BNP PARIBAS REAL ESTATE

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Community Infrastructure Levy Review

Prepared for

London Borough of Tower Hamlets

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1 Executive Summary

1.1 This report reviews the Community Infrastructure Levy ("CIL") rates in the London Borough of Tower Hamlets' ("the Council") Charging Schedule, adopted on 25 February 2015 and implemented on 1 April 2015. Levels of CIL have been tested in combination with the cumulative impact of the requirements of the emerging Tower Hamlets Local Plan 2031, Managing growth and sharing the benefits, Regulation 19 Consultation document (October 2017) ("STHLP"). This is in line with the requirements of the National Planning Policy Framework 2018 ("NPPF") and the Local Housing Delivery Group guidance 'Viability Testing Emerging Local Plans: Advice for planning practitioners' (June 2012). The report builds upon the Local Plan Viability testing update undertaken on behalf of the Council by BNP Paribas Real Estate in June 2017 and updates the September 2017 CIL Viability Review report.

Methodology

1.2 The study methodology compares the residual land values of a range of development typologies on sites throughout the borough to their value in current use (plus a premium), herein after referred to as 'benchmark land value'. If a development incorporating the Council's policy requirements including a given level of CIL generates a higher residual land value than the benchmark land value, then it can be judged that the site is viable and deliverable. Following the adoption of policies, developers will need to reflect adopted levels of CIL and policy requirements in their bids for sites, in line with requirements set out in the RICS Guidance on 'Financial Viability in Planning'[1] and the updated National Planning Practice Guidance ('NPPG') on Viability (July 2018).

1.3 The study utilises the residual land value method of calculating the value of each development typology. 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, sustainability requirements, Section 106 contributions, CIL[2] 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 LBTH is testing the viability of potential development sites at a time when the market has experienced a period of sustained growth. Forecasts for future house price growth point to continuing growth in mainstream London housing markets, although there is a degree of uncertainty following the referendum on the UK's membership of the European Union. We have allowed for this medium term growth over the plan period by running a sensitivity analysis which applies growth to sales values and inflation on costs to provide an indication of the extent of improvement to viability that might result. This analysis is indicative only, but is intended to assist the Council in understanding the ability of developments to absorb its requirements both in today's terms but also in the future.

1.5 The viability analysis in this study provides a high level understanding of the viability of potential development sites in the context of the cumulative impact of the Council's emerging planning policies. It should be noted that some sites may require more detailed site and scheme specific viability analysis when they come forward through the development management process due to specific site circumstances that cannot be reflected in an area wide assessment[3].

[1] This guidance notes that when considering site-specific viability "*Site Value should equate to the market value subject to the following assumption: that the value has regard to development plan policies and all other material planning considerations and disregards that which is contrary to the development plan*". Providing therefore that Site Value does not fall below a site's existing use value, there should be no reason why policy requirements cannot be achieved.

[2] Mayoral CIL 2 and Borough CIL as appropriate.

[3] The Local Housing Delivery Group Guidance 'Viability Testing Local Plans: Advice for Planning Practitioners' notes that "*the role of the test is not to provide a precise answer as to the viability of every development likely to take place during the plan…*

Key findings

1.6 The key findings of the study are as follows:

- The results of this study are reflective of current market conditions, which will inevitably change over the medium term. It is therefore important that the Council keeps the viability situation under review so that policy requirements can be adjusted should conditions change markedly. Since the 2013 Viability Study was completed, there has been an improvement in sales values, which has been partially offset by an increase in build costs. The net result is a degree of improvement in viability and increased capacity to contribute towards local infrastructure.

- As was the case in the 2013 Viability Study, some schemes tested were unviable due to market factors, rather than the impact of the Council's policy requirements. These schemes will not come forward until changes in site specific market conditions and their current unviable status should not be taken as an indication that the Council's requirements cannot be accommodated on other schemes. It reflects the increasing viability of commercial development, with some existing forms of commercial generated higher values than residential development, reducing pressure for commercial buildings to be redeveloped for alternative (residential) use.

<u>Residential</u>

- In many cases, schemes can accommodate the Council's affordable housing requirement at a level of circa 35%, with the capacity to make CIL payments increasing with lower affordable housing proportions.

- Our appraisals indicate that the Council's currently adopted rates of CIL could increase without adversely impacting on viability of developments. The currently adopted and suggested CIL rates are summarised in Table 1.6.1.

Table 1.6.1 Table showing adopted and suggested residential CIL rates

Area	Existing Borough CIL charge Borough (£s per sq m) (indexed charge)	Suggested Borough CIL after buffer (£s per sq m)
CIL Z1	£200 (£211.58)	£280
CIL Z2	£65 (£68.76)	£150
CIL Z3	£35 (£37.03)	£50

<u>Commercial</u>

- In the City Fringe and North Docklands, rents for both offices and retail developments have increased and our appraisals (including affordable workspace) indicate that these uses will be able to absorb a CIL rate of £100 per sq m.

- Viability of retail and office markets outside the City Fringe and North Docklands have not changed sufficiently to warrant any changes to the adopted rates.

[3] *continued... period. No assessment could realistically provide this level of detail. Some site-specific tests are still likely to be required at the development management stage*". We further note that the NPPG on Viability identifies that *"Assessing the viability of plans does not require individual testing of every site or assurance that individual sites are viable. Plan makers can use site typologies to determine viability at the plan making stage. Assessment of samples of sites may be helpful to support evidence. In some circumstances more detailed assessment may be necessary for particular areas or key sites on which the delivery of the plan relies."* Given this position the NPPG acknowledges that there are likely to be particular circumstances which justify the need for a viability assessment at the application stage and provides an illustrative list of such circumstances. The onus is on the Applicant to provide the justification for this.

- Rents and yields of supermarkets and retail warehouses have improved since the adoption of the Charging schedule and appraisal identify that such uses should be able to support an increased CIL charge of £130 per sq m.
- Industrial and warehousing have seen increases in rents and a reduction in yields, partly as a result of a lack of available supply, however our appraisals identify that this does not generate a surplus above the benchmark land values and in this regard we recommend the Council maintains its existing nil charge on such uses.
- Market conditions for student housing and hotels have not changed significantly since the adoption of the Charging Schedule and we recommend no changes to the rates for these uses.
- The currently adopted and suggested CIL rates are summarised in Table 1.6.2.

Table 1.6.2 Table showing adopted and suggested Commercial CIL rates

Use and Location	Existing Borough CIL charge Borough (£s per sq m) (indexed charge)	Potential Borough CIL after buffer (£s per sq m)
Office in City Fringe	£90 *(indexed - £95.21)*	£100
Office in North Docklands	Nil	£100
Retail in City Fringe and North Docklands	£70 *(indexed - £74.05)*	£100
Supermarkets and retail warehouses	£120 *(indexed - £126.95)*	£130

<u>**Strategic Sites**</u>

- Our assessment of the identified strategic sites has concluded that the majority of the sites can viably support the Borough's proposed CIL. With regard to the sites identified as being unviable, we note that the majority the sites are in fact deliverable with between 20% - 30% affordable housing and that the CIL Charge does not have a significant impact on the viability of these schemes i.e. at a nil CIL charge these schemes would not be viable at 35% affordable housing with no CIL. That is that CIL is not making the schemes unviable, it is rather site or scheme specific issues.
- Of the four sites identified as having the most challenging viability three of these are gasworks sites which incur significant abnormal costs. Once again we would highlight that CIL is not the determining factor making these sites unviable, i.e. on three of the four sites adopting a nil CIL rate and 0% affordable housing would not result in the developments generating residual land values above the identified benchmark land value.
- To demonstrate this position we have undertaken an assessment of the proposed Borough CIL liability calculated for each of the strategic sites and compared this to the total development costs. This has identified that the proposed CIL rates result in a liability that is no more than 5% of development costs. In fact, in the four schemes where viability is identified as being most challenging, CIL amounts to no more than 1.12% of development costs. Further, on the schemes identified as being unviable at 35% affordable housing but viable with between 20% and 30% affordable housing CIL is no more than 1.68% of development costs (see Table 7.18.1).
- In light of our findings we recommend that the Council considers maintaining the proposed CIL rates across the Borough and to Strategic Sites as they are not deemed to be of a sufficient magnitude that is likely to threaten the development of the strategic

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sites and as a result *"undermine the deliverability of the plan"* (NPPF paragraph 34) and NPPG Paragraph: 038 Reference. Further, we consider that the proposed approach "strike(s) an appropriate balance between the desirability of funding infrastructure from the levy and the potential impact upon the economic viability of development across (the Council's) area." (NPPG Paragraph 008).

1.7 We summarise in Table 1.7.1 overleaf the suggested updated CIL charging schedule rates.

Table 1.7.1: Suggested rates for LB Tower Hamlets' Updated CIL Charging Schedule

Development Type	Suggested CIL Rate per sq m (GIA) of Development		
Residential	**Zone 1**	**Zone 2**	**Zone 3**
	£280	£150	£50
Offices and Retail (Except Convenience Supermarkets/ Superstores and Retail Warehousing)	**City Fringe & North Docklands**		**Rest of Borough**
	£100		Nil
Convenience Supermarkets/ Superstores and Retail Warehousing	**Borough Wide**		
	£130		
Hotel	£190		
Student Housing Let at Market Rents	£450		
Student Housing Let at Below Market Rents	Nil		
All other uses	Nil		

1.8 The application of CIL is unlikely to be an overriding factor in determining whether a developer brings forward a site or whether not a scheme is viable.

- For residential development, when considered in context of total scheme value, the recommended CIL rates will be a modest amount, typically accounting for between 0.5% and 4.7%. It is worth noting that some schemes would be unviable even if a zero CIL were adopted. We therefore recommend that the Council pays limited regard to these schemes as they are unlikely to come forward unless there are significant changes to main appraisal inputs.
- With respect to commercial schemes, as identified in section 8 of this study the proposed CIL is a marginal factor in a scheme's viability i.e. between 1.45% and 3.13% of total development costs in terms of the uses where increases are proposed.
- In the case of the Strategic Sites, the increased CIL charges amount to no more than 5% of development costs i.e. between 0.71% and 4.5%, with the majority being below 3%.

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2 Introduction

2.1 The Council has commissioned this update study to contribute towards a review of its adopted CIL Charging Schedule, which has been in place since 1 April 2015. The evidence base that underpinned that adopted CIL Charging Schedule was compiled in late 2012 early 2013 and there had been a significant movement in sales values before adoption. The aim of the study is therefore to identify changes in viability that might give rise to amendments to the adopted CIL Charging Schedule. In line with the viability evidence supporting the adopted CIL Charging Schedule, this report tests the cumulative impact of planning policies to determine whether there is scope for CIL rates to change.

2.2 In terms of methodology, we adopted standard residual valuation approaches to test the viability of nine development typologies and 14 strategic sites, including the impact on viability of the Council's planning policies alongside the adopted levels of CIL and alternative amounts 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. For CIL rates, this means leaving adequate headroom below the maximum rates to deal with the differences that often occur when individual schemes come forward through the development management process.

2.3 In light of the above we would highlight that the purpose of this viability study is to assist the Council in understanding changes to the capacity of schemes to absorb CIL and to support any proposed changes to Charging Schedule through Examination in Public. The Study therefore provides an evidence base to show that the requirements set out within the NPPF, CIL Regulations and National Planning Practice Guidance are met. The key underlying principle is that charging authorities should use evidence to strike an appropriate balance between the desirability of funding infrastructure from the levy and the potential impact upon the economic viability of development across their area.

Economic and housing market context

2.4 The housing and commercial property markets are inherently cyclical. The downwards adjustment in house prices in 2008/9 was followed by a prolonged period of real house price growth. By 2010 improved consumer confidence fed through into more positive interest from potential house purchasers. However, this brief resurgence abated with figures falling and then fluctuating in 2011 and 2012. The improvement in the housing market towards the end of 2012 continued through into 2013 at which point the growth in sales values improved significantly through to the last quarter of 2014, where the pace of the improvement was seen to moderate and continued to do so in 2015. The UK economy sustained momentum following the result of the UK's referendum on its membership of the European Union (EU), and as a result the UK housing market surprised many in 2016. The average house price rose 4.5%, which was 0.2% lower than our forecast and ahead of the level recorded in 2015. While first time buyer numbers continued to recover in 2016, overall transaction levels slowed as some home movers and investors withdrew from the market.

