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# Community Infrastructure Levy: Viability Study

Prepared for  
Royal Borough of Kensington & Chelsea

October 2012

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# 1 Executive Summary

- 1.1 This report tests the ability of a range of development types throughout the Royal Borough of Kensington & Chelsea to yield contributions to infrastructure requirements through the Community Infrastructure Levy ('CIL'). Levels of CIL have been tested in combination with the Council's other planning requirements, including the provision of affordable housing.

## Methodology

- 1.2 The study methodology compares the residual land values of a range of generic developments to a range of benchmark land values. If a development incorporating a given level of CIL generates a higher value than the benchmark land value, 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 guides a developer in determining an appropriate offer price 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 below their peak but have subsequently recovered. Despite this recovery, there is some uncertainty as to the likely short term trajectory of house prices. We have allowed for this by running a sensitivity analysis which inflates sales values by 10% and build costs by 5%. This analysis is indicative only, but is intended to assist the Council in understanding the levels of CIL that are viable in today's terms but also the impact of changing markets on viability. We have also tested a fall in sales values of 5%, to enable the Council to take a view on the impact of any adverse movements in sales values in the short term. Our commercial appraisals incorporate sensitivity analyses on rent levels and yields.

## 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 changes.
  - The ability of **residential schemes** to make CIL contributions varies depending on area and the current use of the site. Having regard to these variations, residential schemes should be able to absorb a **maximum** CIL rate of between £200 to £1,000 per square metre. Other charging authorities have set their rates at a discount to the maximum rate, with discounts ranging from circa 25% to 50%. The maximum rates indicated by our appraisals are as follows (all shown inclusive of Mayoral CIL):
    - North of Ladbroke Grove W10: £200 per square metre;
    - Holland Park W11: £800 per square metre;

- Olympia W14: £300 per square metre;
  - Notting Hill Gate and Kensington High Street W8: £600 per square metre;
  - Earls Court SW5 and SW10: £400 per square metre;
  - Chelsea SW3, SW1W: £800 per square metre; and
  - Knightsbridge: £1,000 per square metre.
- Applying a 30% discount to the maximum rates above would indicate that the following CIL rates could be adopted (all shown inclusive of Mayoral CIL)<sup>1</sup>:
- North of Ladbroke Grove W10: £140 per square metre;
  - Holland Park W11: £560 per square metre;
  - Olympia W14: £210 per square metre;
  - Notting Hill Gate and Kensington High Street W8: £420 per square metre;
  - Earls Court SW5 and SW10: £280 per square metre;
  - Chelsea SW3, SW1W: £560 per square metre; and
  - Knightsbridge: £700 per square metre.
- **Extra-care housing** generates slightly lower residual values than standard residential, due to the provision of a greater proportion of communal space and a slower sales rate (even though values are not dissimilar). To account for these factors, maximum rates of CIL would be lower, as follows (shown inclusive of Mayoral CIL):
- North of Ladbroke Grove W10: £100 per square metre;
  - Holland Park W11: £400 per square metre;
  - Olympia W14: £100 per square metre;
  - Notting Hill Gate and Kensington High Street W8: £500 per square metre;
  - Earls Court SW5 and SW10: £300 per square metre;
  - Chelsea SW3, SW1W: £600 per square metre; and
  - Knightsbridge: £800 per square metre.
- Applying a 30% discount to the maximum rates above would indicate that the following CIL rates could be adopted (all shown inclusive of Mayoral CIL):
- North of Ladbroke Grove W10: £70 per square metre;
  - Holland Park W11: £280 per square metre;
  - Olympia W14: £70 per square metre;
  - Notting Hill Gate and Kensington High Street W8: £350 per square metre;

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<sup>1</sup> The CIL regulations and CIL guidance enable charging authorities to combine areas in their evidence for the purpose of setting rates in their Preliminary Draft Charging Schedule. However, rates in these combined areas should be set so that developments in the lowest value area are not made unviable.

- Earls Court SW5 and SW10: £210 per square metre;
  - Chelsea SW3, SW1W: £420 per square metre; and
  - Knightsbridge: £560 per square metre.
- Whilst the maximum rates are significantly higher than the proposed rates, the buffer will help to mitigate a number of risk factors (primarily the potentially adverse impact on land supply of setting the rates at a high level and 'shocking' the market).
- At current rent levels, **Office development in the SW1/SW3 area** should be able to viably absorb a CIL of £125 per square metre (inclusive of Mayoral CIL). Allowing a buffer for site-specific issues and changes in values over time, we recommend that the Council considers a CIL of £88 per square metre (inclusive of Mayoral CIL). After Mayoral CIL has been deducted, the amount of Borough CIL is very modest (£38 per square metre) and the Council should consider whether the additional income that would be raised would be outweighed by the administrative burden of setting a rate for a small area.
- At current rent levels, **Office development elsewhere in the Borough** is unlikely to come forward in the short to medium term as the capital values generated are insufficient to cover development costs. We therefore recommend that the Council sets a nil rate for offices outside the SW1/SW3 area.
- **Student housing** in the Borough generates sufficient surplus residual values to absorb a CIL of £250 per square metre. After allowing for a buffer for site-specific factors, we suggest a rate of £175 per square metre (inclusive of Mayoral CIL).
- **Hotel developments** are able to absorb a maximum CIL (inclusive of Mayoral CIL) of £300 per square metre. After allowing a buffer for site-specific factors, we suggest a rate of £210 per square metre (inclusive of Mayoral CIL).
- Residual values generated by **Retail developments** are somewhat higher than current use values. However, retail development is predominantly redevelopment or re-use of existing space, so the differential in value between current and newly developed space is modest. Consequently, little surplus value is generated and we therefore rerecommend a nil rate of CIL on this type of development.
- Our appraisals of developments of **industrial and warehousing floorspace** indicate that these uses are unlikely to generate positive residual land values. We therefore recommend a zero rate for industrial floorspace.
- D1 and D2 uses often do not generate sufficient income streams to cover their costs. Consequently, they require some form of subsidy to operate. This type of facility is very unlikely to be built by the private sector. We therefore suggest that a nil rate of CIL be set for D1 and D2 uses.
- 1.6 The maximum and suggested rates are summarised in Table 1.6.1 and Table 1.6.2.

**Table 1.6.1: Maximum and suggested CIL rates – residential**

Area	Maximum rate	Net of 30% Discount/ buffer	Mayoral CIL	Net RBKC CIL
North of Ladbroke Grove W10	£100	£70	£50	£20
Holland Park, W11	£400	£280	£50	£230
Olympia, W14	£100	£70	£50	£20
Notting Hill Gate and Kensington High St W8	£500	£350	£50	£300
Earls Court, SW3 and SW10	£300	£210	£50	£160
Chelsea SW3 and SW1W	£600	£420	£50	£370
Knightsbridge	£800	£560	£50	£510

**Table 1.6.2: Maximum and suggested CIL rates – other uses**

Development type	Maximum rate	Net of 30% Discount/ buffer	Mayoral CIL	Net RBKC CIL
Offices – SW1 and SW3	£125	£88	£50	£38
Offices – elsewhere	£0	£0	£50	£0
Student housing	£250	£175	£50	£125
Hotels	£300	£210	£50	£160
Retail	£0	£0	£50	£0
Industrial	£0	£0	£50	£0
D1 and D2 uses	£0	£0	£50	£0

- 1.7 For residential schemes, the application of Borough CIL of up to £510 per square metre is unlikely to be an overriding factor in determining whether or not a scheme is viable. When considered in context of total scheme costs, a Borough CIL of £510 per square metre is a very modest amount, accounting for less than 5% of total development costs (i.e. no more than a developer's contingency which is typically around 5%). Some schemes would be unviable even if a zero CIL were adopted. We therefore recommend that the Council pays limited regard to these sites.

## 2 Introduction

- 2.1 This study has been commissioned to contribute towards an evidence base to inform the Royal Borough of Kensington & Chelsea's ('the Council') CIL Preliminary Draft Charging Schedule ('PDCS'), as required by Regulation 14 of the CIL Regulations April 2010 (as amended in 2011). The aims of the study are summarised as follows:
- to test the impact upon the economics of residential development of a range of levels of CIL;
  - for residential schemes, to test CIL alongside the Council's requirements for affordable housing and other planning obligations; and
  - to test the ability of commercial schemes to make a contribution towards infrastructure through CIL.
- 2.2 In terms of methodology, we adopted standard residual valuation approaches to test the impact on viability of a range of levels of CIL. 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 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 are set so as to allow a sufficient margin to allow for these site specific variations.

### Policy Context

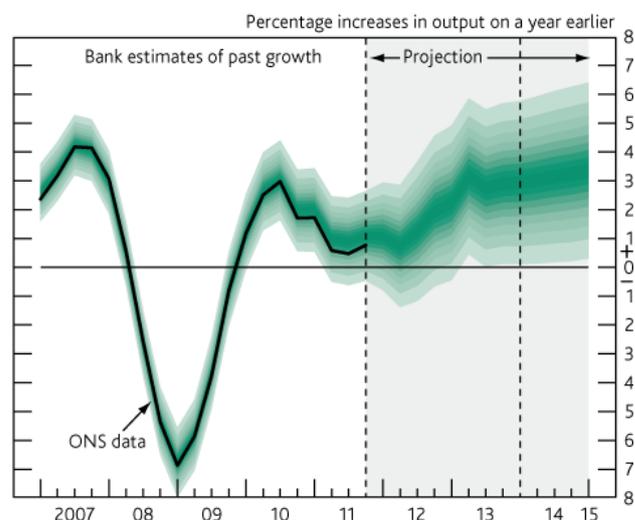
- 2.3 The CIL regulations state that in setting a charge, local authorities must aim to strike "*what appears to the Charging Authority to be an appropriate balance*" between revenue maximisation on the one hand and the potentially adverse impact upon the viability of development on the other. The regulations 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).
- 2.4 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.
- 2.5 The regulations allow a number of reliefs and exemptions from CIL. Firstly, affordable housing and buildings with other charitable uses (if controlled by a charity) are subject to relief. Secondly, local authorities may, if they choose, 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.
- 2.6 The CIL regulations enable local authorities to set differential rates (including zero rates) for different zones within which development would take place and also for different types of development.
- 2.7 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 choose 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).

- 2.8 Several local authorities have undertaken viability assessments and have drafted CIL charging schedules, which they have submitted for independent examination. To date, a number of charging authorities (including the Mayor of London, Portsmouth, Newark and Sherwood, Huntingdon, Wandsworth, Shropshire, Bristol, Poole and Redbridge) have been through the examination process and are at various stages of implementation.

### Economic and housing market context

- 2.9 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.
- 2.10 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 2015) has meant that consumer confidence has started to improve to some extent.



Source: Bank of England

- 2.11 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 Halifax House Price Indices showing a fall of 0.6% in the year to March 2012. The Halifax attributes at least some of the recent recovery in sales values to first time buyers seeking to purchase prior to the reintroduction of Stamp Duty from 1 April 2012.
- 2.12 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.

