BNP PARIBAS REAL ESTATE

Ms Claire Shearing
Senior Planning Officer
Royal Borough of Kensington & Chelsea
Kensington Town Hall
Hornton Street
London
W8 7NX

Anthony Lee MRTPI MRICS
Senior Director
BNP Paribas Real Estate
5 Aldermanbury Square
London EC2V 7BP

Tel: 020 7338 4061
Switchboard: 020 7338 4000
Fax: 020 7430 2628
Email: anthony.lee@bnpparibas.com

Your ref:
Our ref: ADL/120838

12 January 2014

Dear Claire

ROYAL BOROUGH OF KENSINGTON & CHELSEA ('RBKC'): COMMUNITY INFRASTRUCTURE LEVY ('CIL') ADDITIONAL VIABILITY TESTING

I am writing to outline the results of our additional viability testing of developments in the Borough to further test the potential impact of proposed rates of CIL. You have requested the following advice:

1. Consideration of the proposed 30% viability buffer or cushion and evidence to support (or otherwise) a change to a 20% cushion;
2. Consideration of the impact of the proposed CIL on 12 'marginal sites'; and
3. Consideration of the impact of the proposed CIL upon the Borough's strategic sites, being Kensal Gas Works and Earl's Court;

We address each of these issues in the following sections.

1. Viability buffer/cushion

Paragraph 30 of the April 2013 Statutory Guidance requires that charging authorities should "*avoid setting a charge right up to the margin of economic viability across the vast majority of sites in their area*". There is no guidance on the 'buffer' or 'cushion' that should be allowed below the margin of viability. Indeed, the Local Housing Delivery Group guidance ('*Viability Testing Local Plans: Advice for planning practitioners*') notes that "*the decision on what cushion might be appropriate will rest with planning authorities…haven taken a view on the level of risk to delivery*".

The extent of viability buffers varies between different authorities and at different points in the economic cycle. For example, Bristol City Council adopted a substantial viability of cushion by setting their CIL rates at 50% of the theoretical maximum rate. However, at the time Bristol published its Preliminary Draft Charging Schedule ('PDCS') (November 2011), macro-economic conditions were substantially worse than they were in 2013. Furthermore, the housing market recovery in Bristol at the time was much more muted than the recovery in London. Bristol Council's consideration of these factors led to the conclusion that a high viability buffer would be the most appropriate route at the time.

Other authorities who have considered their rates in light of more recent macro-economic developments have adopted considerably lower viability buffers than Bristol. For example, Chelmsford Borough Council were satisfied that a buffer of 18% was sufficient on brownfield sites to ensure that delivery of development was not threatened.

In setting its rates and allowing for an appropriate buffer, the Council may wish to have regard to the following factors:

- Market conditions in the Borough (the demand for residential property appears to have strengthened considerably over the last 6 to 12 months which reduces development risk). The risk of falling prices appears to have receded in the short to medium term.

- Development profit: some advisors have started to argue in the last 6 months that lower development risk should result in reductions in developer's profit. Our appraisals assume a 20% profit, and if the other advisors' position is adopted, this already provides a degree of viability cushion. Arguably, therefore, the Council could probably reduce the buffer below the maximum rate without adversely impact on delivery.

- Build costs: although sales values are likely to increase over the next 5 years (with Savills predicting nominal increases of circa 30% in prime London markets), there are also predictions that build cost inflation will erode some of these increases.

The Council will need to weigh the factors above and decide whether it would be appropriate to reduce the viability buffer, which is currently set at 30%. Whilst the viability buffer is ultimately a matter of judgement by each individual charging authority, we would suggest a buffer should be no lower than 20%. Table 1.1 below shows the CIL rates in the PDCS with a 30% buffer and a reduced 20% buffer.

Table 1.1: RBKC CIL rates from PDCS and with reduced buffer of 20% on residential

CIL zone	CIL rate after 30% buffer	CIL rate after 20% buffer
A	£650	£750
B	£500	£590
C	£370	£430
D	£230	£270
E	£150	£190
F	£100	£110

2. Impact of CIL on marginal sites

The Council has supplied details of 12 'marginal' sites in order that we can consider the impact of the proposed rates of CIL on their viability. The content of the 12 developments are summarised in Table 2.1 below.

