



Appendix 1: Updates to Viability Appraisals following the RDCS Consultation

1 INTRODUCTION

- 1.1 In response to representations received in relation to Tower Hamlet’s Revised Draft Charging Schedule consultation, BNP Paribas Real Estate has updated their commercial viability appraisals to include land value when assessing profit on cost. This has resulted in reductions limited to the Office, Convenience Retail and Hotel Rates. It has not been necessary to amend the Retail (excluding Convenience) rate as a large enough buffer was factored in at the Revised Draft Charging Schedule stage to enable the accommodation of this update to the appraisal methodology.
- 1.2 The results of this change are set out below in the same format as the BNP Paribas Real Estate Viability Study August 2013 for ease of reference.

2 UPDATED APPRAISALS

Office development - City Fringe, and north Docklands locations

- 2.1 Our research on offices in the City Fringe and north Docklands areas indicate that the rent levels are significantly higher than those achieved in the rest of the Borough (circa £25 to £40 per sq ft, compared to circa £15 to £25 per sq ft elsewhere). Rents in the south Docklands area are identified to be lower than those currently achieved in the north at circa £25 per sq ft. Currently yields in the City Fringe locations are stronger (identified as being as keen as just over 4%, however generally being between 5.25% and 5.8%) than those in the Docklands locations (identified as being circa 6.25%) and as a result office values are higher in the City Fringe. This is demonstrated in Charts 2.1.1 and 2.1.2.

Chart 2.1.1: Office development - City Fringe

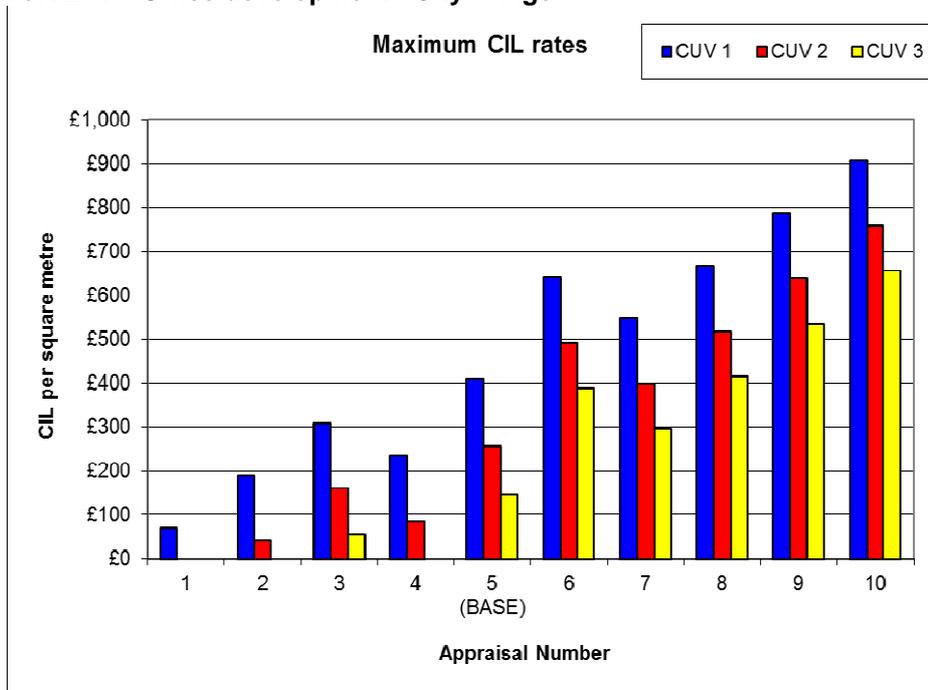
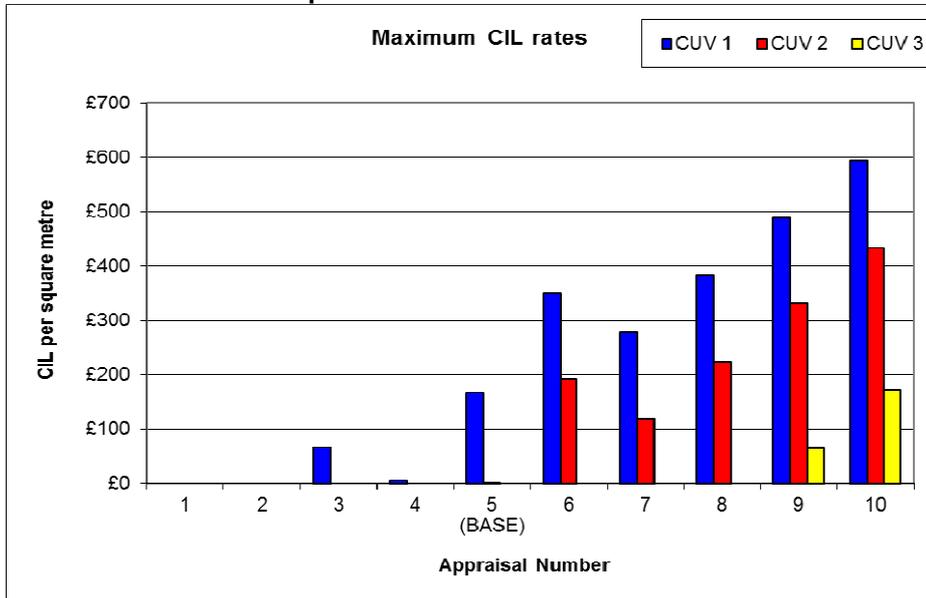