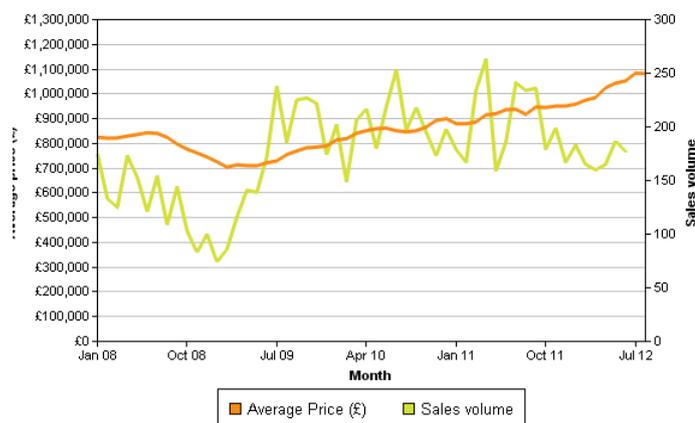
**Figure 2.12.1: House prices in Kensington & Chelsea**

House Price Index - Royal Borough of Kensington And Chelsea London borough



**Figure 2.12.1: Sales volumes in Kensington & Chelsea**

Price and sales volume - Royal Borough of Kensington And Chelsea London borough



Source: Land Registry

- 2.13 According to Land Registry data, residential sales values in Kensington & Chelsea have recovered since the lowest point in the cycle in February 2009. Prices increased by 53.7% between February 2009 and the most recently

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available data in August 2012. Sales values in March 2012 were 28.4% higher than the June 2008 peak value.

- 2.14 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 prime London markets will grow over the period between 2012 to 2016<sup>2</sup>. Savills predict that values in prime central London will increase by 3% in 2012, 0% in 2013, 5% in 2014, 6.5% in 2015 and 6.5% in 2016. This equates to cumulative growth of 22.7% between 2012-2016 inclusive, compared to a UK average of 6% cumulative growth over the same period.

### **Local Policy context**

- 2.15 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 Council expects developments of 800 to 1,200 square metres to make a financial contribution in lieu of on-site affordable housing, at a rate of £2,500 per square metre. For sites providing more than 1,200 square metres, 50% of floorspace is to be provided on-site, with a tenure mix of 85% of housing for rent and 15% for shared ownership or other forms of intermediate housing. The Council's requirements are applied flexibly, having regard to individual site circumstances, including viability of development.

### **Development context**

- 2.16 Developments in Kensington & Chelsea range from small in-fill sites to major regeneration schemes. There are significant variations in residential sales values between different parts of the Council's area, with Knightsbridge attracting the highest values and the area north of the Westway the lowest values. Most of the Borough is considered to be part of the 'prime' London residential market and attracts significant interest from developers. Commercial development is more limited in scale. The Borough's retail centres are performing well, but the Council does not expect to see development of a significant amount of additional floorspace in the medium term. There is also a limited amount of office and industrial development in parts of the Borough.

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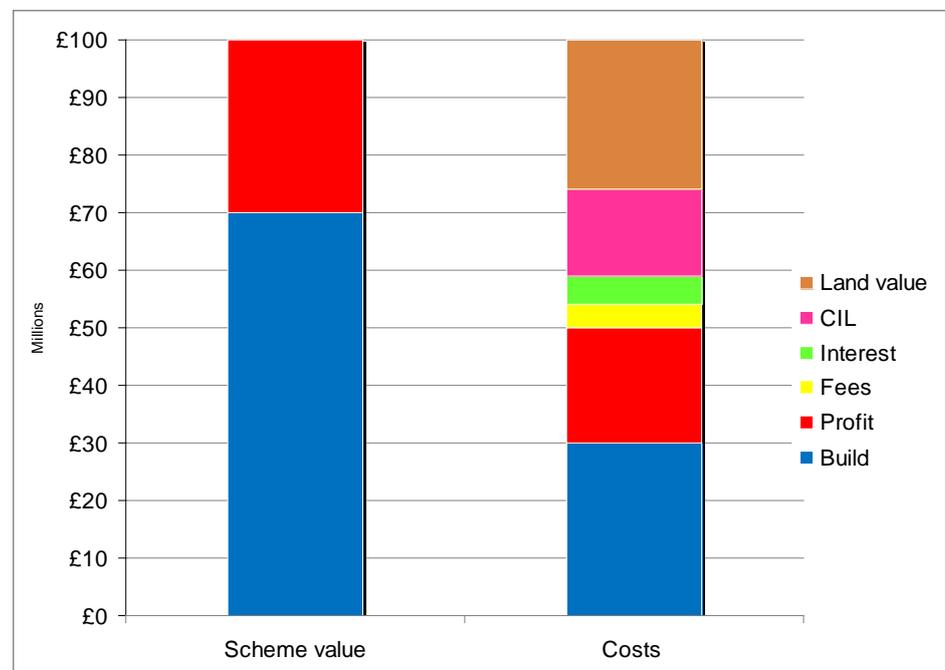
<sup>2</sup> Savills Research: Residential Property Focus, Quarter 3 2012

## 3 Methodology and appraisal inputs

- 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 Kensington & Chelsea and reflects the Council's planning policy requirements.

### 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 completed 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 current 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 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 another appropriate benchmark to make development worthwhile. The margin above current use value 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.
- 3.5 Clearly, however, landowners have expectations of the value of their land

which often exceed the value of the current 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 increases in value.

### **Viability benchmark**

- 3.6 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.
- 3.7 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*".
- 3.8 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."*

- 3.9 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 range of benchmark land values, reflecting differing circumstances in which sites are brought forward.

- 3.10 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).*

- 3.11 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).*

- 3.12 The guidance issued by the Local Housing Delivery Group<sup>3</sup> ('LHDG') on 22 June 2012 advocates the use of current use value plus an appropriate premium as a benchmark for testing CIL and local plan policy requirements.
- 3.13 It is important to stress, however, 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. This will ultimately be a matter of judgement for each individual Charging Authority.

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<sup>3</sup> This group was led by the Homes and Communities Agency and comprises representatives from the National Home Builders Federation, the Royal Town Planning Institute, local authorities and valuers (including BNP Paribas Real Estate).

## 4 Development appraisals

### Residential development

- 4.1 We have appraised a series of generic developments, reflecting both the range of sales values/capital values and also sizes/types of development and densities of development across the area. The inputs to the appraisals are based on research on the local housing market and also have regard to existing viability studies undertaken by the Council.

### Residential sales values

- 4.2 Residential values in the area reflect national trends in recent years but do of course vary between different sub-markets. We have considered comparable evidence of transacted properties in the area and also properties on the market to establish appropriate values for testing purposes. This exercise indicates that developments in the Borough will attract average sales values ranging from circa £7,825 to £31,690 per square metre. There may be a very limited number of super-prime units that exceed the range shown here, but we would regard these as exceptional cases and have excluded them for modelling purposes.
- 4.3 Sales values vary between different parts of the Borough, with the Knightsbridge area attracting the highest values and the parts of Ladbroke Grove north of the Westway the lowest values. The average values we have assumed in our appraisals are shown in Table 4.3.1. These average values are supported by pricing on individual schemes and resale values (attached as Appendix 1). We have reduced all asking prices by 5% to reflect discounts secured by purchasers during negotiations with developers and vendors. In the current market, this discount is likely to be greater than the actual discount secured in many cases.

**Table 4.3.1: Average sales values used in appraisals**

Area	Average values £s per sq m	Average values £s per sq ft
North of Ladbroke Grove W10	7,434	691
Holland Park W11	12,578	1,169
Olympia W14	9,957	925
Notting Hill Gate and Kensington High Street W8	16,464	1,530
Earls Court SW5 and SW10	11,463	1,065
Chelsea SW3, SW1W	17,087	1,587
Knightsbridge	30,105	2,797

- 4.4 As noted earlier in the report, Savills predict that sales values will increase over the medium term. Whilst this predicted growth cannot be guaranteed, we have run a sensitivity analysis assuming growth in sales values of 10%, accompanied by 5% increase in costs (the latter assuming a pick up in construction activity and higher labour and materials costs). We have also modelled a fall in prices of 5%, to provide the Council with an indication of the

impact a reverse in values would have on viability.

### Affordable housing tenure and values

- 4.5 The Council's policy position is that developments should provide up to 50% affordable housing by floor area, subject to viability, with a tenure mix of 85% rented housing and 15% intermediate housing. In some wards with high levels of pre-existing social housing, the tenure mix may be varied at the Council's discretion. The threshold for affordable housing is 800 square metres (gross external area). Schemes providing floorspace of between 800 and 1,200 square metres are required to make financial contributions in lieu of on-site provision (at a rate of £2,500 per square metre on 50% of the floorspace), while schemes exceeding 1,200 square metres are required to provide on-site affordable housing units. Our appraisals take the Council's policy target of 50% for the base position, with sensitivity analyses incorporating 40%, 30% and 20% affordable housing. The results of these sensitivity analyses were taken into account when arriving at a conclusion on appropriate rates of CIL.
- 4.6 The Council has adopted a policy position with regards to rent levels for Affordable Rented properties<sup>4</sup>. Having regard to incomes of households in housing need and the benefit caps under the Universal Credit, the Council has concluded that setting a rent as a percentage of market rents is inappropriate. Instead, the Council has adopted a system that takes Target Rents as a starting point. Where affordability allows, the Council would then add a percentage uplift to rents for certain properties, as shown in Table 4.6.1.

**Table 4.6.1: RBKC Affordable Rent units – proposed rent levels**

Unit type	Percentage uplift under interim housing policy	Rent level (per week) 2011/12	Gross household income required assuming housing costs are no greater than 40% of net income
1 bed	Average RSL Target Rent plus 30%	£143	£26,500
2 beds	Average RSL Target Rent plus 25%	£156	£29,000
3 beds	Average RSL Target Rent plus 12%	£160	£29,714
4 beds	Average RSL Target Rent plus 5%	£169	£31,385
5 beds	Average RSL Target Rent plus 5%	£171	£31,757

Source: RBKC 'Key Decision Report 18 November 2011 – Adoption of the Affordable Rent Interim Housing Policy for Section 106 agreements'

<sup>4</sup> RBKC: 'Key Decision Report 18 November 2011 – Adoption of the Affordable Rent Interim Housing Policy for Section 106 agreements'

- 4.7 The rent levels above ensure that households would receive an adequate amount of Benefit to cover their rent following the introduction of the Universal Credit. Whilst the Tenants Services Authority authorised a guideline limit on rent increases of 6.1% in its most recent regulatory release<sup>5</sup>, our modelling retains the rents at the levels in Table 4.6. Increases above the rent levels shown in the Table would result in some rents exceeding the levels that will be covered by the Universal Credit.
- 4.8 As a sensitivity test, we have also considered two alternative approaches to rent levels for the Affordable Rented units. The first approach assumes that the Council limits rents for social housing to Target Rents. The second approach assumes that rents are pegged to the Local Housing Allowance ('LHA'), which in many cases is considerably lower than 80% of market rents. The weekly LHAs in Kensington & Chelsea are as follows:
- One bed: £250;
  - Two bed: £290;
  - Three bed: £340;
  - Four bed: £400; and
  - Five bed: £400.
- 4.9 The interim policy position on Affordable Rent adopted by the Council may conflict with the position of the Greater London Authority ('GLA') as set out in the emerging London Plan alterations, to which the Council has objected. The GLA has objected to emerging policy in other London boroughs which contain restrictions on rent levels. The Council may be forced to modify its position and remove the affordability criteria for Affordable Rent. Whilst this would have a positive impact in terms of scheme viability, it would clearly have an adverse impact on the Council's ability to house priority households on its waiting list.
- 4.10 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. We recommend that the Council revisits this assumption when it next reviews its charging schedule, by which time a new funding programme may have been introduced by central government.
- 4.11 For shared ownership units, we have assumed that RSLs will sell 25% initial equity stakes and charge a rent of 0.05% on the retained equity. A 10% charge for management is deducted from the rental income and the net amount is capitalised using a yield of 5.25%.