BNP PARIBAS REAL ESTATE

Table 2.1: Marginal developments

Site reference	CIL zone	Description of development
1	F	Change of use from public house to 8 residential units.
2	B	Change of use from post office to 3 residential units and 320 sqm of retail
3	B	Redevelopment of vacant office to provide 50 residential units
4	E	Change of use from public house and 2 residential units to 8 residential units and 439 square metres of A4 floorspace
5	C	Redevelopment of cinema to provide new cinema and 40 residential units
6	B	Redevelopment of existing residential unit to provide 2 new units
7	A	Development of 13 residential units
8	A	Roof extension across three existing properties to create 1 additional dwelling
8	A	Roof extension across three existing properties to create 1 additional dwelling
9	B	Change of use of 1st to 4th floors and rear extension to provide 6 residential units
10	D	Subdivision of existing flat to provide 2 dwellings
11	Student	Conversion of existing building to provide 88 student units
12	Hotel	Extension of existing hotel

Our appraisals of each development are attached as Appendix 1 (30% buffer below maximum rates) and Appendix 2 (20% buffer below maximum rates). In each case, we have adopted appraisal assumptions that are consistent with those adopted in the main viability report. However, given the elapse of time since that report was undertaken, sales values have increased by 9.2% according to Land Registry data. We have therefore increased sales values in each zone by this percentage.

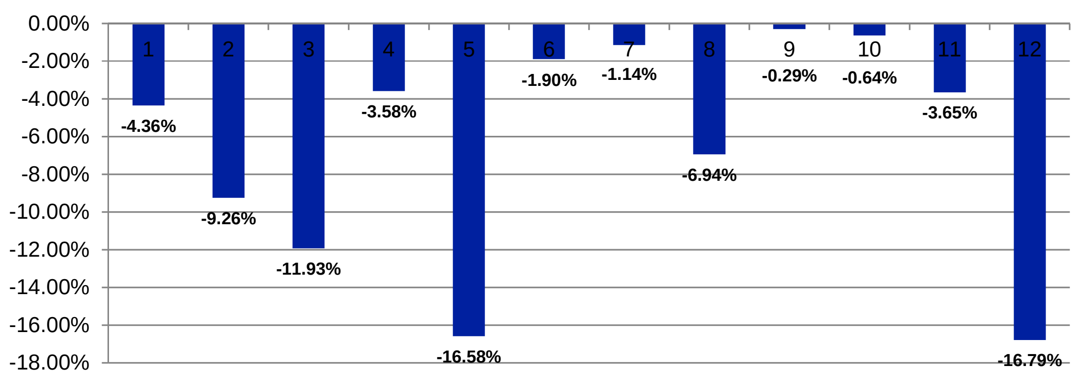
We have considered two factors to determine the impact of CIL on viability. The first is the proposed CIL for each site as a proportion of scheme value. This measure has been accepted as a broad 'test of reasonableness' of proposed CIL rates by examiners at numerous CIL examinations elsewhere. Secondly, we have considered the impact of the proposed CIL on residual land values, as this will be of more relevance to landowners than scheme value. It is important to note, however, that CIL will replace a significant proportion of existing Section 106 obligations and is therefore not an entirely 'additional burden' on development. However, our analysis of the impact of CIL on land value treats CIL as being an additional burden and should therefore be seen as a worst case scenario. Table 2.2 summarises the outputs of our appraisals with CIL rates assuming a 30% buffer (as consulted on in the PDCS).

Table 2.2: Results of marginal sites analysis (30% buffer)

