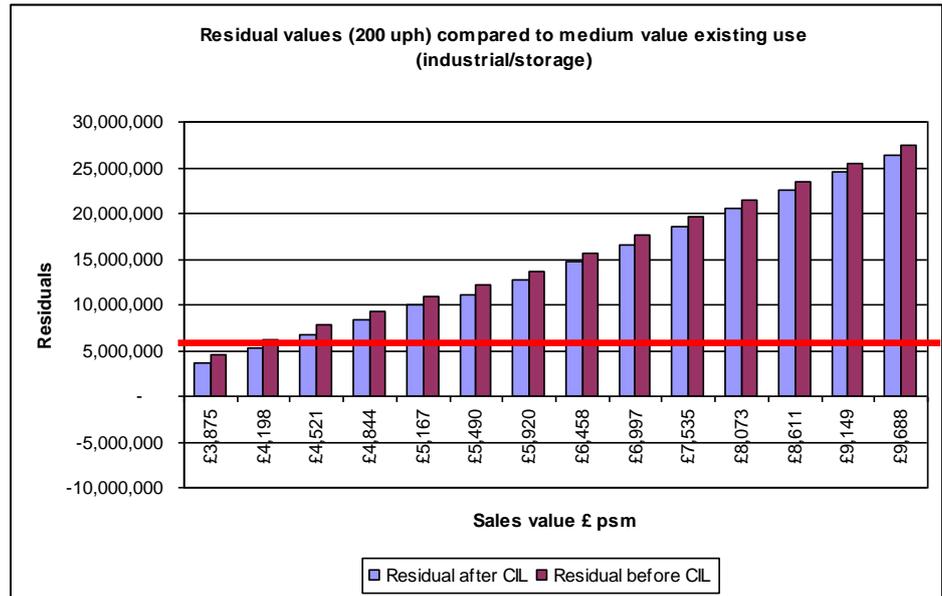


Chart 6.8.3: Viability of CIL charge of £235 levied on net additional floorspace only – Medium/Low EUV benchmark

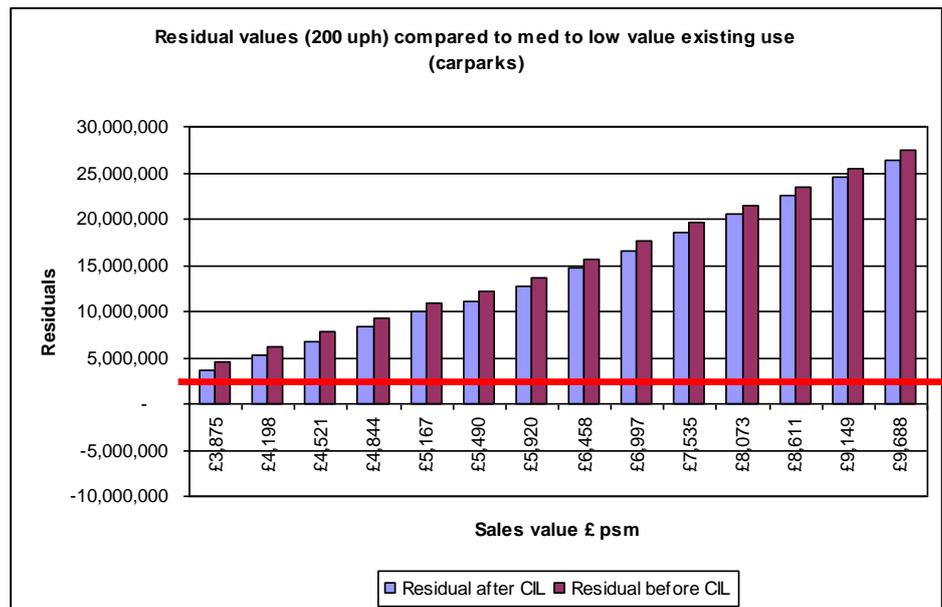
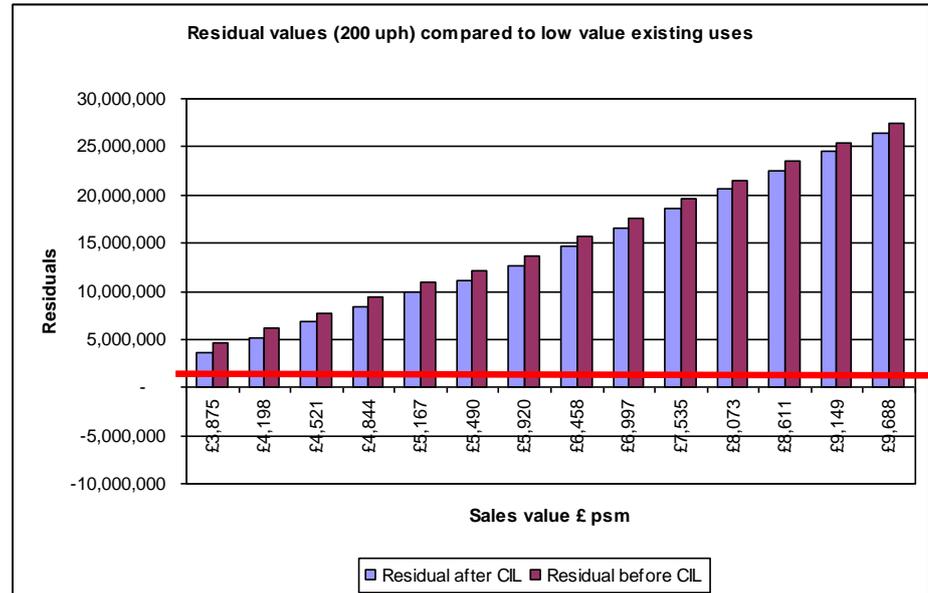