#### **Residential development types, density and mix**

- 4.12 We have run appraisals using the range of densities that are typically encountered in the Borough. We have had regard to the density of development indicated by the Council's Affordable Housing Viability Study, which ranges from 119 to 320 units per hectare (with an average density of 216 units per hectare).
- 4.13 The Council's Core Strategy provides guidance on appropriate mixes of private and affordable housing. The following unit mixes are recommended to

<sup>5</sup> Tenants Services Authority: 'Rents, rent differentials and service charges for private registered providers 2012-13'

address the most acute needs:

- Affordable rented units: 45% one and two bed units; and 55% three and four bed units;
- Intermediate affordable units: 70% one and two bed units; 30% three bed or larger units; and
- Private units: 20% one and two bed units; 80% three and four bed units.

4.14 The mix adopted in our appraisals reflects the Council's requirements, as outlined above. On the smaller schemes, we have reflected the reality on the ground that would not enable the full range of unit types to be provided. For example, on an in-fill scheme, the physical constraints of the site would dictate a certain footplate and unit size. Table 4.13 shows the unit mix adopted for each development typology. The table also shows the average unit sizes used for modelling purposes, which reflect a sample of new build and second hand properties currently available on the market.

4.15 Table 4.15.1 summarises the different development typologies selected for testing purposes. These are intended to reflect the range of developments across the Borough.

**Table 4.15.1: Unit Mix**

Site type	1 Bed flat	2 bed flat	3 bed flat	4 bed flat	3 bed house	4 bed house	5 bed house
Unit size	54	82	135	189	135	189	329
1	-	-	-	-	P: 50%	P: 50%	-
2	-	P: 20%	P: 40%	P: 40%	-	-	-
3	P: 10% A: 20%	P: 10% A: 25%	P: 40% A: 35%	P: 40% A: 20%	-	-	-
4	P: 10% A: 20%	P: 10% A: 25%	P: 40% A: 35%	P: 40% A: 20%	-	-	-
5	P: 10% A: 20%	P: 10% A: 25%	P: 40% A: 35%	P: 40% A: 20%	-	-	-

**Key:** P: private housing  
A: affordable housing

**Table 4.15.1: Development typologies**

	Number of units	Housing type	Development density units per ha	Net developable area (ha)
1	4	Houses	60	0.067
2	5	Flats	100	0.05
3	50	Flats	150	0.33
4	100	Flats	200	0.50
5	200	Flats	300	0.67

### Residential build costs

- 4.16 We have sourced build costs for the residential schemes from the RICS Building Cost Information Service (BCIS), which is based on tenders for actual schemes. However, adjustments to the base costs are necessary to reflect the specification of development in the Borough, which is reflective of high specification and high value property. Our approach for each site is set out in the following paragraphs.
- 4.17 **Site type 1** is a scheme of 4 houses. The upper quartile BCIS base cost for “one-off housing” schemes is £1,149 per square metre, excluding external works and fees. We have adjusted the base costs by 30% to reflect additional costs that would be incurred to meet the expectations of purchasers. The adjusted cost is therefore £1,494 per square metre. After a 15% allowance for external works has been added, the final build cost is £1,718 per square metre. As the scheme is comprised wholly of houses, we have assumed a gross to net ratio of 100%.
- 4.18 **Site type 2** is a scheme of 5 flats. We have adopted the upper quartile BCIS base cost for “flats of 6 or more storeys” of £1,619 per square metre, excluding external works and fees. We have adjusted the base costs by 30% to reflect additional costs that would be incurred to meet the expectations of purchasers. The adjusted cost is therefore £2,105 per square metre. After a 15% allowance for external works has been added, the final build cost is £2,420 per square metre. We have assumed a net to gross ratio of 85%.
- 4.19 **Site type 3** is a scheme of 50 flats. We have again adopted the upper quartile BCIS base cost for “flats of 6 or more storeys” of £1,619 per square metre, excluding external works and fees. We have adjusted the base costs by 15% to reflect additional height above six storeys and the likelihood of the provision of an element of basement car parking. A further 30% is added to reflect additional costs that would be incurred to meet the expectations of purchasers. The adjusted cost is therefore £2,348 per square metre. After a 15% allowance for external works has been added, the final build cost is £2,700 per square metre. We have assumed a net to gross ratio of 82.5%.
- 4.20 **Site type 4** is a scheme of 100 flats. We have again adopted the upper quartile BCIS base cost for “flats of 6 or more storeys” of £1,619 per square metre, excluding external works and fees. We have adjusted the base costs by 30% to reflect additional height above six storeys and the likelihood of the provision of an element of basement car parking. A further 30% is added to reflect additional costs that would be incurred to meet the expectations of

purchasers. The adjusted cost is therefore £2,590 per square metre. After a 15% allowance for external works has been added, the final build cost is £2,979 per square metre. We have assumed a net to gross ratio of 82.5%.

4.21 **Site type 5** is a scheme of 200 flats. We have again adopted the upper quartile BICS base cost for “flats of 6 or more storeys” of £1,619 per square metre, excluding external works and fees. We have adjusted the base costs by 50% to reflect additional height above six storeys and the likelihood of the provision of an element of basement car parking. A further 30% is added to reflect additional costs that would be incurred to meet the expectations of purchasers. The adjusted cost is therefore £2,590 per square metre. After a 15% allowance for external works has been added, the final build cost is £2,979 per square metre. We have assumed a net to gross ratio of 80%.

4.22 A summary of build costs for each scheme type is provided in Table 4.22.1.

**Table 4.22.1: Build costs**

Site type	BCIS base – quarter 2 2012	Base cost	Height adjust	Quality adjust	Adjusted cost	External works	All-in cost
1	One off housing Upper Quartile	£1,149	0	30%	£1,494	15%	£1,718
2	Flats 6+ storeys Upper Quartile	£1,619	0	30%	£2,105	15%	£2,420
3	Flats 6+ storeys Upper Quartile	£1,619	15%	30%	£2,348	15%	£2,700
4	Flats 6+ storeys Upper Quartile	£1,619	30%	30%	£2,590	15%	£2,979
5	Flats 6+ storeys Upper Quartile	£1,619	50%	30%	£2,914	15%	£3,351

4.23 An additional 6% allowance is included across all tenures for meeting Code for Sustainable Homes level 4, which is reflective of the findings of work undertaken by Cyrill Sweett on behalf of CLG.

#### **Professional fees**

4.24 In addition to base build costs, schemes will incur professional fees, covering design, valuation, highways consultants and so on. Our appraisals incorporate a 10% allowance, which is at the higher end of the range for most schemes.

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### **Mayoral CIL**

- 4.25 Mayoral CIL will be payable on all developments that receive planning consent after 1 April 2012. Kensington & Chelsea falls within Zone 1, where a CIL of £50 per square metre will be levied. The Mayoral CIL takes precedence over Borough requirements, including affordable housing. The Council is required to have regard to the Mayoral CIL when setting its own CIL. Our appraisals do not include Mayoral CIL as a cost, so the outputs (in terms of viable levels of CIL) *incorporate* the Mayoral CIL, which should be deducted for the purposes of setting a Borough CIL.

### **Section 278 and residual Section 106 costs**

- 4.26 Our appraisals incorporate an allowance of £1,000 per unit to address any Section 278 and residual Section 106 costs.

### **Development and sales periods**

- 4.27 Development and sales periods vary between type of scheme. However, our sales periods are based on an assumption of a sales rate of 5 units per month. This is reflective of current market conditions, whereas in improved markets, a sales rate of up to 8 units per month might be expected. The build and sales periods for each scheme type are summarised in Table 4.45.1 below.

### **Developer's profit**

- 4.28 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 development costs. 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).
- 4.29 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.
- 4.30 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, and against the backdrop of the current sovereign debt crisis in the Eurozone, the banks may not allow profit levels to decrease much lower than their current level of 20%.
- 4.31 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 GLA 'Development Control Toolkit' guidance and Homes and Communities Agency's guidelines in its Economic Appraisal Tool.

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### Phasing of CIL payments

- 4.32 The Council is yet to formulate its instalment policy. For testing purposes, we have assumed that any CIL due will be split into three equal instalments, payable at the months shown in Table 4.45.1

### Benchmark land values for the residential analysis

- 4.33 Benchmark land values, based on the current use value or alternative use value of sites are key considerations in the assessment of development economics for testing planning policies and tariffs. 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 current use value. Current 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. Current use value or alternative use value are effectively the 'bottom line' in a financial sense and therefore a key factor in this study.
- 4.34 We have arrived at a broad judgement on the likely range of benchmark land values. On previously developed sites, 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 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 current use value in these circumstances.
- 4.35 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).
- 4.36 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, current use values might increase, increasing the base value of sites that might come forward, which may have implications for landowners' decisions on releasing sites for alternative uses.
- 4.37 Redevelopment proposals that generate residual land values below current use values 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. If proven current use value justifies a higher benchmark than those assumed, then appropriate adjustments may be necessary. As such, current use values should be regarded as benchmarks rather than definitive fixed variables on a site by site basis.