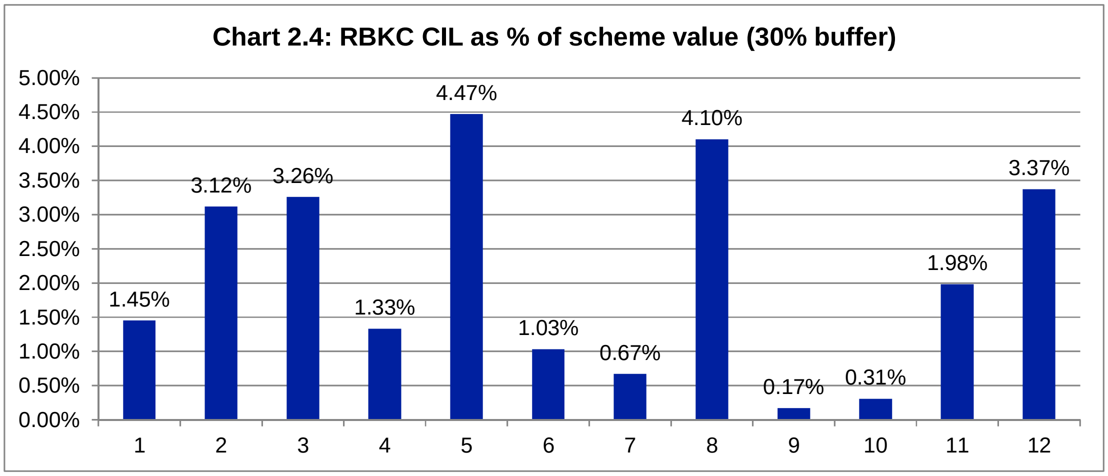
	Residual land value - with RBKC CIL	Residual land value - No RBKC CIL	Impact of CIL on residual land value	GDV	RBKC CIL as % of GDV
1	£1,554,410	£1,625,191	-4.36%	£5,487,766	1.45%
2	£4,091,273	£4,508,836	-9.26%	£15,026,384	3.12%
3	£7,322,438	£8,314,710	-11.93%	£35,134,192	3.26%
4	£2,877,438	£2,984,144	-3.58%	£9,032,383	1.33%
5	£17,493,318	£20,970,732	-16.58%	£89,809,758	4.47%
6	£5,067,090	£5,165,472	-1.90%	£10,761,627	1.03%
7	£100,038,155	£101,196,739	-1.14%	£195,358,927	0.67%
8	£1,473,267	£1,583,052	-6.94%	£2,980,430	4.10%
9	£4,340,065	£4,352,643	-0.29%	£8,465,689	0.17%
10	£758,915	£763,829	-0.64%	£1,787,285	0.31%
11	£8,886,264	£9,222,985	-3.65%	£19,246,216	1.98%
12	£3,421,611	£4,112,232	-16.79%	£23,220,000	3.37%

In all but 3 cases, the CIL reduces the residual land value by less than 10%, with the remaining 3 seeing reductions of 12% and circa 17% (see Chart 2.3 below). The reduction is sufficiently small in all cases for the CIL not to be considered to put these developments at risk, particularly as the residual land values very often result in a considerable uplift in value compared to the existing use values of the sites.

Chart 2.3: Impact of CIL on residual land value (% reduction from 'no CIL' residual land value) 30% buffer



The proposed rates of CIL also represent a modest proportion of overall scheme value, as shown in Chart 2.4 below. In 7 cases, the proposed CIL will amount to less than 2% of scheme value, while on the remaining 5 sites, CIL as a proportion of scheme value ranges from 3.12% to 4.47%. CIL is demonstrably a marginal cost and given its modest scale, is unlikely to threaten the delivery of these 12 sites.