Chart 6.8.4: Viability of CIL charge of £235 levied on net additional floorspace only – Low EUV benchmark



Although the charts above relate to schemes with densities of 200 units per hectare, the broad pattern of results for schemes of higher and lower densities is consistent with the results shown in the charts above, albeit that the range of residual values is higher when densities increase.

Impact of real house price growth

- 6.9 Increasing real house prices will enhance the ability of schemes to absorb a higher rate of CIL in the future. Table 6.9.1 below shows how the current range of values will change in the future as a result of an increase in sales values of 10% and 25% in real terms. This is the increase in excess of the negative impact of other changes, such as increasing build costs.

Table 6.9.1: Impact of inflation on range of sales values

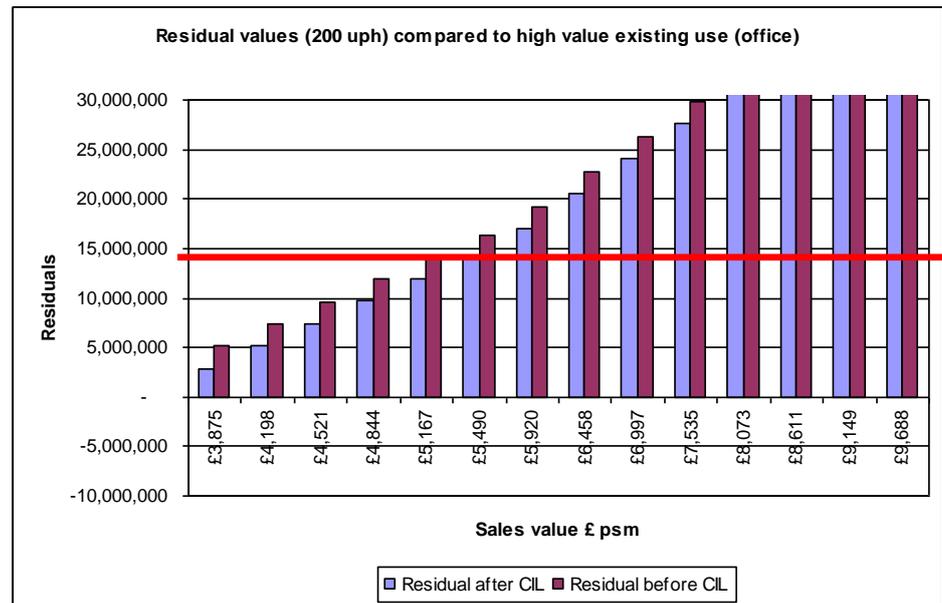
Sales value range	Low (£s per sqm)	High (£s per sqm)
Current	3,875	6,997
10% real terms inflation	4,198	7,535
25% real terms inflation	4,844	8,611

The results from the appraisals with inflated sales values are included within the charts above and the tables attached at Appendix 4. The range of values simply shifts to the right along the scale, so for example, where values are inflated by 10%, the range starts at the second bar in chart, rather than the first.