2.5 The referendum held on 23 June 2016 on the UK's membership of the EU resulted in a small majority in favour of exit. The immediate aftermath of the result of the vote was a fall in the Pound Sterling to a 31 year low and stocks overselling due to the earnings of the FTSE being largely in US Dollars. As the Pound dropped significantly this supported the stock market, which has since recouped all of the losses seen and is near the all-time highs. We are now in a period of uncertainty in relation to many factors that impact the property investment and letting markets. In March 2017 (the point at which Article 50 was triggered signalling the official commencement of the UK's exit from the EU), the Sterling Exchange Rate Index ("ERI") fell a further 1.5% from the end of February and was 10.5% lower compared with the end of March 2016. Since August 2017 the Bank of England's ("BoE's") Inflation Reports have identified that Sterling has broadly remained around 15%-20% below its pre-referendum peak (November 2015). The August 2018 Report identified that ERI was

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2.5% lower than in its run up to the May 2018 Report and around 17% below the late-2015 peak.

2.6 There have been tentative signs of improvement and resilience in the market, however this has been tempered by heightened uncertainty relating to post EU exit arrangements. In BNP Paribas real Estate's Summer 2018 Residential Quarterly Update it identifies that the UK's exit from the EU *"is making gradual progress with details slowly being released. Theresa May has outlined the UK's desired position with regards to the UK's future relationship with the EU. However it is important to note this is just the government's preferred position and has yet to be agreed by the EU and could therefore change substantially over the coming months. The recent announcements have also highlighted the lack of consensus within the government, seeing both the Brexit Secretary and Foreign Secretary resigning."*

2.7 The International Monetary Fund ("IMF") revised its forecast for UK growth in 2016 on 4 October 2016 from 1.7% to 1.8%, thereby partly reversing the cut it made to the forecast shortly after the referendum (1.9% to 1.7%). Notwithstanding this, it further trimmed its 2017 forecast from 1.3% to 1.1%, which stood at 2.2% prior to the Referendum. This figure was subsequently increased to 2% in April 2017, however was reduced in July 2017 to 1.7%. This figure remains unchanged in the July 2018 World Economic Outlook ("WEO") Report Update. The IMF anticipates growth to slow in 2018 and 2019, with current forecasts of 1.4% and 1.5% respectively. The 2018 projection has been reduced from 1.6% projected in the April 2018 WEO. We understand that these figures reflect the anticipated higher barriers to trade and lower foreign direct investment following the UK's exit from the EU.

2.8 The BoE's August Inflation Report sets out that *"Quarterly GDP growth is estimated to have slowed to 0.2% in 2018. That was revised up from 0.1% in the preliminary estimate and, as set out in the May Report, it is expected to be revised up further to 0.3% in the mature estimate. In May, the MPC judged that growth in Q1 was probably depressed by around 0.1 percentage points by disruption from adverse weather. Developments since then have been broadly consistent with that judgement. For example, according to Bank calculations based on responses to the ONS Labour Force Survey, total hours worked were 0.15% lower in Q1 due to the adverse weather. GDP growth is expected to have recovered to 0.4% in Q2, as anticipated in May. That is slightly faster than the estimated growth rate of potential supply − the pace at which output can grow consistent with balanced inflationary pressures. Newly introduced ONS estimates of monthly GDP growth suggest that growth in the three months to May was 0.2%. That growth rate continued to be depressed by the impact of weak activity in March however, probably due to the adverse weather. By contrast, monthly growth in April and May averaged %. The recovery in GDP growth in Q2 is expected to have been driven by a pickup in consumption growth, to 0.5%. A number of indicators of household spending, including consumer credit growth and property transactions, which were weak in Q1, have bounced back since then, suggesting much of the earlier weakness was erratic. In addition, retail sales grew by 2.1% in Q2. Although in the past year the number of retail store closures have increased and retail footfall has fallen, contacts of the Bank's Agents suggest that mainly reflects shifts in consumer demand to online stores and from goods to services. And although growth in household money has slowed, that appears to reflect an unwind of past shifts in demand for different assets"*

2.9 A key issue at present is the above target levels of *inflation that have been experienced. The IMF April 2018 World Economic Outlook Report identifies that, "In most advanced economies, core inflation remains below target but appears to be edging up in response to stronger demand. The United Kingdom is an exception to the pattern of below-target inflation. At 2.4 percent in February, UK core inflation is below the peak it reached in 2017 in the aftermath of the June 2016 Brexit referendum pound depreciation, but remains above the Bank of England's target of 2 percent."* This remains the case in mid-2018 with the BoE's August 2018 Inflation Report stating that, *"CPI inflation was 2.4% in June, pushed above the 2% target by external cost pressures resulting from the effects of sterling's past depreciation and higher energy prices. The contribution of external pressures is projected to ease over the forecast period while the contribution of domestic cost pressures is expected to rise.*

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Taking these influences together, and conditioned on the gently rising path of Bank Rate implied by current market yields, CPI inflation remains slightly above 2% through most of the forecast period, reaching the target in the third year."

2.10 The April 2018 Economic Outlook report by the IMF report identified that, *"The unemployment rate in the United Kingdom is close to historic lows; further declines could add to inflation pressure by triggering faster wage growth in a context of inflation that is already above target following currency depreciation after the June 2016 Brexit referendum. Gradual monetary tightening is therefore needed to ensure that inflation returns to target and expectations remain anchored."* This is recognised by the BoE, however they are also acutely aware of the uncertainty currently presiding and the impact any changes to monetary policy might have on jobs and activity. *"Developments regarding the United Kingdom's withdrawal from the European Union — and in particular the reaction of households, businesses and asset prices to them — remain the most significant influence on, and source of uncertainty about, the economic outlook. In such exceptional circumstances, the MPC's remit specifies that the Committee must balance any trade-off between the speed at which it intends to return inflation sustainably to the target and the support that monetary policy provides to jobs and activity."*

2.11 The BoE's August inflation Report identifies that the *"Bank of England's Monetary Policy Committee ("MPC") sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. At its meeting ending on 1 August 2018, the MPC voted unanimously to increase Bank Rate by 0.25 percentage points, to 0.75%."* The rate remains low by historic standards and BNPPRE considers that any additional rise in interest rate that may occur will likely be introduced slowly and steadily to eliminate economic shock. Nationwide's Chief Economist, Robert Gardiner identifies in the July 2018 House Price Index Report that "*Providing the economy does not weaken further, the impact of a further small rise in interest rates on UK households is likely to be modest. This is partly because only a relatively small proportion of borrowers will be directly impacted by the change. Most lending on personal loans and credit cards is fixed or tends to be unaffected by movements in the Bank Rate. Similarly, in recent years, the vast majority of new mortgages have been extended on fixed interest rates."*

2.12 It is worth noting that stamp duty changes when purchasing residential property from December 2014, has also had an effect on the housing market, as it encourages first time buyers, who predominantly purchase lower priced properties, to pay lower stamp duty rates: up to £125,000 (0%), up to £250,000 (2%); and discourages wealthier families to buy property who have the capital to buy a £1,000,000 home but now have to pay 10% stamp duty rates, which will significantly impede their budgets and affordability. However, for overseas investors, the post-EU referendum fall in sterling has offset the impact of higher Stamp Duty to a large extent. As BNP Paribas Real Estate noted in our Q2 Housing Market Report and reaffirms in our Q3 2017 Housing Market Prospectus Report, "the market has become increasingly reliant on first-time buyers, especially with the depletion of mortgaged movers from the market. Income weakness clearly has potential to dent activity amongst this group given the high average loan-to-value ratios needed to gain the first step on the ladder."

2.13 This position remains relevant into 2018 with the BoE's April 2018 Inflation Report commenting that *"Around four fifths of housing investment consists of new buildings and improvements to existing buildings. Housing investment over 2017 has been supported in part by new home building, with housing starts having increased since 2016 Q1. Contacts of the Bank's Agents have reported that starts have been supported in part by demand for new-build properties from first-time buyers using the Help to Buy equity loan scheme. Starts fell back in 2017 Q3, however, which will weigh slightly on housing investment growth in the near term."* The BoE report goes on summarise that, *"Overall, activity in the housing market is projected to pick up a little in the near term, while house price inflation and housing investment growth are expected to slow slightly. Measures detailed in the November 2017 Budget to support homeownership — such as stamp duty relief for first-time buyers, an expansion of the Help to Buy equity loan scheme and measures aiming to boost*

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housebuilding — may support activity, particularly for first-time buyers. The impact on the overall housing market is likely to be small, however."

2.14 In addition, there remains the further impact on the market due to tax changes on the purchase of second properties. The August BoE's August 2017 Inflation Report highlighted that, *"Much of the weakness in housing market activity over the past 18 months reflects a fall in the number of buy to let property transactions following policy changes such as the introduction of the stamp duty charge for additional properties in April 2016. Buy-to-let mortgage completions fell sharply in April 2016 and have remained broadly flat since then. Perhaps consistent with that, the slowdown in housing market activity over the past 18 months has been particularly pronounced in London and the South East, which together account for around 50% of buy-to-let transactions."*

2.15 BNP Paribas Real Estate's Q3 2017 Housing Market Prospectus Report, highlighted that the Council of Mortgage Lenders (CML) published a report entitled 'Missing Movers: A Long-Term Decline in Housing Transactions?', which investigates the reasons for the low level of housing transactions that have become a feature of the UK market since the financial crisis. The research finds long-term economic and demographic issues are responsible for the dip in activity, with ageing and equity-rich households reducing activity at one end of the market while affordability has sapped activity amongst mortgaged households, the former being the bedrock of housing activity. With little expectation of either improving real incomes, or a growth in equity to make potential moves worthwhile, the report concludes that in the absence of any radical changes to housing or indeed wider related policies *"we should expect for the foreseeable future movement among mortgaged households to remain constrained."* It is notable therefore that more affordable regions of the country such as, the West Midland and the South West, benefiting from a solid economic base are currently "*showing more robust levels of activity (RICS)".*

2.16 Nationwide's July 2018 House Price Index Report identifies that the, *"There was a slight uptick in annual house price growth in July to 2.5%, from 2.0% in June. Nonetheless, annual house price growth remains within the fairly narrow range of c2-3% which has prevailed over the past 12 months, suggesting little change in the balance between demand and supply in the market."* This position correlates with that reported in the August 2018 Halifax House Price Index Report, which states that *"House prices picked up in July, with the annual rate of growth rising from 1.8% in June to 3.3% in July, the largest increase since last November. The average house price is now £230,280, the highest on record. House prices in the three months to July were 1.3% higher than in the previous quarter, the fastest quarterly increase, again, since November."*

2.17 A key feature of the market currently is a mixed regional picture with the UK's house prices showing modest growth overall, but with some regions still outperforming. Robert Gardiner, Nationwide's Chief Economist identified in the March 2018 that, "*For the fourth quarter in a row, regions in the North of England recorded stronger annual house price growth than those in the South."* He further highlighted London to be the weakest performing market stating that "*London continued to experience modest annual price declines, with average house prices down 1% compared with a year ago."* However, in BNP Paribas Real Estate's opinion, these overall figures for London are likely to mask differences between the overheated central London markets versus the still affordable outer London markets, which are still seeing growth as a result of significant demand and regeneration.

2.18 Both Nationwide and Halifax, have highlighted the relationship between muted house price growth, Mortgages remaining affordable despite the recent BoE Base Rate increase and the continuing strength of the UK jobs market, however they differ on the point of the pressures on household finances.

2.19 Russell Galley, Managing Director of the Halifax identifies in the August 2018 report that *"While the quarterly and annual rates of house price growth have improved, housing activity*

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remains soft. Despite the recent modest improvement in mortgage approvals, the latest survey data for new buyer enquiries and agreed sales suggest that approvals will remain broadly flat until the end of the year. In contrast, the labour market remains robust, with the numbers of people in employment rising by 137,000 in the three months to May with much of the job creation driven by a rise in full-time employment. Pressures on household finances are also easing as growth in average earnings continues to rise at a faster rate than consumer prices. With regards to the recent rise in the Bank of England Base Rate, we do not anticipate that this will have a significant effect on either mortgage affordability or transaction volumes"

2.20 Robert Gardiner of Nationwide considers in the July report that, *"Subdued economic activity and ongoing pressure on household budgets is likely to continue to exert a modest drag on housing market activity and house price growth this year, though borrowing costs are likely to remain low. Overall, we continue to expect house prices to rise by around 1% over the course of 2018."*

2.21 Residential sales value forecasts by numerous property firms have continued to identify since June 2016 that uncertainty has weighed down the market slowing sales value growth. In BNP Paribas Real Estate's Summer 2018 Residential Quarterly Update we identify that,

"Now that there have been some initial agreements reached on Brexit, attention can move towards trade negotiations. The route Britain takes with these issues will have large implications on the nature of Brexit and the future strength of the UK economy. The fundamentals of the UK economy remain broadly positive, but sentiment remains very cautious.

