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CIL Consultation
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5 June 2013
Our ref: LNH/ JA

Dear Sir / Madam

Community Infrastructure Levy Draft Charging Schedule

On behalf of our client, Aldgate Place (GP) Ltd, we are pleased to submit representations to the London Borough of Tower Hamlets CIL Draft Charging Schedule (DCS), which has been published for consultation until 5 June 2013.

Deloitte Real Estate has been instructed by Aldgate Place (GP) Ltd to provide consultancy advice in relation to the Council's DCS and to review the Viability Studies dated October 2012 and March 2013 prepared by BNP Paribas. Aldgate Place (GP) Ltd welcomes the opportunity to comment on the Council's CIL.

Context and background

As the Council is aware, British Land and Barratt Homes (of Aldgate Place (GP) Ltd) are supportive of development in Tower Hamlets however there is a concern about the proposed CIL charges and the impact these will have in hindering development coming forward in a strategically important part of London.

By way of background, Deloitte Real Estate is an industry expert on CIL. We advised and appeared at Examination in Public on behalf of Huntingdonshire District Council at their CIL Examination on 6 & 7 March 2012; the successful levy was adopted on 1 May 2012. We continue to work closely with local authorities on CIL and so we are well placed to offer our comments on viability and the proposed CIL charges.

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Preliminary Draft Charging Schedule Consultation Responses

Firstly we wish to comment on the changes that have occurred in the proposed rates from PDCS to DCS stage. We have reviewed the Summary of PDCS Consultation Responses dated April 2013, and we note that a number of queries were raised during the PDCS consultations that do not appear to have been appropriately or adequately addressed.

The Council has made a statement in respect of the changes to the proposed commercial CIL rates. This answer is repeated a number of times in the Consultation Reponses regardless of questions posed:-

> *"The Council has updated its viability evidence and several of the proposed CIL rates have been adjusted for non-residential uses to ensure the introduction of CIL positively enables the local Core Strategy objectives to be delivered, by striking an appropriate balance between the need to fund infrastructure and the impact of CIL on economic viability of development, when taken as a whole across the borough."*

Having reviewed the supporting viability evidence dated October 2012 and March 2013, we can confirm that the Council has not updated its viability evidence in respect of the non-residential uses. Indeed, there is only one change from table 4.48.1 of the two viability reports which would actually serve to reduce the viability of hotel development from PDCS to DCS.

In addition, the Council held a drop-in session on 1 May 2013 which we attended on behalf of our client, and where we queried a number of areas of concern, in particular, why the office rates have been separated into three zones rather than two (City Fringe, North Docklands, Rest of the Borough), and why the rate for the City Fringe zone had increased from £125 psm to £215 psm. We queried what new evidence had been found to support this increased rate given that we are party to marketing evidence which demonstrates that office development is not viable in this location. BNP Paribas claimed that they had found new evidence on values to support this increased rate.

Having reviewed the viability reports supporting the PDCS and the DCS, we can confirm that there has been no new evidence in BNP Paribas's commercial appraisal assumptions. The information provided at the drop-in session therefore appears to be unsubstantiated. In addition, we believe that the repeat responses to the PDCS Consultation did not address the individual questions posed. The responses did not therefore duly consider the important comments raised.

For reference, the Council's proposed CIL rates are:

Use	Proposed CIL rate (£ per sq m)			
Residential	Zone 1	Zone 2	Zone 3	
	£200	£65	£35	
Student Housing	£425			
Hotel	£210			
Offices	City Fringe	North Docklands	Rest of Borough	
	£215	£100	£0	
Small retail (280 sq m or less)	£70	£70	£70	
Convenience based	£195			
All other uses	Nil			

We wish to raise our concerns over a number of the Council's proposed CIL charges, in particular:

- Residential Zone 1 (£200 psm)
- Small Retail (£70 psm)
- Offices (£215 psm in City Fringe)

For the purpose of this letter, we have focussed on the latest supporting viability evidence prepared by BNP Paribas dated March 2013 and we wish to highlight areas of concern in the supporting viability evidence.