Reduced affordable housing

- 6.10 On residential developments, the Council has the option of reducing the quantum of affordable housing if viability issues emerge. To illustrate the impact of reducing affordable housing requirements on scheme viability, chart 6.10.1 shows the residual values generated by a scheme with 10% affordable housing on a high existing use value site.

Chart 6.10.1: Viability of CIL charge of £300 levied on net additional floorspace only – High EUV benchmark – 10% affordable housing



Hotel development

- 6.11 We have separately assessed the ability of hotel developments to make contributions through CIL (appraisal attached at Appendix 5). Assuming a capital value of £110,000 per room, reflective of the lower value end of the market (see Appendix 3), our appraisals indicate that hotel developments on existing industrial sites should be able to absorb a CIL of up to £295 per sqm, including the Mayoral CIL. However, hotels developed on existing office sites would be able to absorb a lower CIL of up to £130 per sqm. Assuming a slightly higher capital value of £130,000, reflective of a mid range hotel, with an increased build cost to reflect the higher specification, hotel developments on existing industrial sites should be able to absorb a CIL of up to £597 per sqm. Higher spec hotels developed on existing office sites would be able to absorb a lower CIL of £432 per sqm.

Student housing development

- 6.12 Student housing developments typically generate high residual land values, although the level of rent charged is a critical factor. Schemes developed by universities themselves tend to have lower rent levels than schemes developed by private sector bodies, such as Unite. Given the financial constraints that universities now operate under, it is likely that most if not all new student housing will be developed by the private sector.
- 6.13 We have run two sets of appraisals. The first appraisals use build costs suggested by Quintain, via their agents, equating to £1,711 per square metre. The second set of appraisals uses costs based on BCIS data, equating to £1,346 per square metre.
- 6.14 Our appraisal indicates that the amount of CIL that student housing schemes could absorb is very sensitive to rent levels. Rents for the major student housing schemes recently developed in the Borough range from £165 to £188 on average per week. The existing use of the site is also another critical factor, with the maximum amount of CIL ranging from £152 per sq metre (at

lower average rents and an existing office site which is 36% of the proposed new floorspace) to £480 per sq metre (at higher average rents and an existing industrial site which is 36% of the proposed new floorspace). The results are summarised in table 6.13.1 to 6.13.4 below. A typical student housing scheme, with rents of £176 per week, should be able to absorb a CIL of £200 per square metre of net additional floorspace (assuming 36% existing floorspace on site⁶). This would allow a comfortable viability margin and for the Mayoral CIL.

Table 6.13.1 – Student housing development on existing office site – existing space equates to 36% of new (as per historic completions) – Quintain suggested build costs

Student housing	Rent of £165 pw	Rent of £188 pw
RLV (£m)	6.42	10.39
EUV benchmark (£m)	5.13	5.13
'Surplus' to fund CIL (£m)	1.29	5.26
CIL per sqm of net additional floorspace	£152	£621

Table 6.13.2 – Student housing development on existing industrial site – existing space equates to 36% of new (as per historic completions) – Quintain suggested build costs

Student housing	Rent of £165 pw	Rent of £188 pw
RLV (£m)	6.41	10.39
EUV benchmark (£m)	3.74	3.74
'Surplus' to fund CIL (£m)	2.67	6.65
CIL per sqm of net additional floorspace	£315	£785

Table 6.13.3 – Student housing development on existing office site – existing space equates to 36% of new (as per historic completions) – BCIS build costs

Student housing	Rent of £165 pw	Rent of £188 pw
RLV (£m)	11.59	15.56
EUV benchmark (£m)	5.13	5.13
'Surplus' to fund CIL (£m)	6.46	10.43
CIL per sqm of net additional floorspace	762	1,230

⁶ Student accommodation coming forward in Brent shows significantly increased site densities, for example with the QED and Victoria Halls schemes, as well as the consented Dexion House scheme and proposals for Kelaty House.