Total transaction levels for England and Wales look to be relatively equivalent to this time last year. However, in PCL despite transactions picking up over the course of 2017, they continue to be low by historic standards. With substantial economic and political uncertainty continuing, it doesn't look likely that this will change any time soon."

2.22 The future trajectory of house prices is currently uncertain. Vanessa Hale, Research Director at BNP Paribas Real Estate, states in the Summer 2018 Residential Quarterly Update that *"We continue to hold our residential house price forecasts for sales and lettings as the wider economic and political uncertainty remains. We maintain that from 2019 onwards it continues to be extremely difficult to forecast the housing market with any certainty, but we would expect some bounce back and a return to growth once more stability has returned to the UK."*

2.23 Forecasts for house price growth identify that values are expected to increase over the next five years, however this price growth is identified as being more moderate than over the past 20 years. There is a consensus that a low level of price growth is expected over the next couple of years with a return to stronger sales value growth in 2020 -2022, when it is anticipated that there will be more certainty on the deal agreed for the UK's exit from the EU and employment growth, wage growth and GDP growth return towards trend levels. Stephanie McMahon, BNP Paribas Real Estate's Head of Research commented in Q1 2018 Residential Forecast that, "*Traditionally the most buoyant housing market in the UK, London experienced a slowdown following the EU Referendum and this may continue until 2020. Regional hotspots are likely to be the drivers of UK house price growth in the meantime, with 18% growth forecast for the UK over 5 years to 2022."* We provide further detail on the mainstream London market sales value forecasts below.

Local housing market context

2.24 According to Land Registry as of August 2009, values had fallen in Tower Hamlets by circa 25% from the April 2008 peak of the market values. Subsequently values recovered steadily to April 2010, from which point values fluctuated within a 7% range until May 2013. From May 2013 average values have been seen to increase at a more rapid rate exceeding the April 2008 peak of the market value in October 2013. As of June 2018 residential sales

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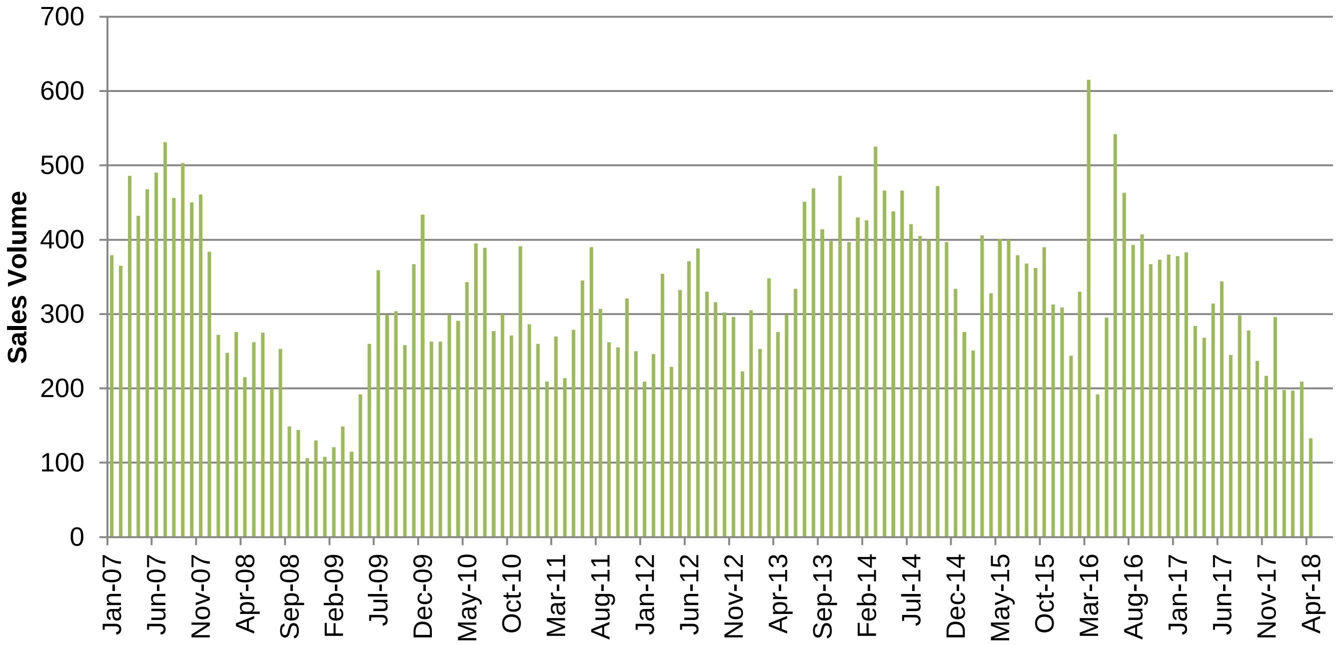
values in Tower Hamlets were circa 140% higher than the April 2008 peak of the market values.

2.25 Tower Hamlets has seen very strong growth in sales values across the borough, where values have been seen to almost double since BNP Paribas Real Estate prepared the Council's previous CIL viability evidence. Growth in values has resulted from a significant number of development schemes coming forward, regenerating the borough. Values in the city fringe, along the Thames and in Canary Wharf area also seen significant increases with a number of schemes achieving sales values in excess of £1,200 per sq ft. These areas are now considered part of the central London 'prime market'. Growth in values in these areas has resulted in part from active interest from domestic and overseas investors.

Figure 2.23.1: Average house prices in Tower Hamlets

Figure 2.23.2: Sales volumes in Tower Hamlets



Source: Land Registry

2.26 The future trajectory of house prices is currently uncertain, although BNP Paribas Real Estate, Knight Frank, JLL and Savills currently forecast growth in house prices over the next five years (see table 2.26.1 below). They identify that the Mainstream London market will grow by between 7.1% to 13.1% over the period between 2018 to 2022 inclusive. This is compared to a UK average of between 12.6% to 18% cumulative growth over the same period.

Table 2.26.1: House price forecasts for prime and mainstream London markets and the UK market as a whole

London Markets	2018	2019	2020	2021	2022	Cumulative growth
Mainstream London - Knight Frank (May 2018)	-0.5%	2.5%	3.0%	3.5%	4.0%	13.1%
Greater London – JLL (January 2018)	0.0%	1.5%	2.0%	3.5%	4.0%	11.4%
Mainstream London – Savills (April 2018)	-2.0%	0.0%	5.0%	2.0%	2.0%	7.1%
UK - Knight Frank (May 2018)	1.0%	2.0%	3.0%	3.5%	4.0%	14.2%
UK – JLL (January 2018)	1.0%	2.0%	2.5%	3.0%	3.5%	12.6%
UK- BNPPRE / Strutt & Parker (August 2018)	2.5%	2.5%	4.0%	4.0%	4.0%	18.0%
UK – Savills (April 2018)	1.0%	2.5%	5.0%	2.5%	2.5%	14.2%

National Policy Context

The National Planning Policy Framework

2.27 In July 2018, the government published a revised National Planning Policy Framework ('NPPF') and revised National Planning Practice Guidance ('NPPG').

2.28 Paragraph 34 of the NPPF states that "*Plans should set out the contributions expected from development. This should include setting out the levels and types of affordable housing provision required, along with other infrastructure (such as that needed for education, health, transport, flood and water management, green and digital infrastructure). Such policies should not undermine the deliverability of the plan*".

2.29 Paragraph 57 of the NPPF suggests that "*Where up-to-date policies have set out the contributions expected from development, planning applications that comply with them should be assumed to be viable. It is up to the applicant to demonstrate whether particular circumstances justify the need for a viability assessment at the application stage. The weight to be given to a viability assessment is a matter for the decision maker, having regard to all the circumstances in the case, including whether the plan and the viability evidence underpinning it is up to date, and any change in site circumstances since the plan was brought into force. All viability assessments, including any undertaken at the plan-making stage, should reflect the recommended approach in national planning guidance, including standardised inputs, and should be made publicly available*".

2.30 In London and other major cities, the fine grain pattern of types of development and varying existing use values make it impossible to realistically test a sufficient number of typologies to reflect every conceivable scheme that might come forward over the plan period. The Council's proposed approach of reflecting the Mayor of London's 'threshold' approach to affordable housing will allow schemes that cannot provide as much as 35% affordable housing to still come forward rather than being sterilised by a fixed or 'quota' based approach to affordable housing.

2.31 Prior to the publication of the updated NPPF, the meaning of a "*competitive return*" has been the subject of considerable debate over the past year. For the purposes of testing the viability of a Local Plan, the Local Housing Delivery Group[4] concluded that the current use value of a site (or a credible alternative use value) plus an appropriate uplift, represents a competitive return to a landowner. Some members of the RICS considered that a competitive return is determined by market value[5], although there was no consensus around this view. The revised NPPF removes the requirement for "competitive returns" and is silent on how landowner returns should be assessed. The revised PPG indicates that viability testing of plans should be based on existing use value plus a landowner premium. The revised PPG also expresses a preference for plan makers to test the viability of planning obligations and affordable housing requirements at the plan making stage in the anticipation that this may reduce the need for viability testing developments at the development management stage. Local authorities have, of course, been testing the viability of their plan policies since the first NPPF was adopted, but have adopted policies based on the most viable outcome of their testing, recognising that some schemes coming forward will not meet the targets. This approach maximises delivery, as there is flexibility for schemes to come forward at levels of obligations that are lower than the target, if a proven viability case is made. The danger of the approach in the revised NPPF is that policy targets will inevitably be driven down to reflect the least viable outcome; schemes that could have delivered more would not do so.

CIL Policy Context

2.32 As of April 2015 (or the adoption of a CIL Charging Schedule by a charging authority, whichever was the sooner), the S106/planning obligations system' i.e. the use of 'pooled' S106 obligations, was limited to a maximum of five S106 agreements. The adoption of a CIL charging schedule is discretionary for a charging authority; however, the scaling back of the use of pooled S106 obligations is not discretionary. As such, should the Council elect not to adopt a CIL Charging Schedule, it may have implications with regard to funding infrastructure in the District in future and the Council will need to be aware of such implications in their decision-making.

2.33 It is worth noting that some site specific S106 obligations remain available for negotiation, however these are restricted to site specific mitigation that meet the three tests set out at CIL Regulation 122 and to the provision of affordable housing. They cannot be used for securing payments towards infrastructure[6] that benefit more than one development, unless they form part of a maximum of five S106 agreements, from which contributions to provide infrastructure can be pooled.

2.34 The CIL regulations state that in setting a charge, local authorities must strike "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).

2.35 Local authorities must consult relevant stakeholders on the nature and amount of any proposed CIL at two stages; after publication of the Preliminary Draft Charging Schedule ("PDCS") and the Draft Charging Schedule ("DCS"). Following consultation, a charging schedule must be submitted for independent examination.

2.36 The payment of CIL becomes mandatory on all new buildings and extensions to buildings with a gross internal floorspace over 100 square metres once a charging schedule has been adopted. The CIL regulations allow a number of reliefs and exemptions from CIL. Firstly, affordable housing and buildings with other charitable uses (if a material interest in the land is

[4] Viability Testing Local Plans: Advice for planning practitioners, June 2012
[5] RICS Guidance Note: Financial Viability in Planning, August 2012
[6] This infrastructure should not be identified on the Council's Regulation 123 list.

owned by the charity and the development is to be used wholly or mainly for its charitable purpose) are subject to relief. Secondly, local authorities may, if they choose, elect to offer an exemption on proven viability grounds. A local authority wishing to offer exceptional circumstances relief in its area must first give notice publicly of its intention to do so. The local authority can then consider claims for relief on chargeable developments from landowners on a case by case basis. In each case, an independent expert with suitable qualifications and experience must be appointed by the claimant with the agreement of the local authority to assess whether paying the full CIL charge would have an unacceptable impact on the development's economic viability.

2.37 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 that the Authority must be satisfied that granting relief would not constitute state aid. It should be noted however that CIL cannot simply be negotiated away or the local authority decide not to charge CIL.

2.38 CIL Regulation 40 includes a vacancy period test for calculating CIL liability so that vacant floorspace can be offset in certain circumstances. That is where a building that contains a part which has not been in lawful use for a continuous period of at least six months within the last three years, ending on the day planning permission first permits the chargeable development, the floorspace may not be offset.