Chart 1.1.2: Office development – north Docklands



- 2.2 The results of our office appraisals indicate that at present, only developments in the City Fringe and north Docklands locations are likely to generate positive residual land values. It is therefore likely that office development will be focused in the City Fringe and north Docklands locations over the life of the Charging Schedule.
- 2.3 Focusing on the 'Base' scenario in north Docklands (appraisal 5 in Chart 2.1.2), office developments can support a CIL rate of between £0 and £167 per square metre (inclusive of any Crossrail Section 106 sought) dependant on the existing use of the site.
- 2.4 With regard to the City Fringe area, the viable level of borough CIL ranges from £147 per square metre to £412 per square metre (inclusive of any Crossrail Section 106 top up sought), depending on the current use value of the site. Based on current use value 2, the maximum potential CIL rate would be circa £257 per square metre (inclusive of any Crossrail Section 106 sought).

Office development – other locations in the Borough

- 2.5 The results of our office appraisals in the rest of the Borough indicate that the rent levels achievable are likely to be considerably lower than in the City Fringe, and north and south Docklands areas (circa £15 - £20 per sq ft).
- 2.6 Consequently, office developments are unlikely to be viable, unless rents increase significantly over the life of the Charging Schedule. Long term demand for offices outside the City Fringe, north and south Docklands areas is likely to be weak and it is therefore unlikely that any significant level of office development will come forward in areas beyond these locations.



Convenience based supermarkets and superstores and retail warehousing

- 2.7 Our appraisals of convenience based supermarkets and superstores¹ and retail warehousing² development indicate a greater degree of viability than for comparison retail.
- 2.8 Other charging authorities have considered the differences in viability between comparison retail and convenience based retail and retail warehousing. It is acknowledged that size does not necessarily result in the higher values generated by convenience based supermarkets and superstores and retail warehousing uses. Rather, is it a combination of factors including:
- The availability of car parking;
 - The operational economics of supermarkets/superstores (these uses are known to be efficient at generating volume sales whilst having low operating costs);
 - The rents that retailers are willing to pay to occupy these units tend to be high (particularly with regard to comparison retailing as these locations will command prime rents in the area);
 - The value which the investment market ascribe to such units is high. This is due to such units being occupied by operators with greater covenant strength, which results in lower yields being applied; and
 - Such large developments are also likely to come forward on sites which have lower existing use values i.e. a large majority of large retail units have historically been developed on former industrial sites and as a result a lower benchmark land value is achieved, which results in a higher surplus and consequently a potential for a higher CIL rate.
- 2.9 We have undertaken a review of convenience based supermarkets in the borough using the VOA business rates website, which has identified units of this nature. We have also researched such occupiers published space requirements when seeking sites as identified on their websites which has also confirmed this position.
- 2.10 Our appraisals show that a maximum borough CIL ranging from £276 to £495 per square metre (inclusive of any Crossrail Section 106 that might be sought) could be levied on such retail space, depending on the size of the store and the value of the existing use of the site (see Charts 2.10.1 and 2.10.2).

