LB Tower Hamlets CIL

Note on further appraisal comments – September 2014

1 DP9 ON BEHALF OF CANARY WHARF GROUP (CWG) AND BISHOPSGATE GOODSYARD REGENERATION (BGY) LIMITED

DP9 identify that:

'BGY cost plan has an additional figure of circa 55% of the total build costs for abnormals, externals and some other costs. In comparing the overall costs between the model included in the Financial Viability Appraisal (to support the planning application) whilst the base build costs appear reasonable BNPP have significantly underestimated the on-costs, when compared to the site specific appraisal that accompanies the planning application, that is those relating to externals, abnormals and premilinary costs/ OH&P.'

This goes to the heart of BNP Paribas Real Estate (BNPPRE) and the Council's frustration in relation to these developments. The Council and BNPPRE have repeatedly requested information and appraisals on the actual schemes from the developers and their consultants, as clearly they are best placed to provide the details on these schemes, however this has not been forthcoming. Even in the most recent representations submitted, DP9 allude to the actual scheme costs and appraisal but do not provide this information. It is up to developers and their agents to provide this specific information and to identify what they wish to be put into the public arena as the site specific viability assessments provided as part of planning applications to the Councils have been identified as confidential. In this regard the onus is firmly on the developer and their agents. It is wholly prejudicial to this exercise that DP9/DS2 keep 'moving the goal posts' with regard to scheme specific inputs to the appraisals as we note that in their earlier representations they highlighted additional costs in relation to abnormals for the BGY site, which the Council and BNPPRE took into consideration. The Council and BNPPRE question why DP9 would 'significantly' understate the abnormal costs at the earlier consultation stages?

We would highlight that including further costs into the scheme of the order of 55% of development costs would add a further £298,060,204 worth of costs to the scheme. We note that DP9 have advised that the revenue identified from the scheme is 'not unreasonable' (i.e. they do not consider that it should be higher) and yet is noted that BGY Regeneration Limited are still pursuing a planning application for the redevelopment of the site. Under these circumstances it seems it would surely be the case that this scheme is undeliverable which begs the question as to whether DP9 is 'cherry picking' the evidence which they are commenting on recommending changes.

DP9 also identifies that including growth is an inappropriate assumption. BNPPRE is aware that (as DP9 have themselves identified in their further representation) that the Wood Wharf (WW) scheme, which recently received a resolution to grant planning consent from the Planning Committee subject to the completion of the S106, that the final viability position upon which the S106 offer was based was in relation to an assumption of growth. Due to the very nature/scale of such schemes, they will come forward over a long period of time in the case of WW, circa 10 years. In this regard an IRR has been adopted to assess the profitability of the schemes, and in BNPPRE and DP9's experience, as discussed at previous meetings, in current day values schemes are not achieving anywhere near the 20% IRR that developers target. They required growth to be built in to start getting towards the levels of profit that encourage a developer to take on the risk of developing the scheme. During the Examination and meetings with DP9, they accepted that ungrown IRRs (i.e. present day) would only be 13% - 14%, whilst grown IRRs might reach 20%.

With respect to the growth assumptions, BNPPRE acknowledges that all growth scenarios are forecasts as the future housing market trajectory is uncertain. However, it is reasonable to assume that there will be growth in values over the life of the proposed strategic developments and our sensitivity testing identifies the viability position if such increases were to occur. In order to establish an appropriate level of growth to model we have undertaken an assessment of the growth in sales values in the London Borough of Tower Hamlets using the Land Registry website (from January 1995 to May 2014, i.e. all information available when the analysis was undertaken). We then adjusted this notional growth by including inflation in build costs as identified by the BCIS database over the corresponding period. Our calculations identified an average annual growth of sales values of 8.24% and a 3.34% average annual increase in build costs.

With respect to the allowance of a maturity factor, in schemes of this nature, once they have taken maturity and 'bedded down' it is common to see an uplift in prices. This increase is not related to the market but is more as a result of the scheme having become established. Given the wider regeneration in the Proposed Development in particular, we consider that the development will create a sense of place. This view is also shared by TfL's advisors JLL in Transport for London's statement in response to examination questions (CIL_MIQ10 – Transport for London).

The £17.808 million benchmark adopted for BGY site was consistent with that adopted for the site in BNPPRE's Site Viability Testing of Tower Hamlets Sites and Place Making Development Plan Document which was examined at the end of 2012 i.e. based on the best available information when we prepared the strategic sites appraisals in early 2013.