2.39 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. The CIL Guidance set out in the NPPG (paragraph 022) clarifies that CIL Regulation 13 permits charging authorities to levy *"differential rates by reference to different intended uses of development."* Charging Authorities taking this approach need to ensure that such different rates are justified by a comparative assessment of the economic viability of those categories of development. Further the NPPG clarifies that the definition of "use" for this purpose is not tied to the classes of development in the Town and Country Planning Act (Use Classes) Order 1987, although that Order does provide a useful reference point.' The NPPG also sets out (paragraph 023) that charging authorities may also set differential rates in relation to, scale of development i.e. by reference to either floor area or the number of units or dwellings.

2.40 The 2010 CIL regulations set out clear timescales for payment of CIL, which are 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 allowed charging 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).

2.41 The Government published the findings of the independent CIL review alongside the Housing White Paper in February 2017. The White Paper identified at paragraph 2.28 that the Government "*continue to support the existing principle that developers are required to mitigate the impacts of development in their area, in order to make it acceptable to the local community and pay for the cumulative impacts of development on the infrastructure of their area."* The White Paper summarised the main finding of the CIL review to be that "*the current system is not as fast, simple, certain or transparent as originally intended."*

2.42 As a result the Government committed to *"examine the options for reforming the system of developer contributions including ensuring direct benefit for communities, and will respond to the independent review and make an announcement at Autumn Budget 2017."* The government's recent consultation on changes to the NPPF includes proposed reforms of CIL, including the following potential changes:

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- The potential for councils to adopt Strategic Infrastructure Tariffs ('SITs') to fund strategic infrastructure that cross borough boundaries. Any potential SIT proposals would need to be factored into the viability testing to ensure rates of CIL that are set are viable alongside SITs and Local Plan policies

- Potential changes to the approach to consultation with stakeholders, with the current formal process replaced with a statement on how the Authority has engaged, which would form part of the Examination in Public.

- Potential removal of pooling restrictions on Section 106. If councils intend to collect funds for infrastructure through pooled contributions, any such contributions would need to be incorporated into viability testing to ensure that the CIL rates charged alongside Section 106 remain viable.

- Encouragement for setting specific rates for all uses on large strategic developments would require the testing of individual strategic sites to determine an appropriate and specific rate. Councils would need to identify which sites this may apply to.

- Setting rates according to existing uses of sites is a key change proposed by the government. This would enable councils to set higher rates on sites that are currently in low value uses (e.g. secondary industrial).

- Changes to the way CIL is indexed, moving from indexation by reference to changes in build costs to changes in values across the borough.

Mayoral CIL

2.43 Tower Hamlets falls within Mayoral CIL Zone 2 in the currently adopted Mayoral CIL Charging Schedule, for which a CIL of £35 per square metre (un-indexed) is levied. In addition, the Crossrail and Mayoral CIL SPG[7] identifies that in particular locations, where appropriate, the Mayor could negotiate Section 106 contributions over and above the Mayoral CIL towards Crossrail, dependent on the size and impact of the development and viability issues.

2.44 We note that the Mayor published the Mayor of London Community Infrastructure Levy 2 Preliminary Draft Charging Schedule (MCIL2 PDCS) on 26 June 2017 for consultation until 7 August 2017 and following this published the Draft Charging Schedule (MCIL2 DCS) for consultation between 18 December 2017 and 4 February 2018. We understand that the Mayor has submitted his Charging Schedule for Public Examination, which is scheduled to take place on 10-12 September 2018. The Mayor intends to introduce MCIL2 on 1 April 2019 which will supersede both the current Mayor's CIL (MCIL1) and the associated planning obligation/S106 charge scheme applicable to areas directly benefiting from Crossrail services.

2.45 The borough remains within Zone 2 of the emerging MCIL2 charging schedule, for which a rate of £60 per square metre will be levied. In addition, a portion of the borough on the eastern boundary is located within the identified MCIL2 Central London charging area and the majority of the Isle of Dogs is located within the Isle of Dogs MCIL2 charging area, Both of these locations are identified as charging areas for offices, retail and hotels at £185, £165 and £140 per square metre respectively.

Tower Hamlets CIL

2.46 Tower Hamlets adopted its CIL Charging Schedule on 25 February 2015 and it came into effect on 1 April 2015. Table 2.46.1 below summarises the rates of CIL charged (un-indexed).

[7] The London Plan Supplementary Planning Guidance on 'Use of planning obligations and Mayoral Community Infrastructure Levy' (March 2016) ("Mayoral CIL and S106 SPG")

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Table 2.42.1: CIL rates in the adopted Charging Schedule

Development Type	Proposed CIL Rate Per sq m (GIA) of Development			
	Zone 1	**Zone 2**	**Zone 3**	**Large Allocated Sites**
Residential	£200	£65	£35	Nil
	City Fringe	**North Docklands**	**Rest of Borough**	**Large Allocated Sites**
Offices	£90	Nil	Nil	Nil
Retail (Except Convenience Supermarkets/ Superstores and Retail Warehousing)	£70	£70	Nil	Nil
	Borough Wide, Except Large Allocated Sites			**Large Allocated Sites**
Convenience Supermarkets/ Superstores and Retail Warehousing	£120			Nil
Hotel	£180			Nil
Student Housing Let at Market Rents	£425			Nil
Student Housing Let at Below Market Rents	Nil			Nil
	Borough Wide			
All other uses	Nil			

Local Policy context

2.47 The study takes into account the emerging policies and standards set out in the Tower Hamlets Local Plan 2031, Managing growth and sharing the benefits, Regulation 19 Consultation document to be published in October 2017 ("STHLP"). These include *inter alia* affordable housing requirements; sustainability and developer contributions towards infrastructure. There are numerous policy requirements that are now embedded in base build costs for schemes (i.e. secure by design, landscaping, amenity space, internal space standards etc.).

2.48 We set out a summary of the policies identified as having cost implications for developments below:

- Policy D.SG5 – Developer contributions (sets out that requirements may include S106 agreements to make provisions to mitigate the impacts of the development and CIL and the Council's approach to the Vacant Building Credit ("VBC"))
- Strategic Policy S.H1 – (sets out the strategic affordable housing target of 50% and identifies the minimum requirement for 35%-affordable homes on sites providing net additional residential units (subject to viability);
- Policy D.H2 - (requires the delivery of affordable housing in a 70% Rent and 30% Intermediate tenure split). It also requires developments for estate regeneration to

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protect the existing quantum of affordable homes and provide an uplift in the number of affordable homes.

- Policy D.H3 – Housing Standards and Quality (in particular accessibility requirements in line with the London Plan)
- Policy D.ES5 – Sustainable Drainage (specifies requirements for SUDs and attenuation on development sites).
- Policy D.ES7 – A Zero Carbon Borough (identifies the Council's aspiration of achieving Zero Carbon development. From 2016 to 2019 a 45% CO2 emissions reduction from the 2013 building regulations is sought and Zero Carbon from 2019-2031 i.e. a minimum of 45% reduction of on-site with the remaining regulated carbon dioxide emissions to 100% to be off-set through a cash in lieu contribution for carbon saving projects elsewhere in the borough.)

Development context

2.49 Tower Hamlets is an inner London borough and sits in an important strategic location for London, linking central London with the rest of the Thames Gateway growth corridor. The STHLP identifies that the borough is the second most densely populated in London, and the townscape is evolving with the increase in density. Many areas have undergone significant change and regeneration, with a mix of redevelopment and restoration/adaption/reuse of buildings. In particular there has been a marked increase in the number of tall buildings, particularly residential ones, causing notable changes to the borough's skyline, with positive and negative implications.

2.50 Developments in Tower Hamlets range from small in-fill sites to major regeneration schemes. The City Fringe and Canary Wharf are strategically important employment locations for London and are the location of the headquarters for a large number of multinational businesses so commercial development is important and strong within these key locations within the Borough.

2.51 The STHLP identifies that the 2015 Indices of Deprivation (DCLG, 2015) show that while Tower Hamlets has become relatively less deprived, deprivation remains widespread and the Borough also continues to have the highest rates of child and pensioner poverty in England (LBTH, 2016). However the borough also contains a number of wards which are within the least deprived in England. This disparity is reflected in the borough's pay ratio which is the largest, reflecting the greatest inequality in London (London Poverty Profile, 2015).

2.52 Given the above it is unsurprising that there are significant variations in residential sales values between different parts of the Borough, with values in the City Fringe, wards along the River Thames and in Canary Wharf generally being the highest and the areas to the north east of the borough achieving lower values. Notwithstanding this position, values in the entire borough have seen significant growth in the last few years with the construction of new residential dwellings (building starts) in the borough exceeding the other London boroughs and the growth shows little signs of abating.

2.53 The STHLP identifies that *'The London Plan (GLA, 2016) identifies a ten-year minimum housing supply target of 39,314 homes within Tower Hamlets over the period 2015-2025. This is equivalent to a minimum requirement of 3,931 homes per annum. The London Plan does not set out specific housing targets beyond 2025 but expects boroughs to 'roll forward' their annual target. The London Plan ten-year target, plus the annual rolled forward target, results in a housing supply target for the borough (2016 – 2031) of 58,965 homes.'*

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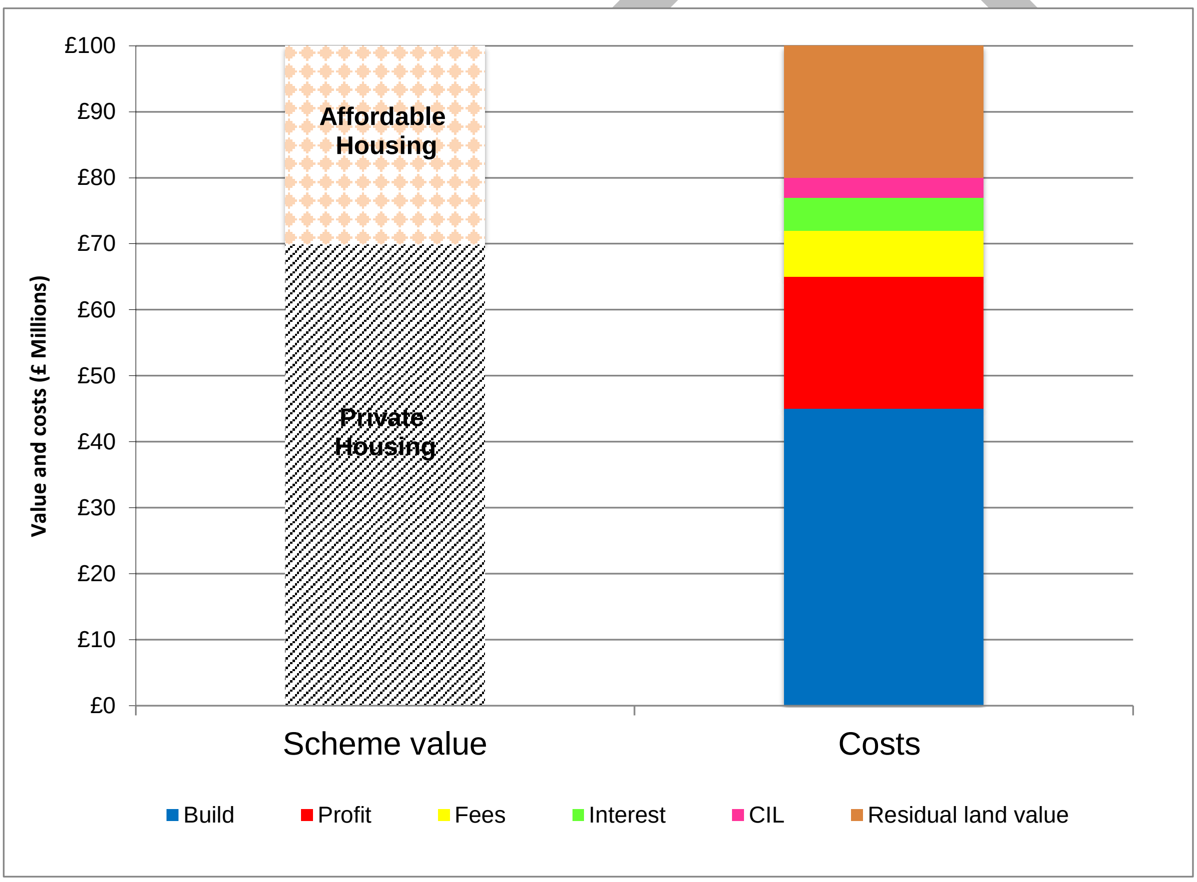
3 Methodology

3.1 Our methodology follows standard development appraisal conventions, using locally-based sites and assumptions that reflect local market circumstances and emerging planning policy requirements. The study is therefore specific to Tower Hamlets 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 (the hatched portion) and the payment from a Registered Provider ('RP') (the chequered portion) for the completed affordable housing units. For a commercial scheme, scheme value equates to the capital value of the rental income after allowing for rent free periods and purchaser's costs. The model then deducts the build costs, fees, interest, CIL 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 existing use value, discussed later), it will be implemented. If not, the proposal will not go ahead, unless there are alternative funding sources to bridge the 'gap'.