¹ Superstores/supermarkets are shopping destinations in their own right where weekly food shopping needs are met and which can also include non-food floorspace as part of the overall mix of the unit.

² Retail warehouses are large stores specialising in the sale of household goods (such as carpets, furniture and electrical goods), DIY items and other ranges of goods, catering for mainly car-borne customers.



Chart 2.10.1: Convenience based supermarkets and superstores and retail warehousing (whole area) (1,000 sq m)

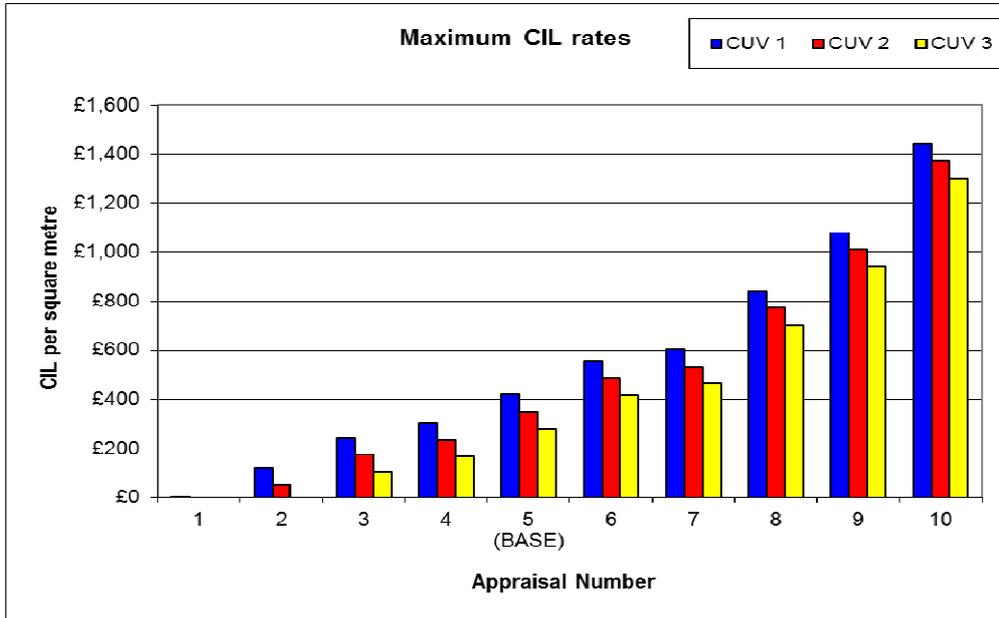
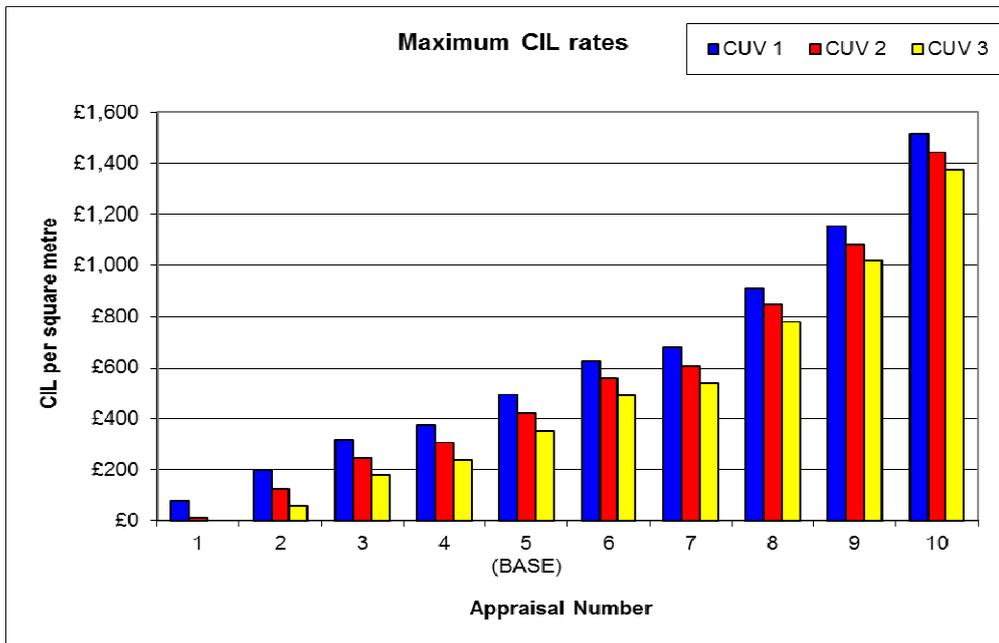