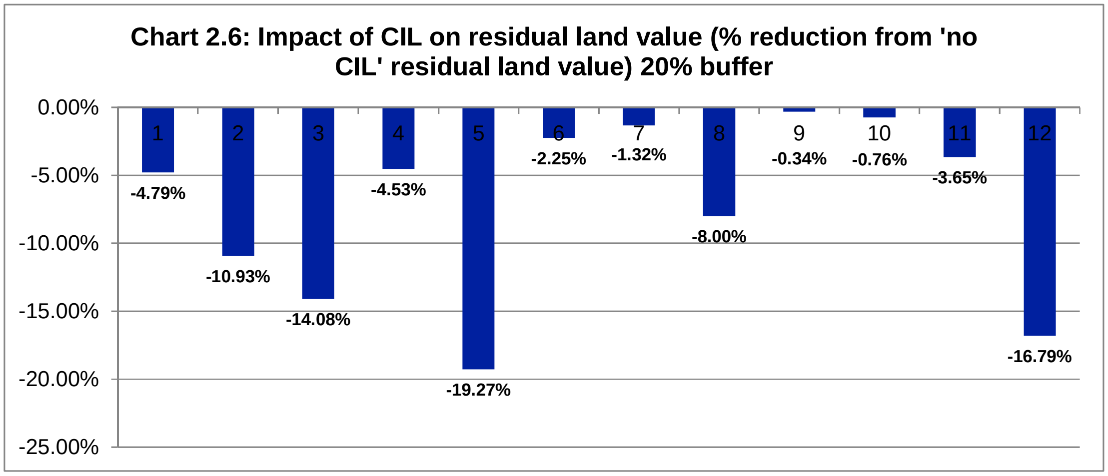


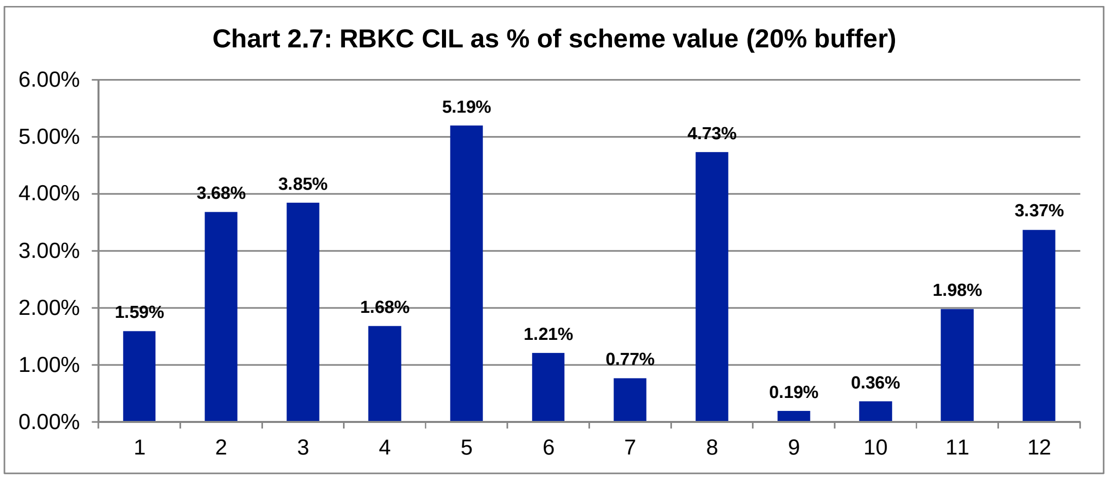
We have repeated the analysis above but with a reduced buffer of 20% below the maximum rate. The CIL rates with a 20% buffer are shown in Table 1.1 above.

Table 2.5: Results of marginal sites analysis (20% buffer)

	Residual land value - with RBKC CIL	Residual land value - No RBKC CIL	Impact of CIL on residual land value	GDV	RBKC CIL as % of GDV
1	£1,547,332	£1,625,191	-4.79%	£5,487,766	1.59%
2	£4,016,111	£4,508,836	-10.93%	£15,026,384	3.68%
3	£7,143,829	£8,314,710	-14.08%	£35,134,192	3.85%
4	£2,848,980	£2,984,144	-4.53%	£9,032,383	1.68%
5	£16,929,412	£20,970,732	-19.27%	£89,809,758	5.19%
6	£5,049,382	£5,165,472	-2.25%	£10,761,627	1.21%
7	£99,859,912	£101,196,739	-1.32%	£195,358,927	0.77%
8	£1,456,377	£1,583,052	-8.00%	£2,980,430	4.73%
9	£4,338,044	£4,352,643	-0.34%	£8,465,689	0.19%
10	£758,060	£763,829	-0.76%	£1,787,285	0.36%
11	£8,886,264	£9,222,985	-3.65%	£19,246,216	1.98%
12	£3,421,611	£4,112,232	-16.79%	£23,220,000	3.37%

With a 20% buffer, the reduction in land value is marginally greater than would be the case with a 30% buffer, as would be expected (see Chart 2.6). However, the impact is not significant. The CIL as a percentage of GDV is also marginally higher (see Chart 2.7).





3. CIL and the strategic sites

The Council considers that two identified sites in the Borough (Earl's Court and Kensal Gas Works) are of strategic importance in terms of delivery of the Development Plan. Key features of the sites are outlined below.