3.4 Problems with key appraisal variables can be summarised as follows:

- Development costs are subject to national and local monitoring and can be reasonably accurately assessed in 'normal' circumstances. In boroughs like Tower Hamlets, the majority of sites will be previously developed. These sites can sometimes encounter ‘exceptional’ costs such as decontamination. Such costs can be very difficult to anticipate before detailed site surveys are undertaken;

- Assumptions about development phasing, phasing of Section 106 contributions and infrastructure required to facilitate each phase of the development will affect residual values. Where the delivery of the obligations are deferred, the less the real cost to the applicant (and the greater the scope for increased affordable housing and other planning obligations). This is because the interest cost is reduced if the costs are incurred later in the development cashflow; and

- While Developer’s Profit has to be assumed in any appraisal, its level is closely correlated with risk. The greater the risk, the higher the profit level required by lenders. While profit levels were typically up to around 15% of completed development value at the peak of the market in 2007, banks currently require schemes to show a profit level that is reflective of current risk. Typically developers and banks have been targeting between 17-20% profit on value of the private housing element.

3.5 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[8]’ or another appropriate benchmark to make development worthwhile. The margin above existing 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.

3.6 Clearly, however, landowners have expectations of the value of their land which often exceed the value of the current use. 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. However, the communities in which development takes place also have reasonable expectations that development will mitigate its impact, in terms of provision of community infrastructure, which will reduce land values. 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

3.7 The NPPF (2018) sets out at paragraph 34 that, *“Plans should set out the contributions expected from development. This should include setting out the levels and types of affordable housing provision required, along with other infrastructure (such as that needed for education, health, transport, flood and water management, green and digital infrastructure). Such policies should not undermine the deliverability of the plan.”* The July 2018 updated NPPG on Viability indicates that for the purposes of testing viability, local authorities should have regard to existing use value of land plus a premium to incentivise release for redevelopment.

3.8 The Mayor’s Affordable Housing and Viability SPG focuses on decision making in development management, rather than plan making, but indicates that benchmark land values should be based on existing use value plus a premium which should be “*fully justified based on the income generating capacity of the existing use with reference to comparable evidence on rents, which excludes hope value associated with development on the site or alternative uses*”.

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[8] For the purposes of this report, existing use value is defined as the value of the site in its existing use, assuming that it remains in that use. We are not referring to the RICS Valuation Standards definition of ‘Existing Use Value’.

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3.9 The Local Housing Delivery Group published guidance[9] in June 2012 which provides guidance on testing viability of Local Plan policies. The guidance notes that "*consideration of an appropriate Threshold Land Value [or viability benchmark] needs to take account of the fact that future plan policy requirements will have an impact on land values and landowner expectations. Therefore, using a market value approach as the starting point carries the risk of building-in assumptions of current policy costs rather than helping to inform the potential for future policy*".

3.10 In light of the weaknesses in the market value approach, the Local Housing Delivery Group guidance recommends that benchmark land value "*is based on a premium over current use values*" with the "*precise figure that should be used as an appropriate premium above current use value [being] determined locally*". The guidance considers that this approach "*is in line with reference in the NPPF to take account of a "competitive return" to a willing land owner*".

3.11 The examination on the Mayor of London's first 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." (paragraph 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*" (paragraph 9).

3.12 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.* (paragraph 32 – emphasis added).

3.13 It is important to stress, therefore, 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 planning authority.

3.14 Respondents to consultations on planning policy documents in other authorities in London have made various references to the RICS Guidance on 'Viability in Planning' and have suggested that councils should run their analysis on market values. This would be an extremely misleading measure against which to test viability, as market values should reflect *existing policies already in place*, and would consequently tell us nothing as to how future (as yet un-adopted) policies might impact on viability. It has been widely accepted elsewhere that market values are inappropriate for testing planning policy requirements.

3.15 Relying upon historic transactions is a fundamentally flawed approach, as offers for these sites will have been framed in the context of current planning policy requirements, so an

9 Viability Testing Local Plans: Advice for planning practitioners, Local Housing Delivery Group, Chaired by Sir John Harman, June 2012

exercise using these transactions as a benchmark would tell the Council nothing about the potential for sites to absorb as yet unadopted policies. Various Local Plan inspectors and CIL examiners have accepted the key point that Local Plan policies and CIL will ultimately result in a reduction in land values, so benchmarks must consider a reasonable minimum threshold which landowners will accept. For local authority areas such as Lambeth, where the vast majority of sites are previously developed, the 'bottom line' in terms of land value will be the value of the site in its existing use. This fundamental point is recognised by the RICS at paragraph 3.4.4. of their Guidance Note on 'Financial Viability in Planning":

"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".

3.16 The Guidance goes on to state that "*it would be inappropriate to assume an uplift based on set percentages … given the diversity of individual development sites*".

3.17 Commentators also make reference to 'market testing' of benchmark land values. This is another variant of the benchmarking advocated by respondents outlined at paragraph 3.14. These respondents advocate using benchmarks that are based on the prices that sites have been bought and sold for. There are significant weaknesses in this approach which none of the respondents who advocate this have addressed. In brief, prices paid for sites are a highly unreliable indicator of their actual value, due to the following reasons:

- Transactions are often based on bids that 'take a view' on squeezing planning policy requirements below target levels. This results in prices paid being too high to allow for policy targets to be met. If these transactions are used to 'market test' CIL rates, the outcome would be unreliable and potentially highly misleading.

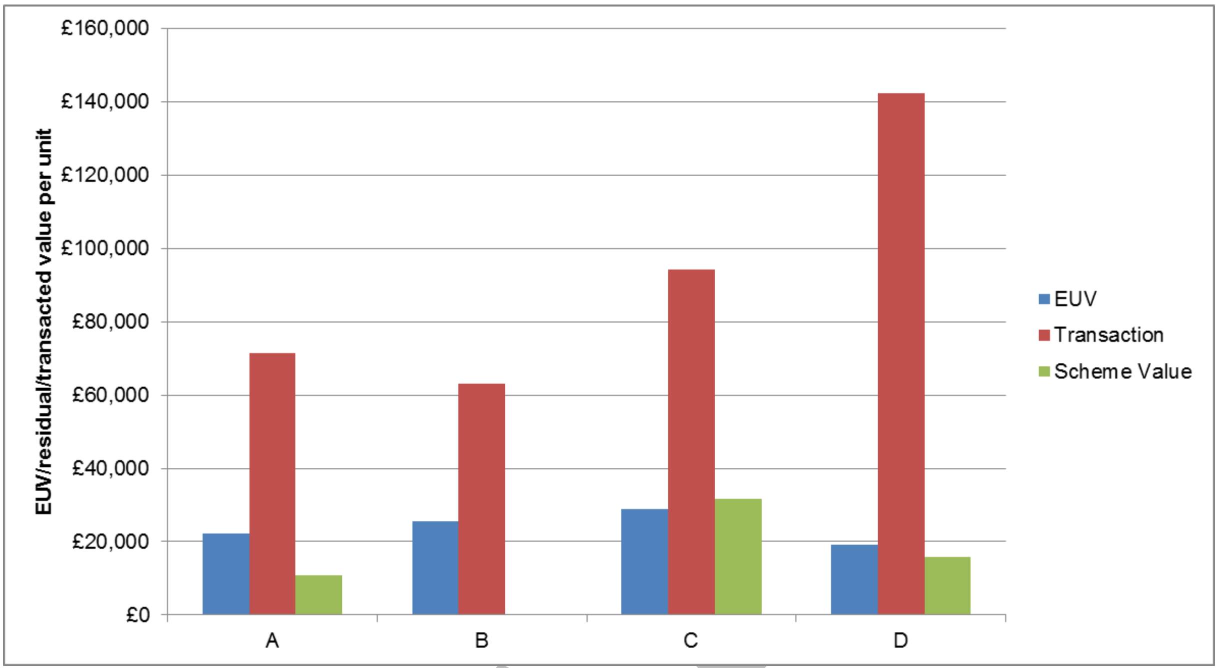
- Historic transactions of housing sites are often based on the receipt of grant funding, which is no longer available in most cases.

- There would be a need to determine whether the developer who built out the comparator sites actually achieved a profit at the equivalent level to the profit adopted in the viability testing. If the developer achieved a sub-optimal level of profit, then any benchmarking using these transactions would produce unreliable and misleading results.

- Developers often build assumptions of growth in sales values into their appraisals, which provides a higher gross development value than would actually be achieved today. Given that our appraisals are based on current values, using prices paid would result in an inconsistent comparison (i.e. current values against the developer's assumed future values). Using these transactions would produce unreliable and misleading results.

3.18 These issues are evident from a recent BNP Paribas Real Estate review of evidence submitted in viability assessments where the differences between the value ascribed to developments by applicants and the amounts the sites were purchased for by the same parties. The prices paid exceeded the value of the consented schemes by between 52% and 18,000%, as shown in Figure 3.18.1. This chart compares the residual value of four central London development proposals to the sites' existing use values and the price which the developers paid to acquire the sites (all the data is on a per unit basis).

Figure 3.18.1: Comparison of scheme residual value to existing use value and price paid for site



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3.19 For the reasons set out above, the approach of using current use values is a more reliable indicator of viability than using market values or prices paid for sites, as advocated by certain observers. Our assessment follows this approach, as set out in Section 4.

3.20 The NPPG 2018 indicates that planning authorities should adopt benchmark land values based on existing use values. It then goes on to suggest that the premium above existing use value should be informed by land transactions. This would in effect simply level benchmark land values up to market value, with all the issues associated with this (as outlined above). The NPPG 2018 does temper this approach by indicating that "*the landowner premium should be tested and balanced against emerging policies*" and that "*the premium should provide a reasonable incentive for a land owner to bring forward land for development while allowing a sufficient contribution to comply with policy requirements*". The guidance also stresses in several places that "price paid for land" should not be reflected in viability assessments. This would exclude use of transactional data thus addressing the issues highlighted in paragraphs 3.17 and 3.18.

4 Appraisal assumptions

Residential development

4.1 We have appraised 9 development typologies, reflecting both the range of sales values/capital values and also sizes/types of development and densities of development across the borough. The Council have reviewed historic planning applications and have based the appraisal typologies on a range of actual developments within the borough. These typologies are therefore reflective of developments that have been consented/delivered as well as those expected to come forward in Tower Hamlets in future. Details of the schemes appraised are provided below in tables 4.1.1 and 4.1.2 below.

Table 4.1.1 Development typologies

Typology No.	Number of units	Housing type	Development density units per ha	Net developable area (ha)
1	3	Houses	100	0.03
2	6	Flats	350	0.02
3	10	Flats	235	0.04
4	11	Flats	235	0.05
5	25	Houses and flats	375	0.07
6	50	Flats	380	0.13
7	100	Flats	210	0.48
8	250	Flats	280	0.89
9	400	Flats	630	0.63

Table 4.1.2: Unit Mix (as identified in the SHMAA)

<table>
<tr><th>Unit Size</th><th>Market</th><th>London Living Rent / Intermediate</th><th colspan="2">Social Target Rent / Tower Hamlets Living rent</th></tr>
<tr><td>1 bed</td><td>30%</td><td>15%</td><td colspan="2">25%</td></tr>
<tr><td>2 bed</td><td>50%</td><td>40%</td><td colspan="2">30%</td></tr>
<tr><td>3 bed</td><td rowspan="2">20%</td><td>35%</td><td rowspan="2">45%</td><td>30%</td></tr>
<tr><td>4 bed</td><td>10%</td><td>15%</td></tr>
<tr><td>Total</td><td>100%</td><td>100%</td><td colspan="2">100%</td></tr>
</table>

4.2 For typology 1 we have assumed 100% of the units are delivered as 3 bed houses and Typology 5 we have assumed that 10% of the 3 bed units are delivered as houses.

4.3 With respect to the size of units adopted in the study, these are set out in Table 4.3.1 below and have been informed by the minimum gross internal floor areas set out in Policy 3.5 and Table 3.3 of the adopted London Plan Consolidated with Alterations since 2011 published in March 2016, Policy D4 and Table 3.1 in the Submission Draft New London Plan and the DCLG's Technical Housing standards' nationally described space standard published in March 2015.