The Examiner's Tests

At Examination in Public, the appointed Examiner would require the Council to address the following three questions:-

> *1. Is the charging schedule supported by background documents containing appropriate available evidence?*
>
> *2. Is the charging rate informed by and consistent with the evidence?*
>
> *3. Does the evidence demonstrate that the proposed charge rate(s) would put the overall development of the area at serious risk?*

We do not believe that the Council, in proposing its DCS CIL rates has satisfied these questions and we have set out below our comments.

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Methodology

A summary of BNP Paribas's viability assumptions is set out in detail in Tables 4.46.1 and Table 4.48.1 of its Viability Report dated March 2013.

The methodology adopted by BNP Paribas for assessing the ability of new development to support CIL is based on the following broad calculation:

Residual Land Value (RLV) of the completed development

less Benchmark Land Value (BLV, assumed by BNP Paribas to be Current use value + landowner premium)

= Total Surplus or Deficit available for CIL (divided by sq m of the development to arrive at £psm).

This would set a maximum CIL level for a scheme, allowing no viability 'cushion' or flexibility, nor appropriately allowing for finance on CIL, which would be needed if it was treated as a development cost.

Clearly if the appraisal result (RLV) does not exceed the Benchmark Land Value (BLV), there will be no scope for CIL. There are a number of concerns we have in relation to the RLV (i.e. the value of the site based on redevelopment), and the BLV (i.e. the return for the landowner). If the BLV is set too low and is not appropriately evidenced, it will falsely reflect a situation where existing landowners are expected to release land at the BLVs, however, in fact they will not, and future development will be stifled. We deal with BLVs separately below, however, in the first instance we have commented on the assumptions underpinning the RLVs.

Residential CIL Rate

The CIL Statutory Guidance dated December 2012 sets out under point 29 that the Charging Authority should "show that the proposed rate (or rates) would not threaten delivery of the relevant Plan as a whole. They should also take into account other development costs arising from existing regulatory requirements, including taking account of any policies on planning obligations in the relevant Plan (in particular those for affordable housing and major strategic sites)."

LBTH Core Strategy (2010): Strategic Objective 7 sets out the Council's vision to deliver housing growth to meet housing demand in accordance with London Plan housing targets, including an overall strategic target for affordable homes of 50% until 2025. Policy SP02 states that this will be achieved by:

> *"Requiring 35%-50% affordable homes on sites providing 10 new residential units or more (subject to viability)"*

BNP Paribas has tested seven residential 'site types', two of which do not include affordable housing as they are below the threshold. The remaining five site types have only been tested based on 35% affordable housing. We believe that affordable housing requirements should have been sensitivity tested across the range, and those results used to inform the proposed CIL rates. We do not believe the Council has followed the CIL Statutory Guidance, and the recommended CIL rates are therefore higher than is viable, taking into account policies in the relevant Plan.

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Small Retail (280 sq m or less)

The BNP Paribas viability evidence concludes that retail development outside of the City Fringe and North Docklands is unable to support a CIL charge, however, a CIL charge of £70 psm can be levied on small retail space of 280 sq m or less in the City Fringe and North Docklands.

The BNP Paribas assumptions on retail use (for new build space of 280 sq m or less) include a rental value of £30psf with 2 years rent free and a 6.25% yield for all new build A1 – A5 use classes.

There are limited comparable schemes in the area however evidence from agents suggests that new schemes in the City Fringe are likely to attract a varied mix of retail tenants including local newsagents and cafés with rents ranging from £16 psf to £30 psf. On this basis, we believe that an average rent of £30psf is not appropriate nor reflective of the current market and the types of occupiers anticipated to come forward in these market areas. In addition, the mixed local tenant profile would also attract a higher yield of 6.5%.

Office

The BNP Paribas viability evidence concludes that office development in the City Fringe is able to support a CIL charge of £215 psm. This recommendation is based on RLVs which include the following assumptions for new build offices: £35 psf headline rent, 24 months rent free / void, and 5.75% yield.