Chart 2.10.2: Convenience based supermarkets and superstores and retail warehousing (whole area) (5,000 sq m)



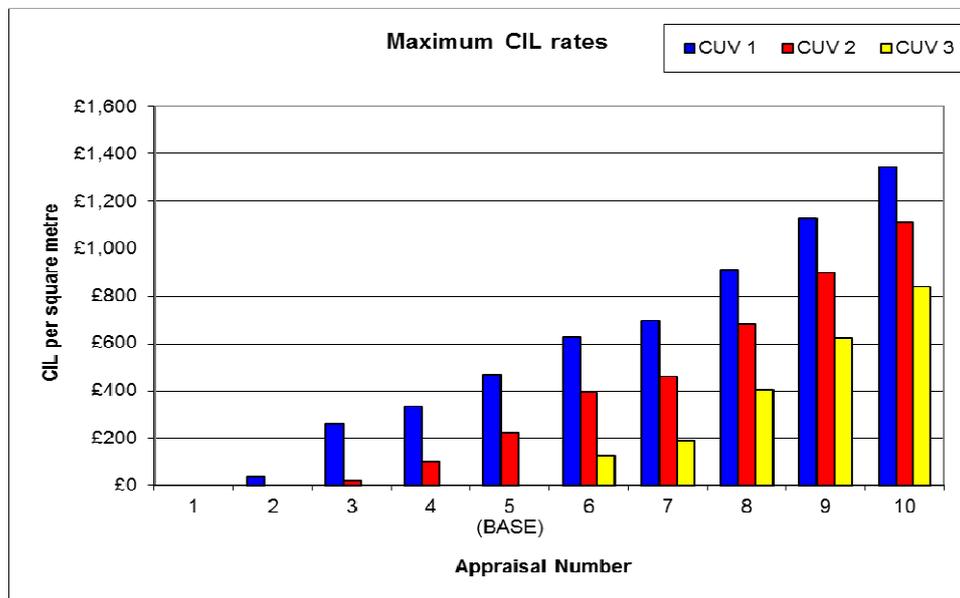
2.11 Given the above, we would recommend the Council sets its CIL rate in the context of a maximum CIL of up to £276 per square metre (inclusive of any Crossrail Section 106 that might be sought) based on CUV 3 of the 1,000 square metre unit appraisal).



Retail development – City Fringe and Canary Wharf/Docklands (excluding convenience based supermarkets and superstores and retail warehousing)

2.12 Our appraisals of the City Fringe and north Docklands retail developments (excluding convenience based supermarkets and superstores and retail warehousing) indicate that residual land values will exceed current use values by a sufficient margin to allow for a CIL to be levied. The maximum borough CIL (inclusive of any Crossrail Section 106 that might be sought) the Council could levy on this development type would be between £0 and £466 per square metre. However, it should be noted that this is sensitive to small changes in the rent or yield i.e. if the yield were to shift out by 0.25% the maximum levels of CIL would be £0 - £333 per square metre, whilst a reduction in the rent by circa 10% would result in a maximum CIL of £0 - £149 per square metre. We consider that a maximum borough CIL rate (inclusive of any Crossrail Section 106 top up sought) of £222 per square metre would be reasonable for such developments in Tower Hamlets based on CUV 2.