As identified in this document, the existing use value was derived using pro-rata values from other sites in the same use and published benchmarks (Valuation Office Agency *January 2011 Property Market Report*). In order to encourage the landowners to bring the sites forward for development i.e. allowing for a competitive return, we added a premium of 20% to the value, in addition to a 20% buffer to account for individual site constraints and unknown factors. The £30 million benchmark adopted for the Hackney assessment was an 'over egged' version of the EUV adopted in both of Tower Hamlets' viability testing exercises to demonstrate that even at nearly double the BLV adopted in LBTH it was still viable. We have undertaken a sensitivity test of the BGY viability appraisal (including 35% Affordable Housing and the proposed Borough CIL), allowing for £30 million instead of £17.808 million and this has identified a reduction in the IRR of 0.61%.

With regard to the benchmark adopted for the WW site, as set out in our August 2013 viability report (ED2.2: Viability Study - Revised Draft Charging Schedule), we considered the site against two benchmark land values, the value of the extant consent £4.250 million and against an industrial land value of £38.480 million, based on £5.3 million per hectare as identified in para 4.44 of the same viability report . We have now included an additional 20% on top of this original figure for land value to ensure it is consistent with the approach taken for the other sites i.e. allowing for a further 20% buffer to account for 'individual site constraints and unknown factors' as the land value of £38.480 million already allows for a 20% premium as set out in para 4.44. BNPPRE have taken into consideration the value of the site in an alternative mixed use, i.e. that of the extant consent, however, this was identified as being lower than the existing use value and this stands to reason, given that CWG have successfully pursued a new planning application for a different mixed use scheme.

BNPPRE remain concerned with considering market transactions as comparison for benchmark land values as there are a number of limitations associated with adopting a market value approach. These are set out clearly in Section B paragraphs 2.11 – 2.13 of submission document ED2.8: Summary of Consultation Responses to the Draft Charging Schedule (October 2013) and reiterated below for emphasis.

- Transactions on other sites will inevitably relate to developments of different densities and building heights, meaning that average values and construction costs will vary substantially;
- The quantum of commercial accommodation provided varies between developments. This makes analysis more complicated. Historic transactions will also have been completed prior to Mayoral CIL being required;
- Transactions may not have been completed after the current Planning Obligations SPD was adopted, which is likely to have resulted in lower Planning Obligations SPD sums being required;
- It is unknown what grant funding might have been allocated to assist with the delivery of affordable housing for these schemes;
- It is unknown which schemes would have incurred abnormal costs e.g. expensive demolition costs, remediation, extensive basement excavation etc;
- It is unknown what specific funding arrangements the purchasers of the sites might have in place to assist with delivery; and
- It is unknown to what extent the developers of those schemes are making a profit.

It is therefore considered that actual land transactions are fundamentally misleading as a means of assessing viability of a planning policy.

Market transactions will always (or should be) based on current planning policy requirements to determine the price to pay for a site; the costs of complying with policies are accommodated in the valuation process. Accordingly, this does not provide a useful starting point in determining what planning requirements *could be sought* as the existing policy requirement is already reflected. Furthermore, it is also the case that market transactions often fail to take full account of planning policy requirements. They frequently include expectations of increasing sales values, so they do not reflect the current market. Basing the assessment on current use value is an approach that both the RICS guidance note recognises as legitimate *("For a development to be financially viable, any uplift from current use value to residual land value that arises when planning permission is granted should be able to meet the cost of planning obligations while ensuring an appropriate Site Value for the landowner and a market risk adjusted return to the developer in delivering that project (the NPPF refers to this as 'competitive returns' respectively). The return to the landowner will be in the form of a land value in excess of current use value…")* as well as the Harman Group guidance; the latter being directly relevant to planning policy testing.

With respect to other costs such as sales fees/marketing, in our experience BNPPRE considers the allowances made to be reasonable and would highlight that with regard to the WW scheme this amounts to a total allowance of circa £44.3 million and for BGY is £21.5 million, which our new homes team has advised are reasonable assumptions for marketing such schemes.