- 4.38 The four benchmark land values used in this study have been selected to provide 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, especially in urban areas.
- 4.39 It is also necessary to recognise that a landowner will require an additional incentive to release the site for development<sup>6</sup>. The premium above current use value would be reflective of specific site circumstances (the primary factors being the occupancy level and strength of demand from alternative occupiers). For policy testing purposes it is not possible to reflect the circumstances of each individual site, so a blanket assumption of a 20% premium has been adopted to reflect the 'average' situation.
- 4.40 **Benchmark Land Value 1:** This benchmark assumes higher value secondary office space on a hectare of land, with 60% site coverage and 4 storeys. The rent assumed is based on third and fourth quartile lettings of second hand offices in the Borough (averaging £23.88 per sq ft), capitalised at a yield of 7% (being reflective of secondary property). We have assumed a £50 per sq ft allowance for refurbishment and a letting void/rent free period of two and a half years. The capital value of the building would be £61.49 million, to which we have added a 20% premium, resulting in a benchmark of £73.78 million.
- 4.41 **Benchmark Land Value 2:** This benchmark assumes lower value secondary office space on a hectare of land, with 40% site coverage and 4 storeys. The rent assumed is based on fourth quartile lettings of second hand offices in the Borough (£21 per sq ft), capitalised at a yield of 7.25%. We have assumed a £50 per sq ft allowance for refurbishment and a letting void/rent free period of two and a half years. The capital value of the building would be £33.27 million, to which we have added a 20% premium, resulting in a benchmark of £39.92 million.
- 4.42 **Benchmark Land Value 3:** This benchmark assumes lower value secondary industrial space on a hectare of land, with 60% site coverage and 1.5 storeys. The rent assumed is based on fourth quartile lettings of secondary industrial floorspace in the Borough (£14 per sq ft). We have assumed a letting void/rent free period of two and a half years. The capital value of the building would be £13.04 million, to which we have added a 20% premium, resulting in a benchmark of £15.65 million.
- 4.43 **Benchmark Land Value 4:** This benchmark assumes a community building or similar facility, which could include buildings owned by the Council and other public sector bodies, and community/charity groups. We have assumed site coverage of 50% across a hectare of land, with a single storey building. The rent assumed is based on our estimate of £10 per sq ft. We have assumed a letting void of one year. The capital value of the building would be £6.23

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<sup>6</sup> This approach is therefore consistent with the National Planning Policy Framework, which indicates that development should provide "competitive returns" to landowners. A 20% return above current use value is a competitive return when compared to other forms of investment.

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million, to which we have added a 20% premium, resulting in a benchmark of £7.48 million.

- 4.44 We would draw readers' attention to the comments on land values in Examiner's report on the Mayor of London's CIL<sup>7</sup>, which indicates that owners will need to adjust their expectations to accommodate allowances for infrastructure.
- 4.45 Our residential appraisal inputs are summarised in Table 4.45.1.

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<sup>7</sup> Para 32: "the price paid for development land may be reduced.... a reduction in development land value is an inherent part of the CIL concept.... 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."

**Table 4.45.1: Residential appraisal assumptions for each site type**

Appraisal input	Source/Commentary	Site type number and assumptions				
		1	2	3	4	5
Number of units		4	5	50	100	200
Base construction costs (£s per sq metre)	BCIS adjusted for location. Based on gross areas before external works. Additional adjustments as set out in Table 4.21.1	£1,494	£2,105	£2,348	£2,590	£2,914
External works (% of build costs)	Based on average scheme cost.	15%	15%	15%	15%	15%
Contingency (% of build cost)	Industry norm (5%)	5%	5%	5%	5%	5%
Professional fees (% of build)	BNPPRE assumption	10%	10%	10%	10%	10%
Construction period (months)	We assume that developers will build at the rate they are able to sell.	16	18	24	30	30
Sales period (months)	Determined by ability of market to absorb new development	1	2	10	20	40
Sale start (month from commencement)	Linked to later stages of construction period	16	18	20	20	20
Sales rate (units per month)	Reflective of current market, could improve.	5	5	5	5	5
Profit on private (% of GDV)	BNPPRE assumption – reflective of current funder requirements	20%	20%	20%	20%	20%
Profit on affordable (% of GDV)	Reduced risk due to pre-sale to RSL	6%	6%	6%	6%	6%
Phasing of CIL payments	BNPPRE assumption – equal splits, paid in months shown in table	1/6/12	1/6/12	1/12/20	1/12/24	1/12/24
Gross to net ratio for flats	BNPPRE assumption	n/a	85%	82.5%	82.5%	80%
Density and site area (ha, developable area)		60 uph 0.07 ha	100 uph 0.05 ha	150 uph 0.33 ha	200 uph 0.5 ha	300 0.67 ha

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## Commercial development

- 4.46 We have appraised a series of hypothetical commercial developments, reflecting a range of use classes at average rent levels achieved on lettings of commercial space in actual developments. In each case, our assessment assumes an intensification of the existing use on the site, based on the same type of commercial development. In each case, the existing use value assumes that the existing building is half the size of the new development, with a lower rent and higher yield reflecting the secondary nature of the building.

### Commercial rents and yields

- 4.47 Our research on lettings of commercial floorspace indicates a range of rents achieved, as summarised in table 4.46.1. This table also includes our assumptions on appropriate yields to arrive at a capital value of the commercial space. There does not appear to have been substantial retail development activity over the past few years. New build office developments are likely to attract a premium rent above second hand rents, but we would expect this to be relatively modest. The rents and yields adopted in our appraisals are summarised in Table 4.46.1.
- 4.48 Our appraisals of commercial floorspace test the viability of developments on existing commercial sites. For these developments, we have assumed that the site currently accommodates the same use class and the development involves intensification of that use. We have assumed lower rents and higher yields for existing space than the planned new floorspace. This reflects 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 is allowed for to reflect costs that would be incurred to secure a letting of the existing space. A 20% landowner premium is added to the resulting existing use value as an incentive for the site to come forward for development. The actual premium would vary between sites, and be determined by site-specific circumstances, so the 20% premium has been adopted as a 'top of range' scenario for testing purposes.

### Commercial build costs

- 4.49 We have sourced build costs for the commercial schemes from the RICS Building Cost Information Service (BCIS), which is based on tenders for actual schemes. These costs vary between different uses and exclude external works and fees (our appraisals include separate allowances for these costs). Costs for each type of development are shown in Table 4.46.1.

### Profit

- 4.50 In common with residential schemes, commercial schemes need to show a risk adjusted profit to secure funding. Profit levels are typically around 20% of developments costs and we have incorporated this assumption into our appraisals.

**Table 4.46.1: Commercial appraisal assumptions for each use**

Appraisal input	Source/Commentary	Student	Hotels	Industrial	Office	Retail
Total floor area (sq ft)	Generic scheme	500 units 142,500 sq ft gross	100 rooms 40,000 sq ft gross	30,000	30,000	30,000
Rent (£s per sq ft)	Based on average lettings sourced from EGI	£200 per wk per room, 42 wk tenancy, 10 wk vacation income @ £250 per room per week	Capital value £220k per room	£12	£40	£60
Rent free/void period (years)	BNPPRE assumption	n/a	2 years	2 years	2 years	2 years
Yield	BNPPRE prime yield schedule	7%	5.75%	6.75%	5.75%	5.75%
Purchaser's costs (% of GDV)	Stamp duty 4%, plus agent's and legal fees	5.75%	5.75%	5.75%	5.75%	5.75%
Demolition costs (£s per sq ft of existing space)	Based on experience from individual schemes	£5	£5	£5	£5	£5
Gross to net (net as % of gross)	Based on experience from individual schemes	70%	75%	90%	82%	82%
Base construction costs (£s per sq ft)	BCIS costs. Offices – 'generally' for air conditioned offices. 'Generally' figure for industrial, supermarkets, retail warehouse and town centre retail.	£165	£250	£60	£200	£200
External works (% of build costs)	BNPPRE assumption	10%	10%	10%	10%	10%
Contingency (% of build costs)	BNPPRE assumption	5%	5%	5%	5%	5%
Letting agent's fee	(% of first year's rent)	10%	10%	10%	10%	10%
Agent's fees and legal fees	(% of capital value)	1.75%	1.75%	1.75%	1.75%	1.75%
Interest rate	BNPPRE assumption	7%	7%	7%	7%	7%
Professional fees (% of build)	BNPPRE assumption, relates to complexity of scheme	10%	10%	10%	10%	10%
Profit (% of costs)	BNPPRE assumption based on schemes submitted for planning	20%	20%	20%	20%	20%

**Table 4.40.1 (continued) Commercial appraisal assumptions for each use – existing uses**

Appraisal input	Source/Commentary	Student	Hotels	Industrial	Office	Retail
Existing floorspace (sq ft)	Assumed to be 50% of new space	35%	50%	50%	50%	50%
Rent on existing floorspace	Reflects poor quality second hand space of same use, low optimisation of site etc and ripe for redevelopment	£22	£26 - £30	£9 - £15	£20 - £24	£50 - £60
Yield on existing floorspace	BNPPRE assumption, reflecting lower covenant strength of potential tenants, poor quality building etc	7%	6.75%	7.25%	7%	6.75%
Rent free on existing space	Years	2.5	2.5	3	2.5	2.5
Refurbishment costs (£s per sq ft)	General allowance for bringing existing space up to lettable standard	£25	£50	£50	£50	£50
Fees on refurbishment (% of refurb cost)	BNPPRE assumption	7%	7%	7%	7%	7%
Landowner premium	BNPPRE assumption – in reality the premium is likely to be lower, therefore this is a conservative assumption	20%	20%	20%	20%	20%

## 5 Appraisal outputs

### Residential appraisals

- 5.1 The full outputs from our appraisals of residential development are attached as Appendix 2. We have modelled five generic site types, reflecting different densities and types of development, which are tested in each of the seven sub-market areas identified in Section 4 and against four land value benchmarks. These types are summarised in table 5.1.1 below.

**Table 5.1.1: Development types**

	Number of units	Housing type	Development density units per ha	Net developable area (ha)
1	4	Houses	60	0.067
2	5	Flats	100	0.05
3	50	Flats	150	0.33
4	100	Flats	200	0.50
5	200	Flats	300	0.67

### Scenarios tested

- 1. Base sales and base costs (including Code for Sustainable Homes Level 4); 50% affordable housing (excluding Site types 1 and 2 that fall below the threshold of 800 square metres) with rented element in line with the Council's rent levels for Affordable Rent<sup>8</sup>;
  - 2. Sales fall by 5%;
  - 3. Sales increase by 10% and costs increase by 5%;
  - 4. As (1), but affordable housing rents set at Local Housing Allowance levels;
  - 5. As (1), but affordable housing rents set at Target rents;
  - 4. As (1) with 40% affordable housing;
  - 5. As (1) with 30% affordable housing; and
  - 6. As (1) with 20% affordable housing.
- 5.2 We assume that all development types will meet Code for Sustainable Homes level 4. Level 4 is reflected through a 6% adjustment to our base build costs for all tenures.
- 5.3 For all types of site, we have run two sensitivity analyses; firstly, with sales values falling by 5%; and secondly, with sales values increasing by 10% and build costs also increasing by 5%. This analysis is provided for illustrative purposes and may assist the Council in understanding how viability might be affected by movements in sales values (up and down) over time. However, the future trajectory of the housing market is inherently uncertain and predictions cannot be relied upon.
- 5.4 The residual land values from each of the scenarios above in each of the seven housing market areas are then compared to four benchmark land values ('BLVs') based on the assumptions set out in paragraphs 4.32 to 4.43.

<sup>8</sup> RBKC: 'Key Decision Report 18 November 2011 – Adoption of the Affordable Rent Interim Housing Policy for Section 106 agreements'

This comparison enables us to determine whether the imposition of CIL would have an impact on development viability. In some cases, the equation RLV less BLV results in a negative number, so the development would not proceed, whether CIL was imposed or not. We therefore focus on situations where the RLV is greater than BLV 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.