Table 6.13.4 – Student housing development on existing industrial site – existing space equates to 36% of new (as per historic completions) – BCIS build costs

Student housing	Rent of £165 pw	Rent of £188 pw
RLV (£m)	11.58	15.56
EUV benchmark (£m)	3.74	3.74
'Surplus' to fund CIL (£m)	7.84	11.82
CIL per sqm of net additional floorspace	925	1,395

Assessment – commercial development

- 6.15 Our appraisals indicate that the ability of commercial schemes to viably make contributions through CIL will vary according to type of development. Retail floorspace generates a positive RLV in excess of EUV benchmarks, generating a surplus that could be used to make CIL contributions. The ability of offices to absorb a CIL contribution is linked to the question of wider demand for this type of development in Brent; there has been little or no office development in the recent past, indicating that there is no demand for new stock. However, should an office scheme come forward in the future, it is likely that a developer will only do so if the rent level they can achieve is of a sufficient level to achieve a profit and generate a positive residual land value.
- 6.16 As noted in section 4, the level of rents that can be achieved for commercial space varies according to exact location; quality of building; and configuration of space. Consequently, our appraisals reflect this range to show the likely contributions that can be secured on the basis of the range. The Council will need to exercise its judgement, in accordance with the CIL regulations, on where an appropriate balance between viability and income maximisation might lie within the range.

Office development

- 6.17 There is some evidence of lettings of office space in the Borough at over £21 per square foot (see Appendix 3), so a reasonable estimation of a primary range for new build office accommodation is £21 to £23 per sq ft. In our appraisals, we have tested the viability of offices accommodation let at rents ranging from £20 to £24 per sq ft. The results are summarised in tables 6.16.1 to 6.16.4. These results indicate that a CIL of up to £100 per sq m could be levied if an office development is brought forward on an existing office site (with existing space equating to the average level of 36%) assuming a rent of £22 per sq ft could be achieved. A higher level of CIL could be absorbed if a scheme was brought forward on an existing industrial site.

Table 6.17.1 – Office development on existing office site – existing space equates to 36% of new (as per historic completions)

Primary range					
Rent level (per sq ft)	£20	£21	£22	£23	£24
RLV (£m)	0.82	1.05	1.29	1.53	1.77
EUV benchmark (£m)	1.08	1.08	1.08	1.08	1.08
'Surplus' to fund CIL (£m)	NA	NA	0.21	0.45	0.69
CIL per sqm of net additional floorspace	NA	NA	£100	£214	£328

Table 6.17.2 – Office development on existing industrial site – existing space equates to 36% of new (as per historic completions)

Primary range					
Rent level (per sq ft)	£20	£21	£22	£23	£24
RLV (£m)	0.82	1.05	1.29	1.53	1.77
EUV benchmark (£m)	0.79	0.79	0.79	0.79	0.79
'Surplus' to fund CIL (£m)	0.03	0.27	0.50	0.74	0.82
CIL per sqm of net additional floorspace	£14	£127	£241	£354	£390

Table 6.17.3 – Office development on existing office site – existing space equates to 50% of new

Primary range					
Rent level (per sq ft)	£20	£21	£22	£23	£24
RLV (£m)	0.80	1.03	1.27	1.51	1.75
EUV benchmark (£m)	1.50	1.50	1.50	1.50	1.50
'Surplus' to fund CIL (£m)	NA	NA	NA	0.01	0.25
CIL per sqm of net additional floorspace	NA	NA	NA	£4	£144

Table 6.17.4 – Office development on existing industrial site – existing space equates to 50% of new

Primary range					
Rent level (per sq ft)	£20	£21	£22	£23	£24
RLV (£m)	0.80	1.03	1.27	1.51	1.75
EUV benchmark (£m)	1.09	1.09	1.09	1.09	1.09
'Surplus' to fund CIL (£m)	NA	NA	0.18	0.42	0.65
CIL per sqm of net additional floorspace	NA	NA	£104	£244	£384

6.18 As noted previously, there has been little new build office development over

the past few years and clearly conditions will need to be right for developers to bring schemes forward. Setting aside the scenarios above where office development is unviable or marginal (where a scheme would clearly not come forward, regardless of CIL), the other scenarios demonstrate that a modest level of CIL could be absorbed. Based on this judgement, the maximum level of CIL would be around £100 per square metre and we would therefore suggest that a CIL of £40 per square metre (exclusive of Mayoral CIL) should not have a significantly adverse impact on office development.