2 JLL ON BEHALF OF TRANSPORT FOR LONDON (TFL) AND THE GREATER LONDON AUTHORITY (GLA)

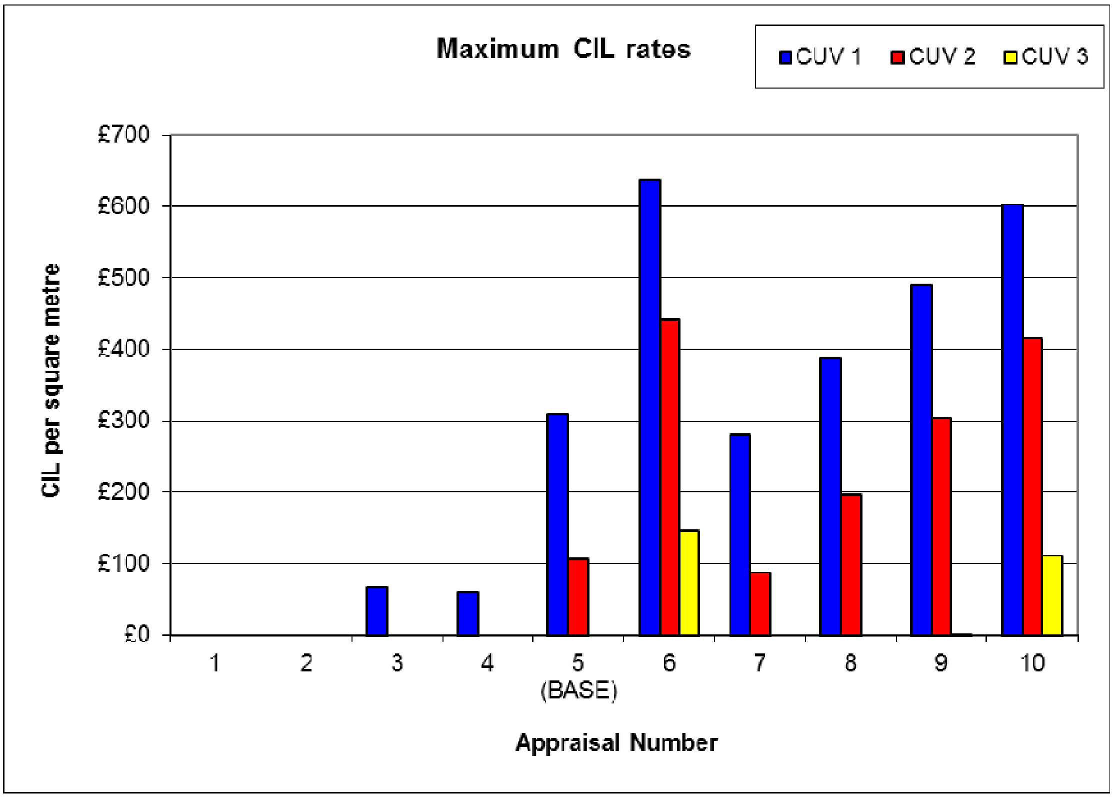
With respect to JLL's comments in relation to the existing use values adopted by BNPPRE in our appraisals, we would reiterate that the reasoning behind the lower current use values adopted is that the future supply of office development in the North Docklands is expected to come forward on sites in existing industrial uses i.e. Wood Wharf and Billingsgate Market. We provide a schedule of industrial deals completed in the area to evidence that the rents and yields adopted (i.e. between £8 per sq ft - £18 per sq ft capitalised at yields of between 8% - 7.25%) by BNPPRE for such space is reasonable (See Appendix 1). In our experience, sites which are able to achieve higher rents and better yields are likely to either stay in their existing office use, given the income stream they generate, or will be redeveloped as residential. This is evidenced by the current development activity in the area as residential uses generate residual land values that exceed existing land values thereby warranting the expense and risk of redevelopment.

Notwithstanding this position BNPPRE has re-run our office assessment adopting:

- JLL's CUV assumptions as set out at Table 8 of their submission document ED2.8: Summary of Consultation Responses to the Draft Charging Schedule (October 2013); however we would note that these CUVs are higher than the vast majority of future development, which will come forward on industrial land.
- a 70% gross to net;
- a rent on new office space of £46.50 (in line JLL's evidence provided on 25 Churchill Place of the same document ED2.8;
- allowing for full Mayoral CIL and Crossrail S106 as a cost to the scheme at £190 per square metre.

The results of this appraisal identify that offices in the North Docklands area would be able to support a maximum CIL rate of between £309 and £0 per square metre, dependant on the current use value (see Chart 2.1 below and appraisal attached at Appendix 2).

Chart 2.1 Results of Office Appraisals adopting JLL Assumptions



In light of these results, the Council's proposed CIL charge of £50 per square metre is both a reasonable and modest charge, particularly given the very conservative assumption relating to CUVs, which the Council and BNPPRE considers achieves the balance required to be struck by Regulation 14. That is between funding necessary infrastructure to facilitate the growth envisaged by the Local Plan whilst not making development across the Council's area unviable and in this regard the charge is considered to support the delivery and objectives of the Local Plan.

With regard to JLL's comments in relation to the Benchmark Land Values needing to be reflective of recorded market transactions we would highlight that, as stated on numerous occasions and as argued by the GLA themselves when defending the Mayoral CIL at Examination; market transactions are of limited relevance to testing a new planning requirement. Market transactions are historic and relate to prevailing planning policies at the time. See further comments above and at Section B paragraphs 2.11 – 2.13 of submission document ED2.8: Summary of Consultation Responses to the Draft Charging Schedule (October 2013) As such, the Market Value approach was found to be an unsound basis for testing the viability of CIL.

Appendix 1: Industrial comparables

Appendix 2: Appraisals adopting JLL assumptions