Chart 6.36.1: Retail developments in the City Fringe and north Docklands areas (excluding convenience based supermarkets and superstores and retail warehousing)



Retail development – rest of the Borough (excluding convenience based supermarkets and superstores and retail warehousing)

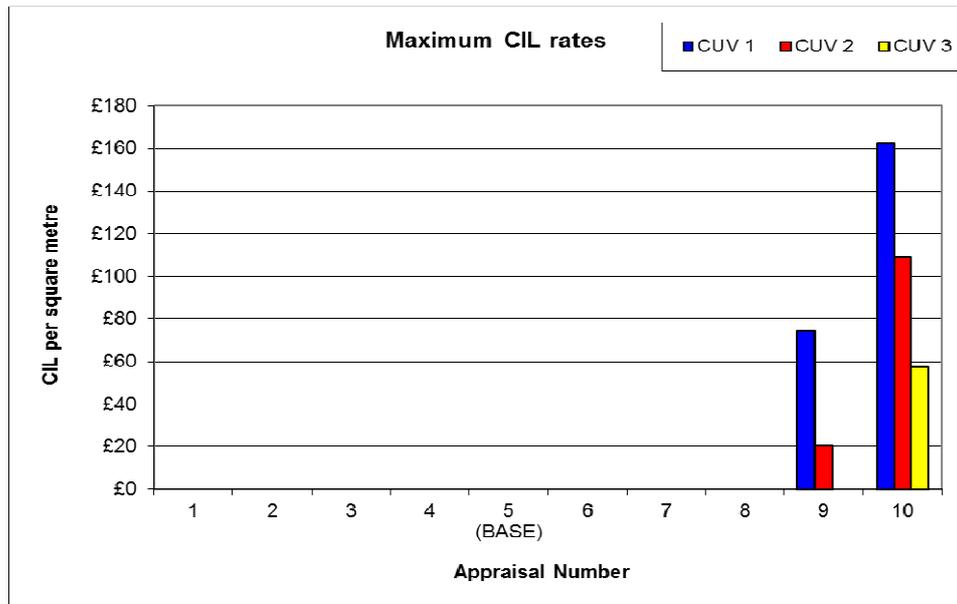
2.13 Rents for retail development (excluding convenience based supermarkets and superstores and retail warehousing) across the rest of the Borough are significantly lower than rents in City Fringe and north Docklands locations (circa £15 - £20 per sq ft). Consequently, it is unlikely that such retail development will be sufficiently viable to attract significant interest from developers at the current time and our appraisals indicate that in the base case CIL cannot viably be levied on retail development outside the prime shopping locations of the City Fringe and north Docklands.



Industrial and warehouse development

2.14 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 £35 per square metre. A considerable increase in new build industrial rents would be required before any CIL could be absorbed (see Chart 2.14.1).

Chart 2.14.1: Industrial development



Hotel development

2.15 Our updated hotel development appraisals are attached at Appendix 1 of this note. These indicate that at current values, this type of development could absorb a maximum borough CIL rate of between £734 to £57 per square metre, which includes any Crossrail Section 106 that might be sought, dependant on the type of hotel and current use value of the site. However, it should be noted that this is sensitive to small changes in the rent or yield i.e. if the yield were to shift out by 0.25% the maximum levels of CIL would be £0 - £590 per square metre, whilst a reduction in the rent by circa 10% would result in a maximum CIL of £0 - £361 per square metre. We consider that a maximum borough CIL rate (inclusive of any Crossrail Section 106 top up sought) of £304 per square metre would be reasonable for such developments in Tower Hamlets based on CUV 2 of the second appraisal.

3 CONCLUSION

- 3.1 In light of the above changes to appraisals and results we set out below our updated Key findings and recommendations on commercial uses in the Borough.
- In specified locations in the Borough the Mayor may seek to negotiate Section 106 contributions over and above Mayoral CIL towards Crossrail on office, hotel and retail developments, dependant on the size and impact of the proposed development and viability issues. This potential additional burden on developments has been taken into consideration when recommending the proposed CIL rates.
 - When recommending rates, full account has been taken of the Mayoral CIL tariff of £35 per square metre required in Tower Hamlets and in areas where Crossrail Section 106 contributions are applicable, the recommended rates account for 100% of the top-up payable with the exception of the North Docklands area. In order to allow for both funding towards Crossrail and Borough infrastructure requirements in this area the Council and BNP Paribas Real Estate consider that a reasonable approach would be to share the



viable level of charge identified.