### Commercial appraisals

- 5.5 Our research on rents achieved on commercial lettings indicates a range of rents within each main use class. Our commercial appraisals therefore model base position and test the range of rates (higher and lower than the base level) and changes to yields. This enables us to draw conclusions on maximum potential rates of CIL. For each use class tested (B1, B2/B8, retail etc), we have run appraisals of a quantum of floorspace, each with rent levels reflecting the range identified by our research.

### Presentation of data

#### Residential appraisals results

- 5.6 The results for each site are presented in six spreadsheets, as follows:
- Base sales values, CSH level 4 on affordable, CSH level 3 on private;
  - Sales values -5%;
  - Sales values + 10%, build costs + 5%;
  - As (1), but affordable housing rents set at Local Housing Allowance levels;
  - As (1), but affordable housing rents set at Target rents;
  - Scenario 1 with reduced affordable housing (40%);
  - Scenario 1 with reduced affordable housing (30%); and
  - Scenario 1 with reduced affordable housing (20%).
- 5.7 A sample of the format of the results is provided below. This sample relates to site type 5.

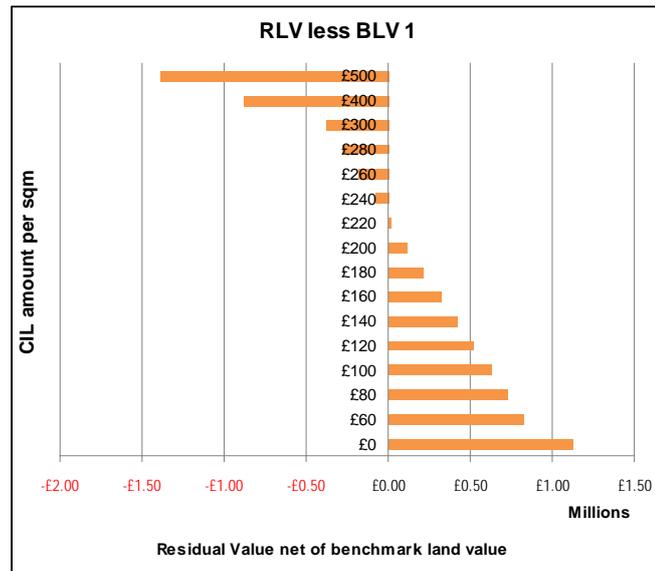
CIL Viability	RBKC	Benchmark Land Values (per net developable ha)				
SITE TYPE	5	BLV1 Offices (higher)	BLV2 Offices (lower)	BLV3 Industrial/WH	BLV4 Community uses	
200 UNITS		£73,782,707	£39,919,671	£15,646,148	£7,475,000	
FLATS						
300 UPH	Net area as percentage of gross	100%				
CSH level:	4 on AH					
	4 on private					
Aff Hsg:	50%					
				Sales value inflation		
				Build cost inflation		
Site type 5	Description:	Area 1 £7434 psm North of L'broke Grove V			Site area:	0.67 ha
CIL amount	RLV	RLV per ha	RLV less BLV 1	RLV less BLV 2	RLV less BLV 3	RLV less BLV 4
0	-13,865,296	20,797,944	94,580,651	60,717,615	36,444,092	28,272,944
25	-14,246,659	21,369,988	95,152,695	61,289,660	37,016,136	28,844,988
75	-15,009,385	22,514,078	96,296,785	62,433,749	38,160,226	29,989,078
100	-15,390,749	23,086,123	96,868,830	63,005,794	38,732,271	30,561,123
150	-16,153,475	24,230,213	98,012,919	64,149,884	39,876,361	31,705,213
200	-16,916,202	25,374,302	99,157,009	65,293,973	41,020,450	32,849,302
250	-17,678,928	26,518,392	100,301,099	66,438,063	42,164,540	33,993,392
300	-18,441,654	27,662,482	101,445,188	67,582,153	43,308,629	35,137,482

- 5.8 Each spreadsheet provides residual values at varying amounts of CIL, starting at £0 and increasing to £1000 per square metre. Whilst CIL applies to net additional floor area only, our appraisals assume that it is applied to the whole development (excluding affordable housing). This reflects a worst case scenario, as many sites in the Borough will have existing buildings, although not necessarily occupied<sup>9</sup>.
- 5.9 Separate data tables are provided in each spreadsheet for each of the housing market areas, as follows. Housing market areas are associated more with postcodes and broad areas and not with wards or other administrative boundaries. Postcodes are a more visible identifier of a property's location and are often a key consideration when purchasers are looking for properties to buy. Postcode boundaries therefore offer a useful way of setting boundaries between different areas, although in practice, values will vary around the boundaries (this is inevitable, whatever method is used to set boundaries).
- Area 1: North of Ladbroke Grove W10;
  - Area 2: Holland Park W11;
  - Area 3: Olympia W14;
  - Area 4: Notting Hill Gate and Kensington High Street W8;
  - Area 5: Earls Court SW5 and SW10;
  - Area 6: Chelsea SW3, SW1W; and
  - Area 7: Knightsbridge
- 5.10 The RLV is converted to a per hectare rate and compared to the four benchmark land values (see paragraphs 4.32 to 4.43). This is shown in the columns headed 'RLV less BLV1, BLV2' etc. A positive number indicates that the development is viable, as the developer will receive a normal level of development profit and the land value will be sufficient for the site to come forward.
- 5.11 The numerical data is then displayed in four graphs, one for each threshold land value. The graphs show the amount by which the RLV exceeds BLV (or is less than BLV) for each level of CIL. In the **illustrative** example below (Chart 5.12.1), the graph shows that the maximum viable level of CIL would be £220 per square metre, but that above this level, higher levels of CIL would render the scheme unviable. It is important to note that the charts do not have the same scale and the reader needs to bear this in mind if comparing one chart to another.

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<sup>9</sup> Existing buildings must be occupied for their lawful use for at least six months out of the twelve to qualify as existing floorspace for the purposes of calculating CIL liability.

**Chart 5.12.1: Illustrative example of data chart**



### Commercial appraisal results

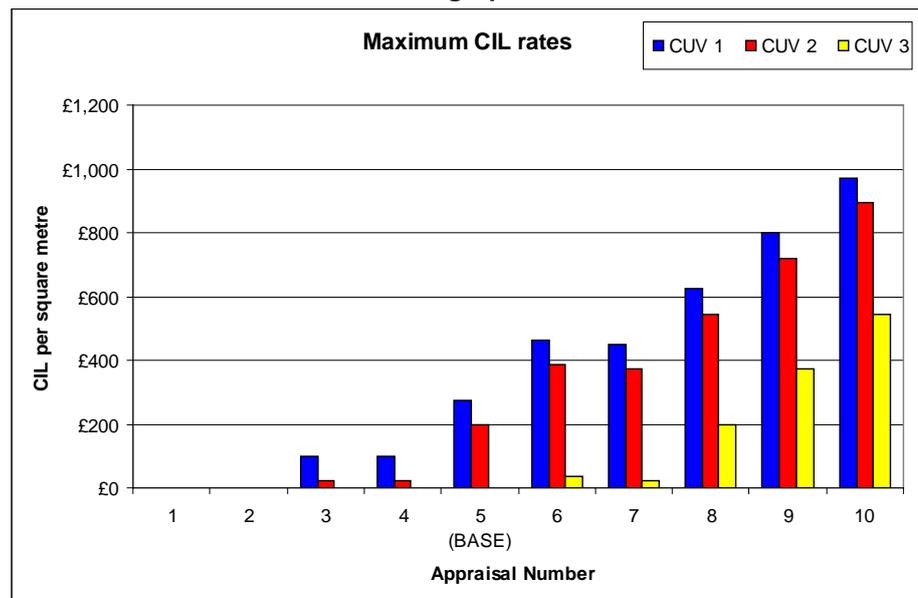
- 5.12 The commercial appraisal results are more straightforward, due to the narrower range of variables that need to be considered in comparison to residential development. The appraisals include a 'base' rent level, with sensitivity analyses which model rents above and below the base level (an illustration is provided in Chart 5.12.1). The maximum CIL rates are then shown per square metre, against three different current use values (see paragraphs 4.25 to 4.34). Chart 5.12.2 provides an **illustration** of the outputs in numerical format, while Chart 5.12.3 shows the data in graph format. In this example, the scheme could viably absorb a CIL of between £0 and £275 per square metre, depending on the current use value (each appraisal includes three current use values, labelled as CUV1, CUV2 and CUV3). The analysis demonstrates the significant impact of very small changes in yields (see appraisals 4 and 6, which vary the yield by 0.25% up or down) on the viable levels of CIL.

**Chart 5.12.1: Illustration of sensitivity analyses**

	£s per sqft	Yield	Rent free
Appraisal 1	£21.00	6.50%	2.00 years
Appraisal 2	£22.00	6.50%	2.00 years
Appraisal 3	£23.00	6.50%	2.00 years
Appraisal 4	£24.00	6.75%	2.00 years
<b>Appraisal 5 (base)</b>	<b>£24.00</b>	<b>6.50%</b>	<b>2.00 years</b>
Appraisal 6	£24.00	6.25%	2.00 years
Appraisal 7	£25.00	6.50%	2.00 years
Appraisal 8	£26.00	6.50%	2.00 years
Appraisal 9	£27.00	6.50%	2.00 years
Appraisal 10	£28.00	6.50%	2.00 years

**Chart 5.12.2: Maximum CIL rates – numerical format**

	Change in rent from base	CUV 1	CUV 2	CUV 3
Appraisal 1	-14%	£0	£0	£0
Appraisal 2	-9%	£0	£0	£0
Appraisal 3	-4%	£100	£23	£0
Appraisal 4	0%	£99	£21	£0
<b>Appraisal 5 (base)</b>	<b>-</b>	<b>£275</b>	<b>£197</b>	<b>£0</b>
Appraisal 6	0%	£465	£387	£38
Appraisal 7	4%	£449	£371	£23
Appraisal 8	8%	£624	£546	£197
Appraisal 9	11%	£798	£720	£371
Appraisal 10	14%	£972	£894	£546

**Chart 5.12.3: Maximum CIL rates – graph format**


## 6 Assessment of the results

- 6.1 This section should be read in conjunction with the full results attached at Appendix 2 (residential appraisal results) and Appendix 3 (commercial appraisal results). In these results, the residual land values are calculated for scenarios with sales values and capital values reflective of market conditions across the Borough. These RLVs are then compared to benchmark land values.
- 6.2 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 of CIL upon the viability of development across the whole area on the other. 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, councils 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, particularly in areas where sales values vary between areas.
  - Fourthly, markets are cyclical and subject to change over short periods of time. Sensitivity testing to sensitivity test levels of CIL to ensure they are robust in the event that market conditions improve 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 widely recognised that there is no requirement for a Charging Authority 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 on the one hand and the need to *minimise* the impact upon development viability on the other. CLG guidance recognises that CIL may make some developments unviable. 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 authority can 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* (including a nil rate) 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 factor that comes into play in the developer's/landowner's decision making. We have therefore disregarded the 'unviable' schemes in recommending an appropriate level of CIL. The unviable schemes will only become viable following a degree of real house price inflation, or in the event that the Council agrees to a lower level of affordable housing in the short term<sup>10</sup>.