Table 4.3.1: Unit Sizes adopted in study

Unit type	1 Bed flat	2 bed flat	3 bed flat	4 bed flat	3 bed house
Unit size (sq m)	50	70	95	108	102

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Residential sales values

4.4 Residential values in the area reflect national trends in recent years but do of course vary between different sub-markets. We note that since our March 2013 CIL Viability Report was published (with research undertaken in mid-2012), the Land Registry's database identifies that house prices in the borough have increased by circa 65%.

4.5 We have undertaken research on updated residential values in the borough using online database sources including Molior London, the Land Registry, Rightmove and discussions with active local agents. We also have an excellent understanding of values attributed to new build developments from viability work undertaken on behalf of the Council. We have considered all of this evidence of transacted properties in the area as well as properties on the market and pricing of new developments to establish appropriate values for testing purposes. This exercise indicates that in general, developments in the city fringe, Thames waterfront regions (such as St Katherine's docks and Wapping), Canary Wharf and docklands will attract average the highest sales values in the borough ranging from circa £8,342 per square metre (£775 per square foot) to £14,531 per square metre (£1,350 per square foot). Lower values are generally achieved in the east of the borough, however in peripheral areas values of new build development have been seen to increase significantly over the last few years. We have established high medium and low values for each of the three adopted CIL Zones as identified in Table 4.5.1.

Table 4.5.1: Average sales values adopted in Tower Hamlets appraisals

Area	Ave values £s per sq m	Ave values £s per sq ft
CIL Zone 1 - High	£14,531	£1,350
CIL Zone 1 - Medium	£10,710	£995
CIL Zone 1 - Low	£8,342	£775
CIL Zone 2 - High	£10,764	£1,000
CIL Zone 2 - Medium	£8,450	£785
CIL Zone 2 - Low	£7,266	£675
CIL Zone 3 - High	£8,611	£800
CIL Zone 3 - Medium	£7,266	£675
CIL Zone 3 - Low	£6,189	£575

4.6 As noted earlier in the report, BNP Paribas Real Estate, Knight Frank and 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 cost inflation of 5%. This sensitivity analysis provides the Council with an indication of the impact of changes in values and costs on scheme viability.

Affordable housing tenure and values

4.7 With respect to affordable housing, the Council's Strategic Policy S.H1 identifies that the Council's strategic target for affordable homes of 50% will be achieved by requiring a minimum of 35% to 50% affordable homes on sites providing net additional residential units (subject to viability). Policy D.H2 'Affordable housing' goes on to identify that the Council will seek to maximise affordable housing in line with Policy S.H1 and will require delivery of housing in accordance with a 70% Rent and 30% Intermediate tenure split. The supporting text at paragraph 4.18 identifies that the plan:

> *"… sets a target of achieving 50% affordable homes through private development as well as council-led initiatives. This target is considered to best reflect local housing need. On developments that yield 11 or more net additional residential units, at least 35% of*

affordable housing is expected. Developments are expected to maximise the provision of affordable housing, having regard to availability of public subsidy, implications of phased development (including provision for re-appraising scheme viability at different stages of development) as well as financial viability. Affordable housing calculations will be made using habitable rooms. Given the extent of local need, it is considered necessary and appropriate to seek financial contributions towards the provision of affordable housing from sites of less than 10 units. Financial contributions will be calculated using our preferred methodology as set out in the Planning Obligations Supplementary Planning Document. Over the plan period, developments on small sites have the potential to contribute over 3,000 new homes and could make a significant contribution towards meeting local affordable housing need (see appendix 7). Financial contributions will be calculated using a sliding-scale target starting at 3.5% across the whole site and increasing to 3.5% for each additional home, reaching 35% for sites of 11 units of more. Further detail (including on financial viability assessments) is provided in the developer contributions policy (D.SG5) and in the latest Planning Obligations Supplementary Planning Document. Policy S.H1 also requires 'a mix of housing sizes and tenures on all sites providing new housing" and further supports *"a variety of housing products in the market and affordable tenure".*

4.8 Policy D.H2 'Affordable housing' sets out that The Council will seek to *'maximise the provision of affordable housing in accordance with a 70% rented and 30% intermediate tenure split.* The supporting text in paragraphs 4.28 and 4.29 identify that:

4.28 Where the development provides up to 35% affordable housing, as per policy S.H1 above, the affordable housing provision should be comprised of:

- *70% rented element, of which 50% should be London affordable rents and 50% should be Tower Hamlets living rent; and*
- *30% intermediate element, which can include London living rent, shared ownership and other intermediate products.*

4.29 Larger intermediate units (3 or more bedrooms) should be prioritised as London Living Rent products, and generally, shared ownership will not be considered appropriate where unrestricted market values of a unit exceed £600,000 (as per the Affordable Housing and Viability Supplementary Planning Guidance [GLA, 2016]). Where the development provides more than 35% affordable housing, the tenure of the additional affordable homes will be subject to negotiation. GLA developed products (including the London Affordable Rent and London Living Rent) may be subject to change over the plan period. Our affordable housing service will provide further guidance on suitable products when assessing applications. Rent levels are determined as part of the viability assessment of each planning application and undertakings are made to retain similar rent levels at the point of completion. The ownership of affordable homes must be transferred to one of our approved local registered providers or other approved affordable housing providers.

4.9 The Council have identified that given the identified need in the borough they require forthcoming applications to split the 70% rented affordable element between SR and THLR. These will be equally split 50/50 between all unit sizes.

4.10 With respect to the 30% intermediate units, the Council has indicated that they are willing to be flexible on these units and have requested that three options of this provision be tested as follows:

- 50% LLR and 50% SO;
- 100% SO; and
- 100% LLR.

4.11 We set out in Table 4.11.1 the weekly rents for Social Rent (based on London Affordable Rent ("LAR"), Tower Hamlets Living Rent and London Living Rent adopted in our appraisals.

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Table 4.11.1 Social Rent (based on London Affordable Rent), Tower Hamlets Living Rent and London Living Rent weekly rents adopted in appraisals

	London Living Rent (LLR) (18/19)				Tower Hamlets Living Rent (THLR) (18/19)				Social rent/London Affordable Rent (18/19)			
Sub Market	1 Bed	2 Bed	3 Bed	4 Bed	1 Bed	2 Bed	3 Bed	4 Bed	1 Bed	2 Bed	3 Bed	4 Bed
Z1 High	£268.94	£298.82	£328.71	£358.59	£191.90	£211.09	£230.28	£249.48	£150.03	£158.84	£167.67	£176.49
Z1 Med	£202.77	£225.30	£247.83	£270.36	£191.90	£211.09	£230.28	£249.48	£150.03	£158.84	£167.67	£176.49
Z1 Low	£202.77	£225.30	£247.83	£270.36	£191.90	£211.09	£230.28	£249.48	£150.03	£158.84	£167.67	£176.49
Z2 High	£260.34	£289.27	£318.19	£347.12	£191.90	£211.09	£230.28	£249.48	£150.03	£158.84	£167.67	£176.49
Z2 Med	£221.75	£246.38	£271.02	£295.66	£191.90	£211.09	£230.28	£249.48	£150.03	£158.84	£167.67	£176.49
Z2 Low	£179.29	£199.22	£219.14	£239.06	£191.90	£211.09	£230.28	£249.48	£150.03	£158.84	£167.67	£176.49
Z3 High	£248.27	£275.85	£303.44	£331.02	£191.90	£211.09	£230.28	£249.48	£150.03	£158.84	£167.67	£176.49
Z3 Med	£196.76	£218.62	£240.48	£262.35	£191.90	£211.09	£230.28	£249.48	£150.03	£158.84	£167.67	£176.49
Z3 Low	£179.29	£199.22	£219.14	£239.06	£191.90	£211.09	£230.28	£249.48	£150.03	£158.84	£167.67	£176.49

4.12 We have used our bespoke model to value the affordable housing, which replicates how RPs undertake such appraisals. This model runs cashflows for the rented tenures in the borough over a period of circa 35 years which capitalises the net rental income stream. With respect to the social rented accommodation the model calculates the gross rent for these properties derived from a combination of property values (as at January 1999). The net rent is then calculated by taking into account factors such as: standard levels for individual registered providers (RP's) management and maintenance costs; finance rates currently obtainable in the sector; allowances for voids and bad debt.

4.13 In the July 2015 Budget, the Chancellor announced that Registered Providers ('RPs') will be required to reduce rents by 1% per annum for the next four years. This will reduce the capital values that RPs will pay developers for completed affordable housing units. From 2019/20 onwards, RPs will be permitted to increase rents by CPI plus 1% per annum. Given that rents will be increasing by CPI plus 1% by the time the new Charging Schedule will be in place, we have applied this assumption to our appraisals

4.14 The CLG/HCA 'Shared Ownership and Affordable Homes Programme 2016-2021: Prospectus' document clearly states that Registered Providers will not receive grant funding for any affordable housing provided through planning obligations on developer-led developments. Consequently, all our appraisals which we rely upon for testing the LBTH's emerging planning policies assume nil grant. Clearly if grant funding does become available over the plan period, it should facilitate an increase in the provision of affordable housing when developments come forward.

4.15 For shared ownership units, we have assumed that RPs will sell 25% initial equity stakes and maximum rent charge of 2.75% 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%.

Build costs

4.16 The Council have commissioned WT Partnership ('WTP') to advise on build costs. WTP have provided advice on base build costs as well as the adjustments to the base costs necessary to reflect the LBTH's emerging policy requirements which are not already included in these base build costs. In addition to the build costs outlined below adopted in this study, our appraisals include a contingency of 5% of build costs. We set out below the details of the costs adopted.

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Table 4.16.1 Base Build costs adopted in study

Typo	No. units	Housing type	Dev density units per ha	Net developable area (ha)	Gross to net for flats	Base build costs per sq m	External Works
1	3	Houses	100	0.03	n/a	1,900	15%
2	6	Flats	350	0.02	80%	2,000	7.5%
3	10	Flats	235	0.04	80%	2,000	7.5%
4	11	Flats	235	0.05	80%	2,000	7.5%
5	25	Houses and flats	375	0.07	75%	1,900 2,600	7.5%
6	50	Flats	380	0.13	75%	2,600	7.5%
7	100	Flats	210	0.48	75%	2,600	7.5%
8	250	Flats	280	0.89	75%	2,600	7.5%
9	400	Flats	630	0.63	75%	3,400	7.5%

4.17 WTP have undertaken an assessment of the existing and proposed THLP and London Plan policies and set out the following additional costs over and above the above base costs.

4.18 An allowance of circa 1% on base build costs should be allowed for achieving BREEAM excellent on commercial type buildings, based on the 2014 BRE / Sweet Group study.

4.19 Wheelchair accessible homes will incur an additional cost and from WTP's benchmarks, equating to an additional circa £5,000 per residential unit.

4.20 With respect to the costs associated with meeting the Council's Energy policy WTP has relied upon published reports. The most recent study London Plan Viability Study dated December 2017 indicates to meet the desired performance a premium of circa £1,500 per dwelling is required to be added and in their opinion this should be added to the base costs above.

4.21 WTP advise that in their experience waste reduction requirements will increase the extent of waste storage required for the extent of recycling and an allowance of £250 per dwelling should be added for additional cupboard space.

Professional fees

4.22 In addition to base build costs, schemes will incur professional fees covering design, valuation highways and planning consultants and the cost of preparing and submitting the planning application and so on. Our appraisals incorporate an allowance of 10-12%, which is at the middle to higher end of the range for most schemes.

Development finance

4.23 Our appraisals assume that development finance can be secured at a rate of 7%, inclusive of arrangement and exit fees, reflective of current funding conditions.

Marketing costs

4.24 Our appraisals incorporate an allowance of 3% for marketing costs, which includes show homes and agents' fees, plus 0.5% for sales legal fees.

Section 106 and CIL

4.25 We have adopted an allowance of £1,220 per unit for residual S106 contributions as per the Council's previous CIL viability study, which we understand from the Council remains a

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reasonable assumption based on elements they would seek S106 towards from such schemes.

4.26 In addition to an allowance for Borough CIL tested at a range of costs, we have also included Mayoral CIL based on the MCIL2 PDCS rate of £60 per sq m.

4.27 CIL applies to net additional floorspace[10]. Given the urban nature of Tower Hamlets our appraisals assume a deduction of 15% for existing floorspace.

Development and sales periods

4.28 Development and sales periods vary between type of scheme. However, our sales periods are based on an assumption of a sales rate of 8 units per month (which accounts for an element of off plan sales). This is reflective of current market conditions, whereas in improved markets, a sales rate of 10 to 12 units per month might be expected. We also note that many schemes in London have sold entirely off-plan, in some cases well in advance of completion of construction. Clearly markets are cyclical and sales periods will vary over the economic cycle and the extent to which units are sold off-plan will vary over time. Our programme assumptions assume that units are sold over varying periods after completion, which is a conservative approach that ensures that the proposed CIL rates are viable for most developments.