- **Office developments** in the City Fringe and north Docklands areas have the potential to generate residual values which would support a CIL rate based on higher rents and yields. Office developments in the south Docklands area, however, are achieving lower rents and our appraisals indicate that CIL could not be viably levied. At current rent and yield 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.
- At current rent levels, office development in **City Fringe** locations have been identified as being able to absorb a maximum CIL of £257 per square metre (inclusive of any Crossrail Section 106 top up that may be sought). After allowing for a buffer of 25%, which in our experience we consider to be appropriate to deal with site-specific issues and changes in values over time, as well as the full Mayoral indicative Crossrail Section 106 top-up of £105 per square metre) we suggest the Council considers setting a rate of £90 per square metre.
- In the **north Docklands area**, our appraisals have identified that office development could support a maximum CIL rate of £167 per square metre (inclusive of any Crossrail Section 106 top up sought) based on CUV 1. After allowing for a buffer of 25%, which we consider to be appropriate to deal with site-specific issues and changes in values over time this produces a maximum rate of £125 per square metre. BNP Paribas Real Estate and the Council consider it reasonable for the Council and the GLA to share the remaining sum available to provide infrastructure to support growth in this area.³ On this basis we would suggest that the Council considers setting a rate of £50 per square metre.
- At current rent levels, our base appraisals indicate that no CIL could be levied on office development in the **south Docklands area and elsewhere in the Borough** and therefore recommend that the Council sets a nil rate for these areas. It is unlikely that office space will come forward in the short to medium term as the capital values generated are insufficient to cover development costs.
- **Convenience based supermarkets and superstores and retail warehousing** is likely to be viable across the Borough with a maximum borough CIL rate of £276 per square metre (inclusive of any Crossrail Section 106 top up sought). After allowing a buffer of 25%, to address any site specific issues and the full indicative Crossrail Section 106 top up charge liable on developments in the borough (the highest being in the Docklands area of £86 per square metre) we would recommend the Council considers adopting a single CIL rate of £120 per square metre for such uses in the Borough.
- Residual values generated by **retail developments (excluding convenience based supermarkets and superstores and retail warehousing)** are higher than current use values to varying degrees across the Borough. However, to a degree smaller retail development will involve the re-use of existing retail space, which will not be CIL liable.
- Residual values generated **by such retail developments in the City Fringe and north Docklands locations** are sufficiently higher than current use values and could absorb a CIL of up to £222 per square metre. Allowing for a buffer, which we consider to be appropriate to deal with site-specific issues and changes in values over time as well as the full indicative Crossrail Section 106 top up charge liable on developments in the borough (the highest being in the Docklands area of £86 per square metre), we suggest the Council considers a CIL of £70 per square metre in the City Fringe and north Docklands areas.
- **Elsewhere in the Borough**, rents for such retail development are considerably lower and our appraisals identify that developments are unable to viably support to absorb

³ It is noted that in mixed use schemes including residential this percentage will be higher given the methodology of discounting Mayoral CIL from the top up liability.



CIL. We therefore recommend that the Council considers a nil rate on retail development outside the City Fringe and north Docklands locations.

- 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 nil rate for industrial floorspace.
- We consider that **Hotel developments** are able to generate a sufficient surplus to absorb a maximum borough CIL (including Crossrail Section 106 top up) of £304 per square metre. After allowing for a buffer of 25%, which we consider to be appropriate to deal with site-specific factors, as well as the full indicative Crossrail Section 106 top up charge liable on developments in the borough (the highest being in the Docklands area of £49 per square metre), we suggest the Council considers a rate of £180 per square metre for such uses across the Borough.

3.2 The proposed amended Tower Hamlets Commercial CIL rates are summarised in Table 3.2.1.

Table 3.2.1: Proposed amended commercial CIL rates following RDCS consultation

Development type	Proposed CIL rate per square metre		
	<i>Elsewhere in Borough</i>	<i>City Fringe</i>	<i>North Docklands</i>
Offices	Nil	£90	£50
Retail (except Convenience supermarkets, superstores and retail warehousing)	Nil	£70	
Hotel	£180		
Convenience retail/retail warehousing	£120		