<u>Rents</u>

We have set out below our evidence and experience of promoting a site within the City Fringe for offices throughout the period 2001 – 2011. Details are set out below:-

The site we refer to was granted planning permission in 2007 for three separate office buildings with maximum floorplates of 14,000 sq ft. The scheme failed to attract a pre-let, and major pre-lets are essential to secure funding for construction. There was a further planning permission in 2009, again for office use with maximum floorplates of 45,000 sq ft. Although this created larger floorplates, the layout was different and construction costs were significantly higher than for a regular building of the same size. This scheme also failed to attract a prelet. We note the hypothetical office appraisal prepared by BNP Paribas is for a building of 30,000 sq ft.

The site we refer to was purchased in 2001 and was promoted for offices for over 10 years. Both planning schemes mentioned above were offered to the market at the minimum viable rent, based on nil land value (£35 per sqft). This was equivalent to a 30% discount on the City Core and was similar to other competing office locations, such as Canary Wharf, King's Cross Central and Paddington. Some 35 interested parties, with requirements ranging from 30,000 sqft to 1 million sqft, considered and rejected the site, including at the peak of the last market cycle. Of those organisations that gave a reason for rejecting the site, over 80% identified location as the main reason. Over half of the interested parties chose alternative premises in the City Core and Canary Wharf. Around a quarter decided not to move or have an ongoing requirement. The remainder selected alternative locations across London and the South East.

The market for occupiers is highly competitive. A contraction in financial services and the public sector has led to a period of consolidating and relocations are rare. Professional services and TMT occupiers are increasingly considering established locations such as the City Core and Canary Wharf, as well as emerging locations with improved transport links.

The evidence above illustrates the challenge in achieving rents of £35 psf, even with sites with planning permission. In addition, if an occupier was to accept a 10 year term they would expect to receive in the region of 21-24 months rent free, with a further void in income required to reflect the marketing void period.

Investment Yields

In terms of assumptions on yield, the lease term that BNP Paribas has assumed in its analysis is unclear. A 10 year lease with a break at year five, or a ten year lease with no break to a strong covenant will affect the appropriate yields adopted.

On the basis of the questionable rental market, and the likely requirement to provide flexible terms and a tenant break clause at year 5 of a standard 10 year term, we believe the office yields should reflect 6.25% - 6.50%.

Benchmark Land Value Evidence Base

We have concerns in relation to the assessment and application of the BLVs. The BLVs are intended to reflect the price a landowner can expect to receive for their land. There are a number of different guidance notes and legislation such as the NPPF on what could constitute a BLV. The NPPF states that "To ensure viability… [there should be]…. competitive returns to a willing landowner and willing developer to enable the development to be delivered." The NPPF's intent is to ensure that BLVs are not simply driven by planning obligations and policy, but rather should bear a relation with local market comparables. In addition, the RICS '*Financial Viability in Planning'* Guidance Note is supportive of a market value approach.

For ease of reference, we have set out below our understanding of how BNP Paribas has assessed the BLVs. Notably, the BLVs used within the viability study differ, depending on whether the Residential or Commercial CIL rates are being derived and so there is an inconsistency in the approach taken. We deal with the BLVs used to derive the Residential CIL rates below.

RESIDENTIAL CIL	BLV 1	BLV 2	BLV 3	BLV 4
Existing use	Office	Office	Industrial	Community
Source	BNP PARIBAS	BNP PARIBAS	BNP PARIBAS	BNP PARIBAS
CUV	Low value offices	Lower value offices	Low value industrial	Low value community
Landowner premium	20%	20%	20%	20%
Final BLV	£6.3 million per acre	£4 million per acre	£2.1 million per acre	£1.2 million per acre

Firstly, the BLV assessments have been based on hypothetical current uses, trading at low rents with refurbishments costs and significant voids. We are of the view that in isolation the resultant BLVs are significantly lower than the figures that land will transact at and therefore do not represent "a willing landowner".

It is apparent to us that the BLVs have not been confirmed with agents active in the market, and there is therefore no appropriate evidence to substantiate BNP Paribas's assumption that landowners in the market are prepared to sell at such discounted prices. Using these BLVs in order to set CIL will undoubtedly stifle development coming forward. The BLVs are underestimated and therefore artificially allow for more CIL than is viable without stifling development.