3.1 Kensal Gasworks

The 16.65 hectare site is located to the south of Kensal Green Cemetery and is bisected by the West Coast Main Line. The site has been the subject of an 'Issues and Options' paper published in 2012 exploring residential-led mixed use schemes on the site. The Site has a Core Strategy policy (Policy CA1) with a land use allocation of:

- Up to 3,500 new homes;
- 10,000 square metres of office floor space;
- 2,000 square metres of non-residential floorspace including social and community uses (inc. possible new GP surgery, nursery and neighbourhood shopping centre);
- Potential expansion and relocation of the existing Sainsbury's supermarket;

- Provision of new bridges over the canal and railway to improve connectivity with the wider area.

The site currently accommodates National Grid gasholders. Other than the Sainsbury's Supermarket and listed Kensal House on Ladbroke Grove (which will be retained), there are no other buildings of any note on the site. Parts of the site are currently being used temporarily by Crossrail for track works and this use is to cease by 2018.

There is very little additional detail on the proposed development at the current time. We have therefore run a high level appraisal based on the parameters outlined above. The key assumptions are as follows:

- Sales values of £675 per square foot (£7,265 per square metre), reflecting the tone of the surrounding area, but adjusting for impact of the railway. This is likely to be at the lower end of likely achievable values.

- Affordable housing blended value of £1,399 per square metre.

- Office rents of £250 per square metre (£23.23 per square foot). The area does not offer considerable amounts of office floor space and there is very little comparable evidence of lettings of new grade A space. We have assumed an investment yield of 6.5%.

- Supermarket rent of £310 per square metre (£28.80 per square foot). We have assumed an investment yield of 4.75%.

- Rents for the Neighbourhood Centre (which will comprise a blend of retail and community uses) assumed to be £150 per square metre (£13.94 per square foot). We have applied an investment yield of 6.5%.

- Base build costs reflecting BCIS costs for various uses (£2,105 per square metre for residential; £1,841 per square metre for offices; £1,057 per square metre for the re-located supermarket; and £1,175 per square metre for the neighbourhood centre). Additional allowance of 15% for site preparation (excluding decontamination) and external works.

- Developer's contingency of 5% of base build costs.

- Allowance for decontamination of the gas holder site of £5 million.

- Professional fees 12% of construction costs.

- Allowance for bridge construction of £29.81 million, based on RBKC's estimate.

- Finance rate 7% applied to all costs.

- 12 month pre-construction period, followed by 84 month residential construction period. Sales commencing 24 months after commencement of construction. Final unit sold 10 months after completion of construction of final unit.

- Mayoral CIL applied to office, retail, neighbourhood centre and private residential at a rate of £50 per square metre and RBKC CIL applied to the private residential units only at a rate of £110 per square metre. We have assumed that the supermarket will attract a nil CIL liability, as it is a direct like for like replacement of the existing store.

Our appraisal is attached as Appendix 3. The appraisal shows a residual land value of £50.14 million, which equates to £3.00 million per hectare. As previously noted, the only building of significant scale is the Supermarket, but our appraisal assumes a like for like replacement. The £50.14 million land value generated by our appraisal would be available to the current landowners in order to incentivise them to bring the site forward for development. If CIL were not levied on the site, the residual land value would increase to £63.44 million. Imposition of CIL at the proposed rate of £110 per square metre would therefore reduce the site's land value by 21%.

Given that there is currently very little detail on the composition of the scheme, the Council may wish to consider adopting a rate of CIL that is consistent with the rest of Zone F (i.e. £110 per square metre). The indicative programme for the development appears to suggest that it will not commence until 2018, by which time the Council may well be reviewing its CIL Charging Schedule. There would be an opportunity to review the rates for the site based on the more detailed scheme that would have been worked up by that point. If the scheme comes forward at an earlier time and viability issues emerge, the Council could grant exceptional relief upon the production of a viability submission by the Developer.

An alternative option would be to accept a small reduction in affordable housing. We have run a second appraisal of the site which maintains a residual land value of £63.4 million (i.e. the same residual as the nil-CIL rate appraisal) by altering the mix of private and affordable housing. Our appraisal indicates that the scheme could absorb the proposed CIL and generate a residual land value of £63.49 million if the affordable housing is reduced from 42.86% to 40.95% of units. This small reduction in affordable housing may be seen as striking an appropriate balance between the desirability of the additional funding for local infrastructure and provision of affordable housing. However, we should stress that we see no compelling reason at this early stage of scheme development why the site should not come forward at a lower land value, thus enabling the Council to secure 42.86% affordable housing.