#### **Determining maximum viable rates of CIL for residential development**

- 6.6 As noted in paragraph 6.5, where a scheme is unviable the imposition of CIL at a zero level will not make the scheme viable. Other factors (i.e. sales values, build costs or benchmark land values) would need to change to make the scheme viable. For the purposes of establishing a maximum viable rate of CIL, we have had regard to the development scenarios that are currently viable and that might, therefore, be affected by a CIL requirement. All the results summarised below assume that current affordable housing requirements are met in full. In addition, the rates discussed below are **inclusive of the Mayoral CIL of £50 per square metre**.
- 6.7 In the main, Site type 1 generates residual values that are higher than the benchmark land values, even in some cases with CIL of as much as £1,000 per square metre. Scheme viability becomes more difficult in N Ladbroke Grove and Olympia, where schemes would be unviable on the sites with higher current use values (see Table 6.7.1).

**Table 6.7.1: Site type 1 - maximum viable rates of CIL (£s per square metre)**

Area	Existing use: Offices (higher)	Existing use: Offices (lower)	Existing use: Industrial	Existing use: community buildings
North of Ladbroke Grove W10	NV11	NV	£1,000	£1,000
Holland Park W11	NV	£1,000	£1,000	£1,000
Olympia W14	NV	NV	£1,000	£1,000
Notting Hill Gate and Kensington High Street W8	NV	£1,000	£1,000	£1,000
Earls Court SW5 and SW10	NV	£400	£1,000	£1,000
Chelsea SW3, SW1W	NV	£1,000	£1,000	£1,000
Knightsbridge	£1,000	£1,000	£1,000	£1,000

<sup>10</sup> However, as shown by the sensitivity analyses (which reduce affordable housing to 40%, 30% and 20%) even a reduction in affordable housing does not always remedy viability issues. In these situations, it is not the presence or absence of planning obligations that is the primary viability driver – it is simply that the value generated by residential development is lower than some existing use values. In these situations, sites would remain in their existing use.

<sup>11</sup> NV = Site is not viable before CIL is applied. These results are disregarded for the purpose of recommended CIL rates, as the sites would remain in their current use, unless other (non-CIL related) factors were to change.

- 6.8 The viable scenarios for Site type 2 indicate that the viable level of CIL would be £1,000 per square metres across all areas and all existing site uses (see Table 6.8.1).

**Table 6.8.1: Site type 2 - maximum viable rates of CIL (£s per square metre)**

Area	Existing use: Offices (higher)	Existing use: Offices (lower)	Existing use: Industrial	Existing use: community buildings
North of Ladbroke Grove W10	£1,000	£1,000	£1,000	£1,000
Holland Park W11	£1,000	£1,000	£1,000	£1,000
Olympia W14	£1,000	£1,000	£1,000	£1,000
Notting Hill Gate and Kensington High Street W8	£1,000	£1,000	£1,000	£1,000
Earls Court SW5 and SW10	£1,000	£1,000	£1,000	£1,000
Chelsea SW3, SW1W	£1,000	£1,000	£1,000	£1,000
Knightsbridge	£1,000	£1,000	£1,000	£1,000

- 6.9 Site type 3 includes affordable housing at 50%, which reduces scheme values considerably, but also results in a significant discount to the amount of CIL payable. This discount helps to mitigate the loss in value from the affordable housing to some degree. However, as would be expected with the introduction of an affordable housing requirement, the viable levels of CIL fall in most areas and on all three of the higher existing use values (see Table 6.8.1).

**Table 6.9.1: Site type 3 - maximum viable rates of CIL (£s per square metre) with 50% affordable housing**

Area	Existing use: Offices (higher)	Existing use: Offices (lower)	Existing use: Industrial	Existing use: community buildings
North of Ladbroke Grove W10	NV	NV	NV	NV
Holland Park W11	NV	NV	£1,000	£1,000
Olympia W14	NV	NV	NV	£300
Notting Hill Gate and Kensington High Street W8	NV	£600	£1,000	£1,000
Earls Court SW5 and SW10	NV	NV	£400	£1,000
Chelsea SW3, SW1W	NV	£800	£1,000	£1,000
Knightsbridge	£1,000	£1,000	£1,000	£1,000

- 6.10 Site type 4 is a denser scheme, which reduces the site area required (saving costs of land purchase) but build costs increase in comparison to Site type 3. The combined impact of these factors results in a slight reduction in the maximum rates of CIL that could be absorbed (see Table 6.9.1). The maximum rate ranges from £25 to £1,000 per square metres, depending on area and existing use.

**Table 6.10.1: Site type 4: Maximum viable rates of CIL (£s per square metre) with 50% affordable housing**

Area	Existing use: Offices (higher)	Existing use: Offices (lower)	Existing use: Industrial	Existing use: community buildings
North of Ladbroke Grove W10	NV	NV	NV	NV
Holland Park W11	NV	NV	£900	£1,000
Olympia W14	NV	NV	NV	£75
Notting Hill Gate and Kensington High Street W8	NV	£1,000	£1,000	£1,000
Earls Court SW5 and SW10	NV	NV	£400	£900
Chelsea SW3, SW1W	NV	£1,000	£1,000	£1,000
Knightsbridge	£1,000	£1,000	£1,000	£1,000

- 6.11 Site type 5 assumes a further increase in density to 300 units per hectare. This means that the whole development can be constructed on a modest site area, which reduces land costs, but at the expense of a further increase in build costs. The maximum viable levels of CIL fall slightly in most scenarios (see Table 6.11.1) with the highest rates at £1,000 per square metre in Knightsbridge on sites in all types of existing use.

**Table 6.11.1: Site type 5: Maximum viable rates of CIL (£s per square metre) with 50% affordable housing**

Area	Existing use: Offices (higher)	Existing use: Offices (lower)	Existing use: Industrial	Existing use: community buildings
North of Ladbroke Grove W10	NV	NV	NV	NV
Holland Park W11	NV	NV	£800	£1,000
Olympia W14	NV	NV	NV	NV
Notting Hill Gate and Kensington High Street W8	NV	£1,000	£1,000	£1,000
Earls Court SW5 and SW10	NV	NV	£350	£700
Chelsea SW3, SW1W	£25	£1,000	£1,000	£1,000
Knightsbridge	£1,000	£1,000	£1,000	£1,000

#### Sensitivity analysis on affordable housing percentage

- 6.12 We re-rested sites 3, 4, 5, 6 and 7 with a reduced level of affordable housing (40%, 30% and 20% of units). The results of these analyses are included within Appendix 2. The primary purpose of this exercise was to determine whether changes to affordable housing requirements on individual schemes would enable unviable sites to contribute towards infrastructure. The results show positive movement in terms of the viability of CIL rates when affordable housing levels are reduced. While we are not suggesting that the Council should change its affordable housing policies, the exercise demonstrates that the Council's flexible application of its policy will ensure that CIL will not render development unviable. However, we appreciate that the Council will be keen

to minimise the impact on affordable housing as far as possible and this is a key risk factor when determining rates of CIL.

**Table 6.11.1: Site type 5: Maximum viable rates of CIL (£s per square metre) with 30% affordable housing**

Area	Existing use: Offices (higher)	Existing use: Offices (lower)	Existing use: Industrial	Existing use: community buildings
North of Ladbroke Grove W10	NV	NV	NV	NV
Holland Park W11	NV	£1,000	£1,000	£1,000
Olympia W14	NV	NV	£600	£900
Notting Hill Gate and Kensington High Street W8	£1,000	£1,000	£1,000	£1,000
Earls Court SW5 and SW10	NV	£500	£1,000	£1,000
Chelsea SW3, SW1W	£1,000	£1,000	£1,000	£1,000
Knightsbridge	£1,000	£1,000	£1,000	£1,000

### Suggested CIL rates

- 6.13 Although the results indicate that relatively high rates of CIL could be levied in some areas, we would advise that a substantial buffer or margin should be allowed for to address risk. There are four key risk factors:
- the first is that individual sites might incur exceptional costs (decontamination, difficult ground conditions etc) and as a result the residual land value could fall. Developers will try and reflect such costs in their offer to the landowner, but the extent of any issues is not always fully apparent until the land value is fixed. Where sites have an existing use, an owner will not be prepared to accept a reduction below the value of the current building to accommodate exceptional costs on a redevelopment;
  - Secondly, current use values on individual sites will inevitably vary and will fall somewhere between the values used in our appraisals. As a result, the ability of schemes to absorb high rates of CIL could be adversely affected;
  - Thirdly, sales values could fall or normal build costs could rise over the life of the Charging Schedule, adversely affecting scheme viability; and
  - Fourthly, imposing a high rate of CIL (that vastly exceeds the current levels of Section 106 obligations) in the Council's first Charging Schedule could 'shock' the land market with a consequential risk that land supply falls. This factor has led many charging authorities to seek to limit their CIL rates to around 5% of development costs.
- 6.14 In arriving at a conclusion on recommended rates, it is necessary to consider the different weight that should be attached to appraisal results tested against each of the four benchmark land values. Whilst the highest rates of CIL can be generated when a scheme is developed on a low value site in community use, these types of site are unlikely to constitute a significant proportion of the Council's land supply; former industrial sites, low value office sites and similar

uses are much more likely to be prominent.

- 6.15 Given the range of results above, and the risk factors outlined in the previous paragraph, our recommendation is that the **maximum rate** of CIL that the Council might set would be as follows (shown **inclusive** of Mayoral CIL):
- North of Ladbrooke Grove W10: £200 per square metre;
  - Holland Park W11: £800 per square metre;
  - Olympia W14: £300 per square metre;
  - Notting Hill Gate and Kensington High Street W8: £600 per square metre;
  - Earls Court SW5 and SW10: £400 per square metre;
  - Chelsea SW3, SW1W: £800 per square metre; and
  - Knightsbridge: £1,000 per square metre.
- 6.16 In determining the maximum levels of CIL and the recommended rates above, we have based our assessment on current costs and values only. We have run a set of appraisals that show the impact of an increase in sales values, accompanied by an increase in build costs; and a further set of results that show the impact of a fall in sales values (the results are included in Appendix 2). These appraisals provide an indication of the likely movement in viability that the 'buffer' below the maximum rates would need to accommodate. The ranges in paragraph 6.15 allow for a sufficient buffer to accommodate these changes.

#### **Extra-care housing schemes**

- 6.17 Extra-care housing schemes are generally developed as standard self-contained residential units, located around communal areas and facilities, with an ability for residents to buy-in additional support services according to their individual needs. The planning system therefore treats these types of scheme as C3 use and developments would qualify for affordable housing.
- 6.18 We have appraised site type 3 as an extra-care housing scheme. The main differences in terms of viability are the additional communal space and the sales rate. We have adjusted the net to gross area in our appraisals to 70%, allowing for additional communal areas. We have extended the time period over which the units in the scheme are marketed to reflect the more limited number of buyers and the ability of potential purchasers to sell their existing properties in the current market.
- 6.19 Table 6.19.1 summarises the viability results.