Retail development

- 6.19 Tables 6.19.1 to 6.19.6 summarise the results of our appraisals of retail development. These appraisals consider retail development on existing retail sites, retail development on existing office sites and on former/existing industrial sites. We have appraised schemes which attract average rents ranging from £20 to £25 per sq ft. The results indicate that existing retail developments are unlikely to be redeveloped as retail, as the new development would generate a lower value than the existing use value. However, where retail development is brought forward on existing office and industrial sites, developments would be able to absorb a CIL ranging from £15 to £607 per sq metre. Given this range, we would suggest a CIL of £80 per sq metre (exclusive of Mayoral CIL) would have limited impact upon the viability of retail development, across the area as a whole.

Table 6.19.1 – Retail development on existing retail site – existing space equates to 36% of new (as per historic completions)

	Primary range					
Rent level (per sq ft)	£20	£21	£22	£23	£24	£25
RLV (£m)	0.88	1.14	1.40	1.66	1.91	2.17
EUV benchmark (£m)	2.23	2.23	1.40	2.23	2.23	2.23
'Surplus' to fund CIL (£m)	NA	NA	NA	NA	NA	NA
CIL per sqm of net additional floorspace	NA	NA	NA	NA	NA	NA

Table 6.19.2 – Retail development on existing office site – existing space equates to 36% of new (as per historic completions)

	Primary range					
Rent level (per sq ft)	£20	£21	£22	£23	£24	£25
RLV (£m)	0.88	1.14	1.40	1.66	1.91	2.17
EUV benchmark (£m)	1.08	1.08	1.08	1.08	1.08	1.08
'Surplus' to fund CIL (£m)	NA	0.06	0.32	0.57	0.83	1.09
CIL per sqm of net additional floorspace	NA	£26	£139	£252	£365	£478

Table 6.19.3 – Retail development on existing industrial site – existing space equates to 36% of new (as per historic completions)

	Primary range					
Rent level (per sq ft)	£20	£21	£22	£23	£24	£25
RLV (£m)	0.88	1.14	1.40	1.65	1.91	2.17
EUV benchmark (£m)	0.79	0.79	0.79	0.79	0.79	0.79
'Surplus' to fund CIL (£m)	0.09	0.35	0.61	0.87	1.13	1.38
CIL per sqm of net additional floorspace	£43	£156	£269	£382	£495	£607

Table 6.19.4 – Retail development on existing retail site – existing space equates to 50% of new

	Primary range					
Rent level (per sq ft)	£20	£21	£22	£23	£24	£25
RLV (£m)	0.86	1.12	1.38	1.65	1.89	2.15
EUV benchmark (£m)	3.10	3.10	3.10	3.10	3.10	3.10
'Surplus' to fund CIL (£m)	NA	NA	NA	NA	NA	NA
CIL per sqm of net additional floorspace	NA	NA	NA	NA	NA	NA

Table 6.19.5 – Retail development on existing office site – existing space equates to 50% of new

	Primary range					
Rent level (per sq ft)	£20	£21	£22	£23	£24	£25
RLV (£m)	0.86	1.12	1.38	1.65	1.89	2.15
EUV benchmark (£m)	1.50	1.50	1.50	1.50	1.50	1.50
'Surplus' to fund CIL (£m)	NA	NA	NA	0.13	0.39	0.65
CIL per sqm of net additional floorspace	NA	NA	NA	£71	£207	£343

Table 6.19.6 – Retail development on existing industrial site – existing space equates to 50% of new

	Primary range					
Rent level (per sq ft)	£20	£21	£22	£23	£24	£25
RLV (£m)	0.86	1.12	1.38	1.65	1.89	2.15
EUV benchmark (£m)	1.09	1.09	1.09	1.09	1.09	1.09
'Surplus' to fund CIL (£m)	NA	0.02	0.28	0.54	0.80	1.06
CIL per sqm of net additional floorspace	NA	£15	£151	£287	£424	£560

Industrial development

- 6.20 Table 6.20.1 summarises the result of our appraisal of industrial development, which is attached as Appendix 5. We have tested the viability of industrial developments on existing industrial sites only, as it is very unlikely that this type of development would be considered on higher value sites, including retail and offices.