3.2 Earl's Court

This 9.06 hectare site currently comprises a major Exhibition Centre; commercial floorspace; residential units; and education/community uses. The site is located on Warwick Road, immediately opposite Earl's Court Underground Station and extends beyond the District Line which bisects the site to the west of the Exhibition Centre.

The site is located in both RBKC and also London Borough of Hammersmith and Fulham ('LBHF'). RBKC and LBHF have granted planning permission for the parts of the site located in their respective boroughs, subject to completion of section 106 agreements, which we understand are about to be signed.

During the application, the Applicant (Capital and Counties) submitted a confidential viability assessment in support of its negotiations with the boroughs on the level of affordable housing and Section 106 obligations that the scheme would provide. This information is not in the public domain and is therefore not available to the Council as 'appropriate available evidence'. However, viability work commissioned by the boroughs and the GLA (produced by the District Valuer Service ('DVS')) has been made available on LBHF's website. This document is titled '*Development Infrastructure Study: Earl's Court and West Kensington Opportunity Area Draft Join Supplementary Planning Document – Viability Assessments of Each of the Development Capacity Scenarios'* (attached as Appendix 4).

We have used the analysis in the DVS report to consider the potential impact of the Council's proposed CIL on the viability of the development proposals.

The DVS report considers three scenarios: 4,000 residential units; 6,000 residential units; and 8,000 residential units. The third scenario (8,000 units) most closely resembles the quantum of units in the outline planning permission (7,500 units).

Section 5 of the DVS study summarises the results of the appraisals. Table 3.2 below sets out the residual land values derived from the DVS study. The column headed "*Residual land values – Excl RBKC CIL*" is the corresponding figure from the DVS study, which incorporates Mayoral CIL and both of the boroughs' full affordable housing requirements. In the second column headed "with RBKC CIL", we have added our calculation of the RBKC CIL at a rate of £270 per square metre (assuming for the purposes of this exercise that the RBKC rate would apply across the whole scheme, including parts of the scheme that are located in LBHF). Our calculations are attached as Appendix 5.

Although the reduction in residual land value is relatively modest for scenario 1 (12%), this scheme is also the most unviable, with a negative value of -£410 million before RBKC CIL and -£459 million including RBKC CIL. A similar result emerges for scenario 2. However, scenario 3 is the most viable of the three options, with a negative land value of -£100 million before RBKC CIL is deducted. However, when RBKC CIL is deducted, the scheme becomes significantly more unviable, with a negative residual value of -£288 million, a change of -186%.

Table 3.2: Results of DVS analysis and re-worked results including RBKC CIL

DVS results - Policy compliant Aff Hsg with Mayoral CIL and RBKC CIL	Residual land values		Change in land value
	Excl RBKC CIL	With RBKC CIL	
Scenario 1	-£410,022,000	-£459,015,930	-12%
Scenario 2	-£417,707,000	-£535,820,930	-28%
Scenario 3	-£100,455,000	-£287,688,930	-186%

The change in residual land value resulting from the application of CIL to the site is considerably greater than the results of the other sites we have considered earlier in this analysis. Given the strategic importance of this site to delivering the scale of housing identified in the Development Plan, it would not be possible to conclude that the site would be unaffected by CIL, certainly in the short term. We would therefore suggest that the Council might consider setting a nil rate for this strategic development. In light of the fact that the scheme has secured planning permission (with completion of the Section 106 agreement imminent and certainly well in advance of adoption of CIL by the Borough), setting a nil rate is unlikely to have an adverse impact on CIL income.

I trust the analysis above is useful to the Council in considering its CIL rates in its Draft Charging Schedule.

Yours sincerely

Anthony Lee MRTPI MRICS
Senior Director

Encs:

Appendix 1: Marginal Sites appraisals (30% buffer below maximum rates)

Appendix 2: Marginal Sites appraisals (20% buffer below maximum rates)

Appendix 3: Kensal Gas Works site appraisal

Appendix 4: DVS report on Earl’s Court

Appendix 5: Calculations of CIL liability on Earl’s Court