**Table 6.19.1: Extra care housing scheme: Maximum viable rates of CIL (£s per square metre) with 50% affordable housing**

Area	Existing use: Offices (higher)	Existing use: Offices (lower)	Existing use: Industrial	Existing use: community buildings
North of Ladbroke Grove W10	NV	NV	NV	NV
Holland Park W11	NV	NV	£200	£800
Olympia W14	NV	NV	NV	NV
Notting Hill Gate and Kensington High Street W8	NV	NV	£1,000	£1,000
Earls Court SW5 and SW10	NV	NV	NV	£350
Chelsea SW3, SW1W	NV	NV	£1,000	£1,000
Knightsbridge	£1,000	£1,000	£1,000	£1,000

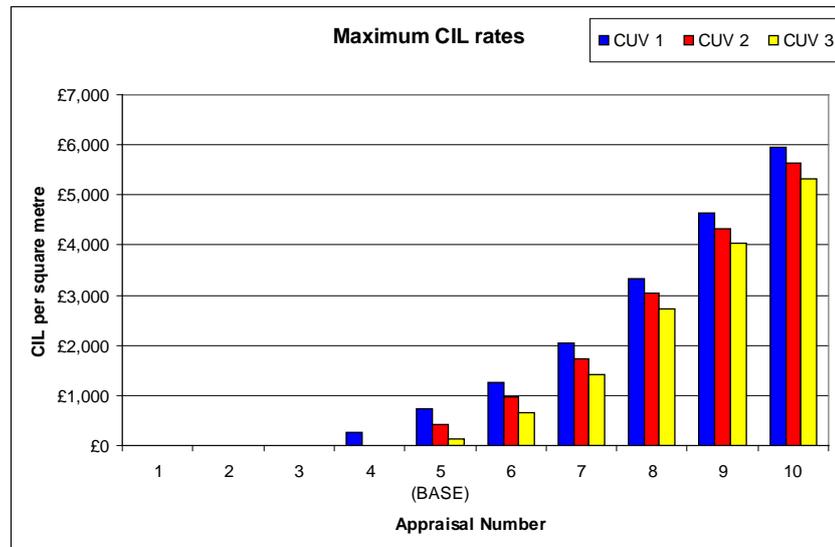
### Assessment – commercial development

- 6.20 Our appraisals indicate that the potential for commercial schemes to be viably delivered varies between different uses and between areas across the Borough. Office rents are higher in certain areas and developments would generate sufficient surplus residual value to absorb a CIL. For other types of development, such as retail, there is unlikely to be considerable amounts of net additional floorspace and rents for new build floorspace are not appreciably higher than rents for existing space.
- 6.21 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 adopt a 'base' position based on average rents for each type of development and show the results of appraisals with lower and higher rents. This analysis will enable the Council to consider the robustness of potential CIL charges on commercial uses, including the impact that changes in rents might have on viability.

#### Office development – SW1 and SW3 area

- 6.22 The results of our office appraisals in the SW1 and SW3 areas indicate that the rent levels that could be secured on new developments are likely to be sufficiently high to generate positive residual land values. Comparable lettings evidence indicates that average office rents are circa £40 per sq ft at the current time. Long term demand for offices in the West End is considered to be robust and it is therefore likely that office development will continue to come forward in this area over the life of the Charging Schedule. The results of our appraisals, with varying rates of CIL, are shown in Chart 6.22.1 below.

**Chart 6.22.1: Viable levels of CIL on office development in City Fringe**

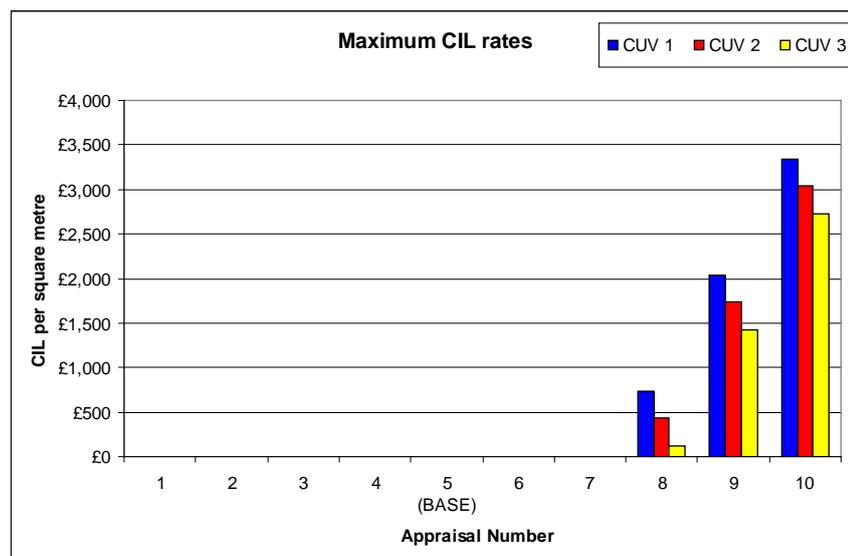


- 6.23 Focusing on the 'Base' scenario (appraisal 5 in the Chart), the viable level of CIL ranges from £738 per square metre to £125 per square metre, depending on the current use value of the site. Based on current use value 3, the maximum potential CIL rate would be **£125 per square metre**, inclusive of Mayoral CIL.

**Office development – elsewhere across the Borough**

- 6.24 The results of our office appraisals elsewhere in the Borough indicate that the rent levels that could be secured on new developments are likely to be considerably lower. As a result, office development is unlikely to generate positive residual land values that exceed current use values. Comparable lettings evidence indicates that average office rents are circa £30 per sq ft at the current time. The results of our appraisals, with varying rates of CIL, are shown in Chart 6.24.1 below.

**Chart 6.24.1: Viable levels of CIL on office development – rest of Borough**

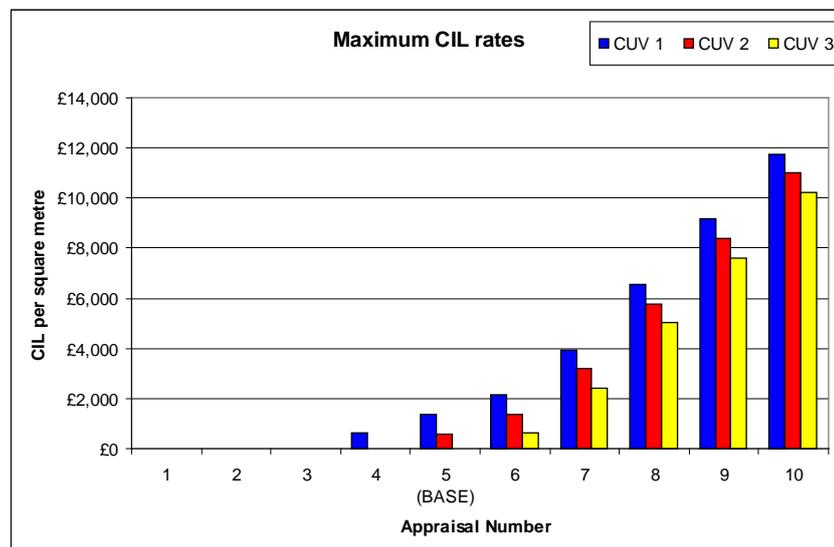


- 6.25 Rents would need to increase considerably before office development could generate sufficient residual values to enable them to pay CIL. Appraisal 8 in Chart 6.24.1 assumes a rent of £40 per sq ft, compared to £30 per sq ft in the 'Base' Scenario, indicating the increase required for schemes to be sufficiently viable to absorb CIL.

### Retail development

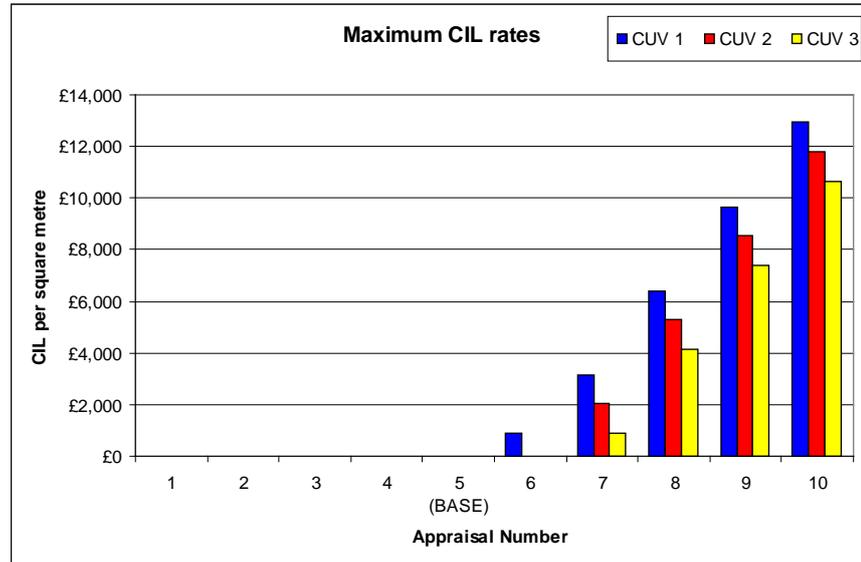
- 6.26 Lettings of existing and new/refurbished retail floorspace indicates that rents are on average £68 per sq ft. The vast majority of retail development in the Borough involves recycling existing retail floorspace. Consequently, retail development generates very little net additional floorspace that would be chargeable for CIL. Furthermore, development of new retail floorspace on existing retail sites is unlikely to generate significant surpluses that could fund CIL. This is because rents for new build floorspace are only slightly higher than rents for existing floorspace. Chart 6.26.1 summarises the retail development appraisals.

**Chart 6.26.1: Viable levels of CIL on retail development**



- 6.27 Although the appraisal indicates that a CIL could be absorbed in some circumstances in the 'base' scenario, the results are very sensitive to the amount of existing floorspace built into the current use value. If the existing floorspace increased from 50% to 60% of new floorspace, scheme viability would be adversely affected and no CIL could be absorbed (see Chart 6.27.1). Consequently, we advise that a nil rate of CIL should be set on retail development.