Table 6.20.1 – Industrial development on existing industrial site – existing space equates to 36% of new

Rent level (per sq ft)	£12
RLV (£m)	-0.19
EUV benchmark (£m)	0.46
'Surplus' to fund CIL	NA
CIL per sqm of net additional floorspace	NA

Affordable Workspace

- 6.21 We have also considered the ability of schemes providing 'affordable workspace' to make contributions through CIL. For the purposes of this assessment, we have assumed that the workspace is let at 75% of the lowest rent in the range of office rents. This equates to a rent of £15 per sq ft. The results indicate that affordable workspace would not generate sufficient value to make any CIL contribution.

Table 6.21.1: Affordable workspace development on existing industrial site – existing space equates to 36% of new

Rent level (per sq ft)	£15
RLV (£m)	-0.37
EUV benchmark (£m)	0.79
'Surplus' to fund CIL	NA
CIL per sqm of net additional floorspace	NA

D1 floorspace development

- 6.22 D1 floorspace typically includes uses that do not accommodate revenue generating operations, such as schools, health centres, museums and places of worship. Other uses that do generate an income stream (such as swimming pools) have operating costs that are far higher than the income and require public subsidy. Many D1 uses will be infrastructure themselves, which CIL will help to provide. It is therefore unlikely that D1 uses will be capable of generating any contribution towards CIL.
- 6.23 In light of these results, the next section of this report sets out our recommendations to the Council on how it might approach setting appropriate levels of CIL to strike an appropriate balance between revenue maximisation and viability.

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 of 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), subject to the Council seeking confirmation that this is permissible under the current regulations.
 - 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 the amount of CIL that **student housing** schemes could absorb is very sensitive to rent levels. Rents for the major student housing schemes recently developed in the Borough range from £165 to £188 on average per week. The existing use of the site is also another critical factor, with the maximum amount of CIL ranging from £152 per sq metre (at lower average rents and an existing office site) to £785

per sq metre (at higher average rents and an existing industrial site). Given this range, the Council might consider setting a CIL rate of £200 per square metre for student housing developments.

- **Hotel developments** could accommodate a CIL of up to a maximum of £295 per sq metre. We would suggest a starting rate of £200 per sq metre to allow a buffer and the Mayoral CIL.
 - **Office developments** are not a key feature of the development pipeline in Brent, as there is limited demand for new build office accommodation. Conditions will need to be right for developers to bring schemes forward. Setting aside the scenarios above where office development is unviable or marginal (where a scheme would clearly not come forward, regardless of CIL), the other scenarios indicate that a modest level of CIL could be absorbed. The maximum level of CIL would be £100 per sq m, or £40 after allowing a margin to absorb site specific viability issues, plus the Mayoral CIL.
 - Residual land values generated by **Retail developments** vary according to rent levels and the existing use of sites coming forward for development. Our appraisals indicate that existing retail sites are unlikely to be redeveloped, as the residual value would be lower than the existing use value. Retail developments would be viable on existing office and industrial sites, generating a range of CIL levels between £15 to £607 per sq metre. The viable levels of CIL increase very steeply with modest increases in rents (from £21 to £23 per sq ft). In arriving at a balance between the two ends of the range, the Council might consider adopting a CIL of £80 per sq metre, exclusive of the Mayoral CIL. This rate of CIL would be at the lower end of the range and have a minimal impact on viability across the area as a whole.
 - 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.
- 7.5 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 (Table 7.5 shows the recommended CIL rates as a percentage of development costs). 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.

Table 7.5: Recommended CIL rates as a percentage of development costs

Development type	Development costs	Net additional Private floor area (sqm)	CIL liability (including Mayoral CIL)	CIL as % of development costs
Residential	£36,318,000	7,459	£1,752,912	4.83%
Retail	£9,028,000	2,098	£241,326	2.67%
Offices	£7,952,000	1,982	£148,642	1.87%
Hotels	£15,891,000	3,763	£884,348	5.57%
Student	£51,966,000	8,473	£1,991,081	3.83%

Appendix 1 Sample residential appraisal

Appendix 2 Completions data

Appendix 3 Commercial lettings

Appendix 4 Residential appraisal results

Appendix 5 Commercial appraisal results