There appears to be no weight given to the type of land likely to come forward for development in the borough and the likely land values expected to be achieved by landowners. There appears to be equal weighting granted to office, industrial and community use sites and a presumption that landowners will accept these BLVs as appropriate values in order to release their land. There also does not appear to be any weighting given to the very low value community land in informing the CIL charges, and what planning allocation may be granted to such sites. There has also been no reference made to residential land values.

As a basic principle, an existing building, even if vacant will have an inherent value which will be reflected in its investment value and any hope value for achieving a higher value use. In addition, DCLG's recent proposals for relaxation of planning rules for change of use from offices to residential further strengthen the arguments for higher BLVs than those shown above.

We have set out below market evidence in relation to local land values in the borough. (Source: Molior).

Address	Detail	Date	Price
Goodman's Field, Leman Street	(A) Full planning permission for the development of a 250 bedroom hotel (Use Class C1), 164 residential units (Use Class C3) with ancillary gym/swimming pool (857sqm GEA), 1,758m2 (GEA) of ground floor commercial/leisure floorspace (Use Classes A1 - A5, B1a, D1 and D2) all to be provided in a single block and a basement of 18,447m2 (GEA) incorporating 253 car parking spaces, cycle parking and including ancillary facilities (storage, management facilities and plant) with access, landscaping, surface car parking and related infrastructure and engineering works. (B) outline planning permission for a mixed use development (with all matters reserveed except for access) comprising up to 700 residential units (Use Class C3), up to 6,891m2 (GEA) of ground floor commercial/leisure floorspace (Use Classes A1 - A5, B1a, D1 and D2), vehicular/ pedestrian/cycle accesses and related infrastructure and engineering works.	December 2010	£60m for 2.22 ha £10.9 million / acre
Avant Garde, 32-34 Bethnal Green Road	Demolition of existing building and erection of two buildings ranging from 4 to 25 storeys in height to provide 3,434 sqm of commercial floorspace within use class A1, A2, A3, A4, B1, B8, D1 & D2 and 360 residential units (comprising of 32 x studios, 135 x 1 bed, 116 x 2 bed, 65 x 3 bed, 7 x 4 bed, 5 x 5 bed), car parking, bicycle parking, refuse /recycling facilities, access, public amenity space and new public space.	November 2007	£25.18 m for 0.55 ha £18.6 million / acre
61-75 Alie Street; 16-17 Plough Street 20 Buckle Street	Demolition of existing buildings and erection of two buildings of 7 and 28 storeys to provide 235 residential units, A1/A3 (retail/restaurant/cafe) floor space and B1 (Business), formation of associated car and cycle parking and highway access, hard and soft landscaping and other works associated to the redevelopment of the site] to allow submission of details either prior to occupation or following demolition rather than prior to commencement.	July 2011	£15.3m for 0.193 ha £32 million / acre
52-58 Commercial Road	Redevelopment of site to provide a total of 136 x 1, 2 and 3 bedroom flats including 38 affordable units and six live/work units, 25 parking spaces, storage and plant space in the basement, café (A3), retail (A1), health	October 2006	£12.1m for 0.13 ha

	club (D2) and office space (B1) on the ground floor along with six reinstated car parking spaces from the social housing west of Gower's Walk, offices, flats and live / work units on the second and third floors, offices, flats, live/work units and a health club on the third floor and flats on all of the floors above.		£37 million / acre
City Quarter, 99 Leman Street	40 residential dwellings (refurbishment)	September 2005	£10.4m for 0.11 ha £38 million / acre
14-20 Alie Street	Erection of a basement plus six storey building to provide commercial uses (Use Classes A1, A2, A3, B1 or D1) at part lower ground floors and 31 residential units above (13x1, 9x2, 9x3 beds).	October 2007	£4.2m for 0.03 ha £56 million / acre
111-120 Whitechapel High Street & One Commercial Road	Erection of a building comprising basement plus 23 storey building (with roof terrace) providing (i) parking, plant and 755mý of Class A1, A2 or A3 (retail, office and food and drink) uses at basement level; (ii) 1,367m of either Class A1, A2, A3, D2 (retail, food and drink, and leisure) uses on the ground floor; (iii) 1,609m of either Class A1, A2, A3, B1, D1 (retail, food and drink, offices or leisure (D2) uses on the first floor; (iv) 8,430m of offices (Class B1) on the 2nd to 6th floors; and (v) 217 residential units on the 7th to 22nd floors, together alterations to the entrance of the Aldgate Station Underground Station	Jan 12	£38.9m for 0.11ha £143 million / acre