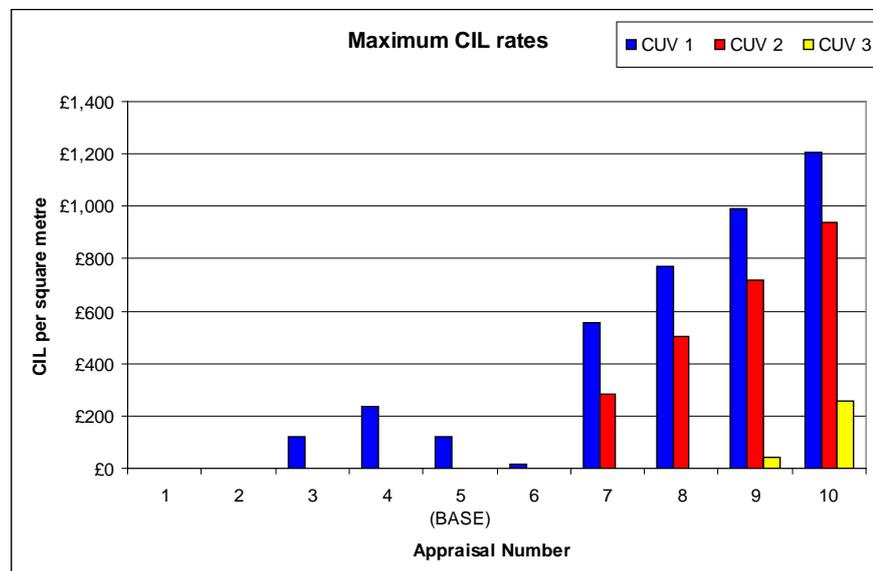
**Chart 6.27.1: Viable levels of CIL on retail development (increased existing floorspace)**



**Industrial and warehouse development**

6.28 Our appraisals of industrial development indicate that residual values are likely to be too low to absorb any level of CIL above the existing Mayoral CIL requirement of £50 per square metre (see Chart 6.28.1).

**Chart 6.28: Industrial development**



**Student Housing**

6.29 Rents for student housing in the Borough are not dissimilar from schemes in other central London boroughs (circa £200 per week for a single ensuite room). Our appraisal (attached as Appendix 3) indicates that student housing schemes could generate a CIL contribution of up to £257 per square metre, inclusive of Mayoral CIL.

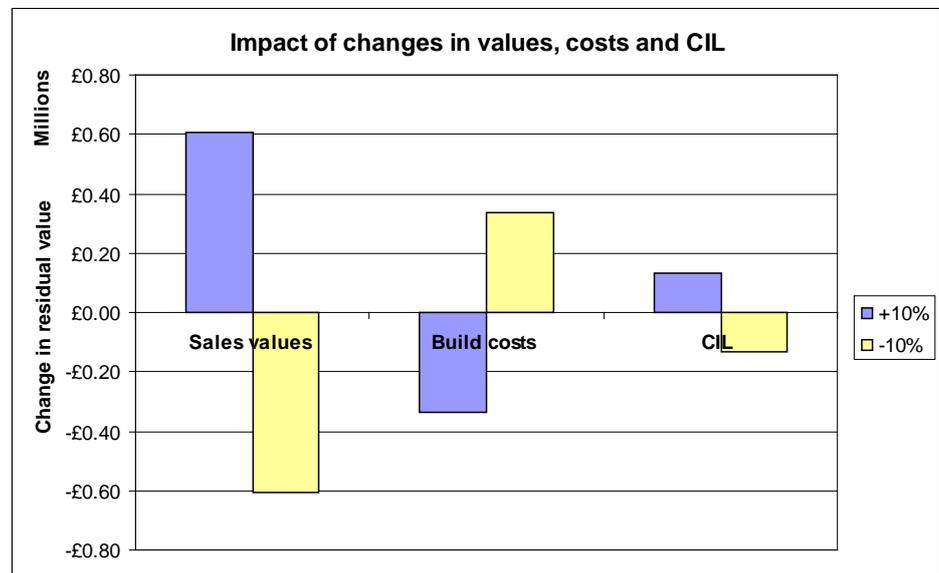
### **D1 and D2 floorspace development**

- 6.30 D1 and D2 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 and D2 uses will be capable of generating any contribution towards CIL.

## 7 Conclusions and recommendations

- 7.1 The results of our analysis indicate a degree of variation in viability of development in terms of different uses. 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 types of development 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. In other words, the Council could be securing the benefit of simplicity at the expense of potential income foregone that could otherwise have funded infrastructure. Secondly, the Council has the option of setting different rates for different types of development and different areas. The results of our study point firmly towards the second option as our recommended route, particularly for residential development.
- 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 *the* critical factor in determining whether a scheme is viable or not (with the relationship between scheme value, costs and land 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 charts in Section 6. This point is also illustrated in Chart 7.2.1 below, which compares the impact on the residual value of a scheme of a 10% increase and decrease in sales values and a 10% increase and decrease in build costs to a £100 per sq metre change in CIL.

**Chart 7.2.1: Impact of changing levels of CIL in context of other factors**



- 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 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 changes.
- The ability of **residential schemes** to make CIL contributions varies depending on area and the current use of the site. Having regard to these variations, residential schemes should be able to absorb a **maximum** CIL rate of between £200 to £1,000 per square metre. Other charging authorities have set their rates at a discount to the maximum rate, with discounts ranging from circa 25% to 50%. The maximum rates indicated by our appraisals are as follows:
  - North of Ladbrooke Grove W10: £200 per square metre;
  - Holland Park W11: £800 per square metre;
  - Olympia W14: £300 per square metre;
  - Notting Hill Gate and Kensington High Street W8: £600 per square metre;
  - Earls Court SW5 and SW10: £400 per square metre;
  - Chelsea SW3, SW1W: £800 per square metre; and
  - Knightsbridge: £1,000 per square metre.
- Applying a 30% discount to the maximum rates above would indicate that the following CIL rates could be adopted (all shown inclusive of Mayoral CIL):
  - North of Ladbrooke Grove W10: £140 per square metre;
  - Holland Park W11: £560 per square metre;
  - Olympia W14: £210 per square metre;
  - Notting Hill Gate and Kensington High Street W8: £420 per square metre;
  - Earls Court SW5 and SW10: £280 per square metre;
  - Chelsea SW3, SW1W: £560 per square metre; and
  - Knightsbridge: £700 per square metre.
- Whilst the maximum rates are significantly higher than the proposed rates, the buffer will help to mitigate a number of risk factors (primarily the potentially adverse impact on land supply of setting the rates at a high level and 'shocking' the market).
- **Extra-care housing** generates slightly lower residual values than standard residential, due to the provision of a greater proportion of communal space and a slower sales rate (even though values are not dissimilar). To account for these factors, maximum rates of CIL would be lower, as follows (shown inclusive of Mayoral CIL):

- North of Ladbroke Grove W10: £100 per square metre;
  - Holland Park W11: £400 per square metre;
  - Olympia W14: £100 per square metre;
  - Notting Hill Gate and Kensington High Street W8: £500 per square metre;
  - Earls Court SW5 and SW10: £300 per square metre;
  - Chelsea SW3, SW1W: £600 per square metre; and
  - Knightsbridge: £800 per square metre.
- Applying a 30% discount to the maximum rates above would indicate that the following CIL rates could be adopted (all shown inclusive of Mayoral CIL):
- North of Ladbroke Grove W10: £70 per square metre;
  - Holland Park W11: £280 per square metre;
  - Olympia W14: £70 per square metre;
  - Notting Hill Gate and Kensington High Street W8: £350 per square metre;
  - Earls Court SW5 and SW10: £210 per square metre;
  - Chelsea SW3, SW1W: £420 per square metre; and
  - Knightsbridge: £560 per square metre.
- Whilst the maximum rates are significantly higher than the proposed rates, the buffer will help to mitigate a number of risk factors (primarily the potentially adverse impact on land supply of setting the rates at a high level and 'shocking' the market).
- At current rent levels, **Office development in the SW1/SW3 area** should be able to viably absorb a CIL of £125 per square metre (inclusive of Mayoral CIL). Allowing a buffer for site-specific issues and changes in values over time, we recommend that the Council considers a CIL of £88 per square metre (inclusive of Mayoral CIL). After Mayoral CIL has been deducted, the amount of Borough CIL is very modest (£38 per square metre) and the Council should consider whether the additional income that would be raised would be outweighed by the administrative burden of setting a rate for a small area.
- At current rent levels, **Office development elsewhere in the Borough** is unlikely to come forward in the short to medium term as the capital values generated are insufficient to cover development costs. We therefore recommend that the Council sets a nil rate for offices outside the SW1/SW3 area.
- **Student housing** in the Borough generates sufficient surplus residual values to absorb a CIL of £250 per square metre. After allowing for a buffer for site-specific factors, we suggest a rate of £175 per square metre (inclusive of Mayoral CIL).
- **Hotel developments** are able to absorb a maximum CIL (inclusive of Mayoral CIL) of £300 per square metre. After allowing a buffer for site-specific factors, we suggest a rate of £210 per square metre (inclusive of Mayoral CIL).

- Residual values generated by **Retail developments** are somewhat higher than current use values. However, retail development is predominantly redevelopment or re-use of existing space, so the differential in value between current and newly developed space is modest. Consequently, little surplus value is generated and we therefore recommend a nil rate of CIL on this type of development.
- Our appraisals of developments of **industrial and warehousing floorspace** indicate that these uses are unlikely to generate positive residual land values. We therefore recommend a zero rate for industrial floorspace.
- D1 and D2 uses often do not generate sufficient income streams to cover their costs. Consequently, they require some form of subsidy to operate. This type of facility is very unlikely to be built by the private sector. We therefore suggest that a nil rate of CIL be set for D1 uses.

7.5 The maximum and suggested rates are summarised in Table 7.5.1 and Table 7.5.2.

**Table 7.5.1: Maximum and suggested CIL rates – residential**

Area	Maximum rate	Net of 30% Discount/ buffer	Mayoral CIL	Net RBKC CIL
North of Ladbroke Grove W10	£100	£70	£50	£20
Holland Park, W11	£400	£280	£50	£230
Olympia, W14	£100	£70	£50	£20
Notting Hill Gate and Kensington High St W8	£500	£350	£50	£300
Earls Court, SW3 and SW10	£300	£210	£50	£160
Chelsea SW3 and SW1W	£600	£420	£50	£370
Knightsbridge	£800	£560	£50	£510

**Table 7.5.2: Maximum and suggested CIL rates – other uses**

Development type	Maximum rate	Net of 30% Discount/ buffer	Mayoral CIL	Net RBKC CIL
Offices – SW1 and SW3	£125	£88	£50	£38
Offices – elsewhere	£0	£0	£50	£0
Student housing	£250	£175	£50	£125
Hotels	£300	£210	£50	£160
Retail	£0	£0	£50	£0
Industrial	£0	£0	£50	£0
D1 and D2 uses	£0	£0	£50	£0

7.6 For residential schemes, the application of Borough CIL of up to £510 per square metre is unlikely to be an overriding factor in determining whether or not a scheme is viable. When considered in context of total scheme costs, a

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Borough CIL of up to £510 per square metre is a very modest amount, accounting for less than 5% of total development costs (i.e. no more than a developer's contingency which is typically around 5%). Some schemes would be unviable even if a zero CIL were adopted. We therefore recommend that the Council pays limited regard to these sites.

## Appendix 1 Private residential sales values

## Appendix 2 Residential appraisal results

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## Appendix 3 Commercial appraisal results