Developer's profit

4.29 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 house builders will set targets for minimum profit).

4.30 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.

4.31 The near collapse of the global banking system in the final quarter of 2008 has resulted 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 were for a time reluctant to allow profit levels to decrease. Perceived risk in the in the UK housing market had receded with a range of developer profit of between 17% to 20% being seen on developments across London, but the outcome of the referendum on the UK's membership of the European Union has resulted in a degree of uncertainty about the future trajectory of house prices. We have therefore adopted a profit margin of 20% for testing purposes (being at the higher end of the range previously experienced), although individual schemes may require lower or higher profits, depending on site specific circumstances.

4.32 Our assumed return on 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 RP prior to commencement. Any risk associated with take up of intermediate housing is borne by the acquiring RP, not by the developer. A reduced profit level on the affordable housing reflects the GLA 'Development Control Toolkit'

[10] Existing buildings must be occupied for their lawful use for at least six months out of the previous 36 months (three years) prior to grant of planning permission to qualify as existing floorspace for the purposes of calculating CIL liability.

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guidance (February 2014) and HCA's guidelines in its Development Appraisal Tool (August 2013). This issue was considered in detail by the Inspector of the Former Holsworthy Showground, Trewyn Road, Holsworth Appeal[11].

Exceptional costs

4.33 Exceptional costs can be an issue for development viability on previously developed land. Exceptional costs relate to works that are 'atypical', such as remediation of sites in former industrial use and that are over and above standard build costs. However, in the absence of detailed site investigations, it is not possible to provide a reliable estimate of what exceptional costs might be, further these costs will vary on a site by site basis. Our analysis therefore excludes exceptional costs, as to apply a blanket allowance would generate misleading results.

4.34 It is expected however, that when purchasing previously developed sites developers will have undertaken reasonable levels of due diligence and would therefore have reflected obvious remediation costs/suitable contingencies into their purchase price.

Benchmark land values

4.35 Benchmark land values, based on the existing 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 existing use value. Existing 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. Existing use value or alternative use value are effectively the 'bottom line' in a financial sense and therefore a key factor in this study.

4.36 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.

4.37 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.

[11] Appeal Ref: APP/W1145/Q/13/2204429

4.39 It is also necessary to recognise that a landowner will require an additional incentive to release the site for development[12]. 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 40% site coverage and 4 storeys. The rent assumed is based on lettings of second hand offices in the Borough at £25 per sq ft. We have assumed a £50 per sq ft allowance for refurbishment and a letting void of two years. The capital value of the building would be £55.254 million, to which we have added a 20% premium, resulting in a benchmark of £66.306 million.

4.41 **Benchmark Land Value 2**: This benchmark assumes medium value secondary office space on a hectare of land, with 40% site coverage and 4 storeys. The rent assumed is based on lettings of second hand offices in the Borough at £20 per sq ft. We have assumed a £50 per sq ft allowance for refurbishment and a letting void of two years. The capital value of the building would be £25.531 million, to which we have added a 20% premium, resulting in a benchmark of £38.11 million.

4.42 **Benchmark Land Value 3**: This benchmark assumes lower value secondary office space or community use on a hectare of land, with 50% site coverage and 2 storeys. The rent assumed is based on such lettings of second hand premises in the Borough at £15 per sq ft. We have assumed a £35 per sq ft allowance for refurbishment and a letting void of two years. The capital value of the building would be £16.379 million, to which we have added a 20% premium, resulting in a benchmark of £19.655 million.

4.43 **Benchmark Land Value 4**: 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 lettings of secondary industrial floorspace in the Borough at £8.50 per sq ft. We have assumed a £20 per sq ft allowance for refurbishment and a letting void of two years. The capital value of the building would be £8.768 million, to which we have added a 20% premium, resulting in a benchmark of £10.521 million.

Table 4.43.1: Summary of Benchmark Land Values

Use	Benchmark per gross hectare
Higher Value Secondary Offices	£66,305,933
Medium Value Secondary Offices	£45,731,626
Lower Value Secondary Offices / Community Use	£19,654,906
Secondary Industrial/Warehousing	£10,521,240

Commercial development

4.44 We have appraised a series of commercial development typologies, 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 site, based on three current commercial uses of the site, providing a range of current use values. In each case, the existing use value assumes that the existing building is 30%-50% of the size of the new development, with a lower rent and higher yield reflecting the secondary nature of the building.

[12] This approach is therefore consistent with the NPPG, which indicates at paragraph 013 that *"The premium for the landowner should reflect the minimum return at which it is considered a reasonable landowner would be willing to sell their land."* The Premium should provide a reasonable incentive.

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Commercial rents and yields

4.45 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. New build developments are on the whole likely to attract a premium rent above second hand rents, particularly in such areas of the borough where commercial development achieves higher rents i.e. City Fringe and Docklands areas. The rents and yields adopted in our appraisals are summarised in Table 4.46.1.

4.46 Our appraisals of commercial floorspace test the viability of developments on existing commercial sites. For these developments, we have assumed that the site could currently accommodate one of three existing uses (i.e. thereby allowing the site to be assessed in relation to a range of three current use values ('CUVs')) and the development involves the intensification of site. 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 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

4.47 We have sourced build costs for the commercial schemes from the 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.

4.48 It is noted that the Council's Policy D.ES7: A zero carbon borough" in the STHLP sets out the Council's aspiration to achieve at least BREEAM 'very good' with an aim to achieve 'Excellent' on all non-residential development. In this regard we have included an allowance of 1% of base build costs towards achieving BREEAM 'very good' in our commercial appraisals, which reflects the advice contained in the BREEAM and Sweett Group Research 'Delivering Sustainable Buildings: savings and payback' 2014.

Profit

4.49 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.

Residual Section 106 costs

4.50 The extent to which the Council will seek Section 106 contributions on commercial floorspace is unclear at this stage, but we have incorporated a notional £20 per square metre allowance. This figure is considered to be a reasonable proxy for likely sums to be sought after CIL is adopted. It is noted that Section 106 contributions will remain negotiable and in this regard there is scope for these to flex according to viability.

Mayoral CIL

4.51 We have allowed for Mayoral CIL based on the submission DCS MCIL2 rates as set out in Table 4.51.1 below.

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Table 4.51.1 MCIL2 PDCS rates

Use and location	MCIL 2 £ per sq m
Office (Docklands and City Fringe)	£185
Retail (Docklands and City Fringe)	£165
Hotel (Docklands and City Fringe)	£140
All other uses and the above developments outside of the Docklands and City Fringe area	£60

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Table 4.46.1: Commercial appraisal assumptions for each use

Appraisal input	Source/Commentary	Offices	Industrial and warehousing	Supermarkets and Retail warehousing	All other Retail (A1-5)	Hotels	Student Accommodation
Total floor area (sq ft)	Scheme	30,000	15,000	30,000	9,000	4* Hotel - 190 rooms (93,496 sq ft) 5* Hotel – 155 rooms (136,584 sq ft) Budget Hotel – 189 rooms (54,649 sq ft)	500 rooms (142,500 based on 285 sq ft per room)
Rent (£s per sq ft)	Based on average lettings sourced from Costar and property market reports from property companies including BNP Paribas Real Estate, Colliers, Savills, Knight Frank, Cushman and Wakefield, Glenny's etc.	City Fringe - £65 North Docklands and Canary Wharf ("CW") - £45 South Docklands - £35 Rest of Borough - £20	£12.75	£24	Prime (North Docklands CW & City Fringe) - £50 Rest of Borough - £30	4* Hotel - £313,158 cap val per room 5* Hotel – £1,161,290 cap val per room Budget Hotel – £185,185 cap val per room	£224 per week for private let room £155 per week for affordable room
Rent free/void period (years)	BNPPRE assumption	2	2	0.6	1.5	n/a	95% occupancy of rooms
Yield	Knight Frank yield schedule and property company reports as above.	City Fringe - 4.75% North Docklands and Canary Wharf ("CW") – 4.75% South Docklands – 5.5% Rest of Borough - 6.5%	4.75%	4.75%	Prime (North Docklands CW & City Fringe) - 4.5% Rest of Borough - 6%	4.75% - 5%	4.5%
Purchaser's costs (% of GDV)	Stamp duty 5%, plus agent's and legal fees	6.80%	6.80%	6.80%	6.80%	6.80%	6.80%
Demolition costs (£s per sq ft of existing space)	Based on experience from individual schemes	£8	£8	£8	£8	£8	£8
Gross to net (net as % of gross)	Based on experience from individual schemes	82%	90%	82%	82%	N/A as rent based on per room and room size based on gross area per room.	N/A as rent based on per room and room size based on gross area per room.
Base construction costs (£s per sq ft)	BCIS costs	City Fringe - £219 North Docklands and Canary Wharf ("CW") – £219 South Docklands - £208 Rest of Borough - £191	£90	£155	Prime (North Docklands CW & City Fringe) - £242 Rest of Borough - £190	£176 - £224	£196
BREEAM Very Good (% of base build costs)	BREEAM and Sweett Group Research 'Delivering Sustainable Buildings: savings and payback' 2014	1%	1%	1%	1%	1%	1%
External works (% of base build costs)	BNPPRE assumption	10%	10%	10%	10%	10%	10%
Contingency (% of build costs)	BNPPRE assumption	5%	5%	5%	5%	5%	5%
Letting agent's fee	(% of first year's rent)	10%	10%	10%	10%	10%	N/A
Agent's fees and legal fees	(% of capital value)	1.75%	1.75%	1.75%	1.75%	1.75%	1.5%
Interest rate	BNPPRE assumption	7%	7%	7%	7%	7%	7%
Professional fees (% of build)	BNPPRE assumption, relates to complexity of scheme	10%	10%	10%	10%	10%	10%
Profit (% of costs)	BNPPRE assumption based on schemes submitted for planning	20%	20%	20%	20%	20%	20%

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Table 4.46.2 Commercial appraisal assumptions for each use – current use benchmarks

Appraisal input	Source/Commentary	Offices	Industrial and warehouses	Supermarkets and Retail warehousing	All other Retail (A1-5)	Hotels	Student Accommodation
Existing floorspace	Assumed to be between 30% to 50% of new space (N.B. appraisals do not discount existing floorspace)	50%	50%	50%	50%	50%	50%
Rent on existing floorspace (£s per sq ft)	Reflects three types of poor quality second hand space (industrial, office and retail as appropriate), low optimisation of site etc. and ripe for redevelopment.	City Fringe - £35 -£55 North Docklands and Canary Wharf ("CW") – £20 - £30 South Docklands - £15 - £25 Rest of Borough - £9 - £15	£7 - £9	£13 - £20	Prime (North Docklands CW & City Fringe) - £30 - £40 Rest of Borough - £9 - £15	Docklands 7& City Fringe - £25 - £45 Docklands and Rest of Borough - £15 - £25	£20
Yield on existing floorspace	BNPPRE assumption, reflecting lower covenant strength of potential tenants, poor quality building etc.	City Fringe - 5.5% - 5% North Docklands and Canary Wharf ("CW") – 6.25% - 5.75% South Docklands - £7% - 6% Rest of Borough – 7.5% - 7%	7%	7% - 6.5%	Prime (North Docklands CW & City Fringe) - 5.75% – 5.25% Rest of Borough - 7%	Docklands 7& City Fringe – 6% - 5.25% Docklands and Rest of Borough – 7% - 6%	6.25%
Rent free on existing space	Years	2	2	2	2	2	2
Refurbishment costs (£s per sq ft)	General allowance for bringing existing space up to lettable standard	£50	£30	£35	£50	£50	£50
Fees on refurbishment (% of refurb cost)	BNPPRE assumption	7%	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%	20%

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5 Appraisal outputs

Residential appraisals

5.1 The full outputs from our appraisals of residential development are attached as **Appendix 1 to 5**. We have modelled nine site types, reflecting different densities and types of development, which are tested in the nine broad housing market areas identified in Section 4 and against the typical land value benchmarks for the borough.

Scenarios tested

5.2 The purpose of the exercise is to test whether the rate of CIL can be varied from the current rates in the adopted Charging Schedule. We have therefore tested the eight development typologies with 50% to 10% affordable housing to reflect the range of affordable housing required by the Council's policies. We set out below the scenarios tested:

1. Policy position with base sales values and base costs (including extra overs for planning policy requirements);

- 35% affordable housing:
  - Current costs and values:
    - AH split 35% SR, 35% THLR, 15% LLR and 15% SO;
    - AH split 35% SR, 35% THLR, 30% SO; and
    - AH split 35% SR, 35% THLR, 30% LLR.