There is clearly a wide range of land values ranging from £10 million to £143 million per acre. The sites will vary in density, date of transaction and level of affordable housing provision and other s106 contributions, however, it is apparent that landowners are not willing to sell their sites for less than £10 million per acre for residential use (which is the CIL use being tested utilising the above BLVs).

Indeed, Deloitte Real Estate is currently marketing a site in Whitechapel E1, London Borough of Tower Hamlets of 3.5 acres in size and the guide price is £40 million, equating to a sales price of £11.4 million per acre.

In relation to the BLVs used for commercial testing, we would comment that there are a number of inconsistencies in approach which have not been justified or explained, notably:

- Percentage of net additional floorspace ranging from 30% - 50% with 30% and 35% adopted for two differing office appraisals
- Landowner premiums of 15% in some instances and 20% in other instances

Other Key Issues

Viability Buffer

In any CIL setting process, it is important to ensure a suitable 'viability cushion' or buffer is allowed to account for unforeseen circumstances. In particular, we note that the BNP Paribas appraisals have omitted a number of costs which could severely affect site viability. We would usually expect the viability buffer to reflect the uncertainty in market conditions over time and unforeseen additional costs, however a number of costs have been omitted in the BNP Paribas appraisals such as abnormal costs, basement

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works, car parking costs, Mayoral CIL, s106 Crossrail Tariff, sustainability costs, affordable housing, etc. On this basis, we would request to see a re-run of the appraisals with known costs included, or alternatively a sufficient viability buffer to account for these additional costs.

The BNP Paribas viability report states that a recommended buffer of 30% from the ‘maximum’ CIL rates should be applicable to London Borough of Tower Hamlets. There is a twofold point here: firstly, we do not believe that a 30% buffer is a sufficient ‘viability cushion’, particularly as it is has been used to allow for a number of known costs. Secondly, despite the descriptive text of the Viability Study suggesting a 30% buffer is recommended for this borough; in fact, BNP Paribas has only allowed for a buffer of between 22% - 25% in setting its recommended CIL rates (see Table 1.5.1. of the March 2013 Viability Study).

Instalment Policy

It is unclear if and how an instalment policy has been tested in terms of viability. Instalment policies affect viability as CIL is a development cost which is payable on commencement of development and attracts finance costs much as any other development cost. We believe it will be taken into consideration by an Examiner and we wish to understand what assumption has been made on this and whether any difference in approach has been made for the residential and commercial CIL charges, and if so, the reason why. If no instalment policy has been tested, we would recommend that the viability buffer is further increased as the maximum CIL charges would assume that CIL is payable on completion of development which thereby overestimates the quantum of CIL.

In addition point 3.2 of Appendix 2 of the DCS makes reference to adopting the same instalment policy as that which may be proposed for Mayoral CIL. It is unclear if this instalment policy has been tested in terms of viability.

Mayoral CIL and Crossrail s106 Tariff

It is unclear how Mayoral CIL has been accounted for in the appraisals. We disagree that this cost should be netted off at the end of the appraisal rather than inputted as a known development cost.

We disagree with the approach taken to the Crossrail s106 charge. Geographically, much of the borough will fall within the Central London Charge Zone or the Isle of Dogs Charge Zone, and therefore the following charges will apply:

Central London Charge Zone	Isle of Dogs Charge Zone
Office £140 psm	Office £190 psm
Retail £90 psm	Retail £121 psm
Hotels £61 psm	Hotels £84 psm

There does not appear to be any allowance within the ‘viability buffer’ to account for these additional obligations which will be required of developers. Taking, for example, the maximum CIL charge for offices of £300 psm, and deducting Mayoral CIL of £35 psm, leaves a viability buffer of only £65 psm if adopting the BNP Paribas recommended office CIL charge of £200 psm. Clearly a viability buffer of £65psm is insufficient to cover the Crossrail s106 Obligation of £140 psm within the Central London Charge Zone, and this allows for no viability cushion for a number of additional costs such as sustainability requirements, abnormal costs, changes in market conditions, and affordable housing in line with Council policy.

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Purchaser's Costs

There are instances where the viability report contradicts itself, and indeed where it refers to different inputs which are not then incorporated into the viability appraisals, for example, point 4.25 refers to stamp duty and acquisition costs of 5.8% (4% stamp duty, 1% agents fees and 0.8% acquisition fees).

Either BNP Paribas has missed out VAT on fees or has misrepresented or misunderstood its own 5.8%. Notwithstanding this, the appraisals at Appendix 4 actually show purchaser's costs at 5.75% which are therefore insufficient and inconsistent with the report. This error may also be present in the residential appraisals, however insufficient information has been provided in order to comment appropriately.

Exceptional Circumstances Relief

We would request to understand whether the Council is electing ECR in its borough and we are supportive of this.

CIL as a Development Cost

CIL is a development cost which is payable on commencement of development and attracts finance costs much as any other development cost. We can see no evidence that CIL has been appropriately incorporated into the appraisals, but rather that that it is an output of the appraisal assumptions and this leads us to question whether sufficient deductions have been made to the maximum CIL output to ensure finance charges are taken into account.

Build Costs

Paragraphs 4.12 and 4.50 set out the build costs assumption used for the residential and commercial appraisals, respectively. BNP Paribas has relied upon BCIS in its assumption on build costs. We do not believe the use of BCIS is an appropriate index for London Boroughs, particularly as the sample of tenders for actual schemes in London sourced from BCIS is limited. The range of residential build costs adopted by BNP Paribas is £95psf to £131psf. We would question whether these build costs are reflective of the London market, in particular, as a limited allowance has been granted for external works at 15%.

We have evidence of build costs around £230 psf for mixed use schemes, albeit this is inclusive of some external works. We would expect costs for external works in London to be significantly higher than those adopted by BNP Paribas. For example, car parking spaces are often provided at basement level in London and no allowance has been made for car parking costs. In addition, although the descriptive text in the Viability Report suggests a 15% allowance has been made for external works (see 4.13 - 4.19), the commercial appraisals at Appendix 4 only provide an allowance of 10% for external works. The appraisals are therefore inconsistent with the viability report and the cost allowances are insufficient as compared to actual scheme evidence provided above.

Summary

We believe the number of points highlighted above is sufficient to call into question the credibility of the proposed CIL charges. In summary we wish to raise the following comments:

- We are concerned by the responses provided at PDCS stage and the drop-in session which do not adequately address the concerns raised.
- We request to see at least one residential appraisal which sets out the exact calculations used to arrive at the RLVs.

- We can see no evidence that sensitivity testing for CIL has been done based the affordable housing policy range of 35% - 50%.
- We believe retail rents have been overestimated and we have provided appropriate evidence to the contrary.
- We believe the assumptions in relation to new build offices are incorrect and we have provided appropriate evidence to the contrary.
- Critically, the BLVs adopted within the viability study have not been market tested and significantly underestimate the level of land value required for a “willing landowner”. Again, evidence has been provided which should be considered.
- The viability buffer is insufficient to deal with both known and unknown additional costs.
- We request to understand if and how an instalment policy has been tested in terms of viability.
- CIL is a development cost which attracts finance as any other development cost.
- Fundamental inputs such as purchaser’s costs are incorrect and insufficient in the appraisals.
- We believe the build costs are not reflective of new build developments in London and we have provided evidence to the contrary.

We request that the Council reconsiders its viability evidence and the comments we have provided, in particular in relation to BLVs, to ensure landowners receive an appropriate return for their land and that development is not stifled in this borough.

In addition, we wish to understand how the charging authority intends to prioritise, capture and spend CIL in the borough in a manner which does not delay development coming forward.

We wish to work collaboratively with the Council in resolving these issues and in ensuring the revised Charging Schedule takes into consideration the comments that we have made.