2. As (1) above with 50%, 40%, 30%, 20%, 10% and 0% affordable housing;

3. As (1) above with 10% increase in sales values and 5% increase in build costs; and

4. As (1) above with 5% fall in sales values.

5.3 CIL applies to net additional floor area only. Our base appraisals assume no deduction for existing floorspace, thereby providing the worst case scenario[13].

5.4 The residual land values from each of the scenarios above in each housing market area are then compared to the benchmark land value based on the assumptions set out in paragraphs 4.40 to 4.43. The outcome of this analysis is compared to This comparison enables us to determine whether the imposition of higher rates of CIL than those in the adopted Charging Schedule (with indexation) would have a demonstrably more significant impact on development viability in comparison to the adopted rates. In some cases, the equation RLV less BLV results in a negative number, so the development would not proceed, whether the adopted level of CIL was imposed or not. Given that the rates would apply to such scenarios currently, as the CIL is in force, the question we need to explore is the extent to which a higher rate of CIL would significantly change the result, such that the scheme would almost certainly not come forward.

5.5 The results for each site type are presented in tables showing the CIL rate and the corresponding RLV (which is then converted into a RLV per hectare). The RLV per hectare is then compared to the four benchmark land values, which are also expressed as a per hectare value. Where the RLV exceeds the benchmark, the amount of CIL entered into the appraisal is considered viable.

[13] Existing buildings must be occupied for their lawful use for at least six months in the three years prior to grant of planning permission to qualify as existing floorspace for the purposes of calculating CIL liability.

5.6 A sample of the format of the results is provided in Figure 5.6.1 below. This sample relates to site type 5.

Figure 5.6.1: Sample format of residential results

Community Infrastructure Levy
LB Tower Hamlets

Benchmark Land Values (per gross ha)

BLV1	BLV2	BLV3	BLV4
Benchmark land value 1 - Higher value secondary offices	Benchmark land value 2- Medium value secondary offices	Benchmark land value 3 - Lower value secondary office or community use	Benchmark land value 4 - Lower value secondary industrial
£66,305,933	£45,731,626	£19,654,906	£10,521,240

Site type 5	
	Houses & Flats
No of units	25 units
Density:	375 dph

Affordable %	35%
% Social Rent	35%
% LBTH Living Rent	35%
% Lon Living Rent	15%
% Shered Ownership	15%

Site area	0.07 ha
Net to gross	100%

Growth

Sales	0%
Build	0%

CIL Z1 Med (£995 psf)

Private values	£10710 psm

CIL amount per sq m	**RLV**	**RLV per ha**	**RLV less BLV 1**	**RLV less BLV 2**	**RLV less BLV 3**	**RLV less BLV 4**
0	2,978,583	44,678,747	-21,627,186	-1,052,879	25,023,841	34,157,508
80	2,837,065	42,555,980	-23,749,954	-3,175,647	22,901,074	32,034,740
100	2,814,493	42,217,398	-24,088,536	-3,514,229	22,562,492	31,696,158
125	2,786,277	41,794,160	-24,511,774	-3,937,467	22,139,254	31,272,920
150	2,758,062	41,370,936	-24,934,997	-4,360,690	21,716,031	30,849,697
175	2,729,848	40,947,713	-25,358,220	-4,783,913	21,292,807	30,426,474
200	2,701,632	40,524,475	-25,781,459	-5,207,152	20,869,569	30,003,235
225	2,673,417	40,101,252	-26,204,682	-5,630,375	20,446,346	29,580,012
250	2,645,201	39,678,013	-26,627,920	-6,053,613	20,023,108	29,156,774
275	2,616,986	39,254,790	-27,051,143	-6,476,836	19,599,884	28,733,550
300	2,588,771	38,831,567	-27,474,367	-6,900,060	19,176,661	28,310,327
325	2,560,555	38,408,329	-27,897,605	-7,323,298	18,753,423	27,887,089
350	2,532,340	37,985,105	-28,320,828	-7,746,521	18,330,199	27,463,866
375	2,504,125	37,561,882	-28,744,051	-8,169,744	17,906,976	27,040,642
400	2,475,910	37,138,644	-29,167,290	-8,592,983	17,483,738	26,617,404
450	2,419,479	36,292,182	-30,013,751	-9,439,444	16,637,276	25,770,943

Maximum CIL rates (per square metre)

BLV1	**BLV2**	**BLV3**	**BLV4**
#N/A	#N/A	£450	£450

Commercial appraisals

5.7 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 type of development tested, we have run appraisals of a quantum of floorspace, each with rent levels reflecting the range identified by our research.

5.8 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 5.8.1). The maximum CIL rates are then shown per square metre, against three different current use values (see Table 4.46.1). Chart 5.8.2 provides an **illustration** of the outputs in numerical format, while Chart 5.8.3 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. 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.

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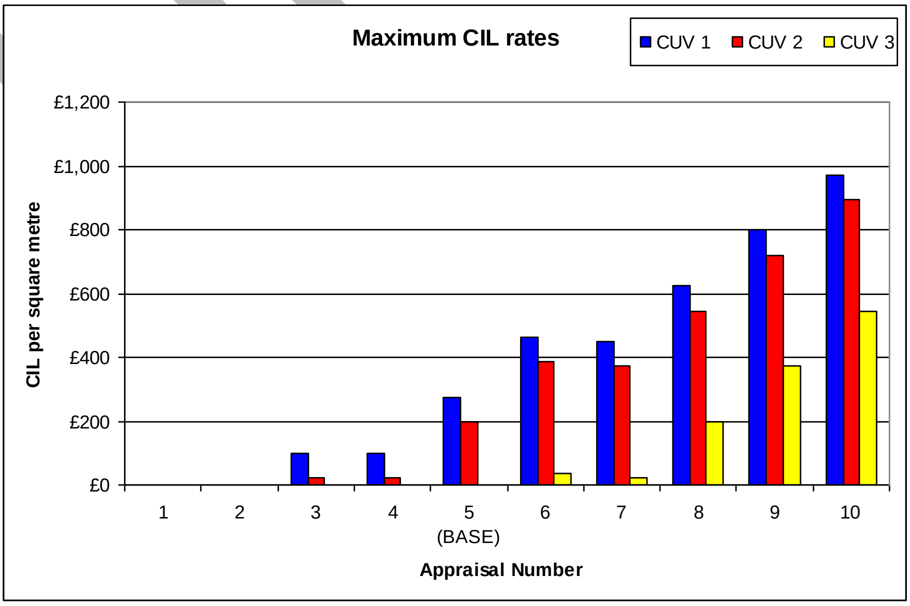
Chart 5.8.1: Illustration of sensitivity analyses

	£s per sq ft	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
Appraisal 5 (base)	**£24.00**	**6.50%**	**2.00 years**
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 5.8.2: 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
Appraisal 5 (base)	**-**	**£275**	**£197**	**£0**
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 5.8.3: Maximum CIL rates – graph format



6 Assessment of the results

6.1 This section sets out the results of our appraisals with the residual land values 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 for each site.

6.2 Development value is finite and – in densely developed Boroughs such as Tower Hamlets - is rarely enhanced through the adoption of new policy requirements. This is because existing use values are sometimes relatively high prior to development. In contrast, areas which have previously undeveloped land clearly have greater scope to secure an uplift in land value through the planning process.

6.3 In assessing the results, it is important to clearly distinguish between two scenarios; namely, schemes that are unviable *regardless of the Council's policy requirements, including the level of CIL* (including a nil rate) and schemes that are viable *prior* to the imposition of policy requirements. If a scheme is unviable before policy requirements and CIL are levied, it is unlikely to come forward and policy requirements and CIL would not be a factor that comes into play in the developer's/landowner's decision making. The unviable schemes will only become viable following an increase in values and sites would remain in their existing use.

6.4 The CIL regulations state that in setting a charge, local authorities must "strike 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.

6.5 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.

6.6 This conclusion follows guidance in paragraph: 019 of the CIL Guidance set out in the NPPG, which states that *'there is no requirement for a proposed rate to exactly mirror the evidence… There is room for some pragmatism.'* The Council 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. Further, Paragraph: 021 of the NPPG identifies that, *'Charging authorities that plan to set differential levy rates should seek to avoid undue complexity.'*

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Assessment – residential development

6.7 CIL operates as a fixed charge and - as was previously the case with the adopted rates - 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, although experience to date indicates that this is a very rare occurrence. 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.

6.8 As previously stated, 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 critical factor. 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[14].

Determining maximum viable rates of CIL for residential development

6.9 As noted in paragraph 6.8, 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 MCIL2 (£60 per sq m).**

6.10 We set out below the results of our appraisals identifying the maximum CIL rates against each of the four benchmark land values for the nine typologies we have tested all of which include affordable housing at 35% provided as 70% rented (split 35% Social Rent and 35% THLR) and 30% intermediate (split 15% LLR and 15% SO).

Table 6.10.1: Site type 1 (3 houses)

Site type	T1 - 3 Houses			
	BLV1	BLV2	BLV3	BLV4
CIL Z1 High (£1,350 psf)	N/V[15]	450	450	450
CIL Z1 Med (£995 psf)	N/V	N/V	450	450
CIL Z1 Low (£775 psf)	N/V	N/V	250	450
CIL Z2 High (£1,000 psf)	N/V	N/V	450	450
CIL Z2 Med (£785 psf)	N/V	N/V	350	450
CIL Z2 Low (£675 psf)	N/V	N/V	N/V	450
CIL Z3 High (£800 psf)	N/V	N/V	450	450
CIL Z3 Med (£675 psf)	N/V	N/V	N/V	450
CIL Z3 Low (£575 psf)	N/V	N/V	N/V	200

[14] However, as shown by the sensitivity analyses (which reduce affordable housing to 30%, 20%, 10% and 0%) 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.

[15] N/V = not viable

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Table 6.10.2: Site type 2 (6 flats)

Site type	T2 - 6 Flats			
	BLV1	BLV2	BLV3	BLV4
CIL Z1 High (£1,350 psf)	450	450	450	450
CIL Z1 Med (£995 psf)	N/V	450	450	450
CIL Z1 Low (£775 psf)	N/V	N/V	450	450
CIL Z2 High (£1,000 psf)	N/V	450	450	450
CIL Z2 Med (£785 psf)	N/V	N/V	450	450
CIL Z2 Low (£675 psf)	N/V	N/V	400	450
CIL Z3 High (£800 psf)	N/V	N/V	450	450
CIL Z3 Med (£675 psf)	N/V	N/V	400	450
CIL Z3 Low (£575 psf)	N/V	N/V	N/V	275

Table 6.10.3: Site type 3 (10 flats)

Site type	T3 - 10 Flats			
	BLV1	BLV2	BLV3	BLV4
CIL Z1 High (£1,350 psf)	175	450	450	450
CIL Z1 Med (£995 psf)	N/V	N/V	450	450
CIL Z1 Low (£775 psf)	N/V	N/V	450	450
CIL Z2 High (£1,000 psf)	N/V	N/V	450	450
CIL Z2 Med (£785 psf)	N/V	N/V	450	450
CIL Z2 Low (£675 psf)	N/V	N/V	N/V	450
CIL Z3 High (£800 psf)	N/V	N/V	450	450
CIL Z3 Med (£675 psf)	N/V	N/V	N/V	450
CIL Z3 Low (£575 psf)	N/V	N/V	N/V	N/V

Table 6.10.4: Site type 4 (11 flats)

Site type	T4 - 11 Flats			
	BLV1	BLV2	BLV3	BLV4
CIL Z1 High (£1,350 psf)	175	450	450	450
CIL Z1 Med (£995 psf)	N/V	N/V	450	450
CIL Z1 Low (£775 psf)	N/V	N/V	450	450
CIL Z2 High (£1,000 psf)	N/V	N/V	450	450
CIL Z2 Med (£785 psf)	N/V	N/V	450	450
CIL Z2 Low (£675 psf)	N/V	N/V	N/V	450
CIL Z3 High (£800 psf)	N/V	N/V	450	450
CIL Z3 Med (£675 psf)	N/V	N/V	N/V	450
CIL Z3 Low (£575 psf)	N/V	N/V	N/V	N/V

Table 6.10.5: Site type 5 (25 houses and flats)

Site type	T5 - 25 Houses and Flats			
	BLV1	BLV2	BLV3	BLV4
CIL Z1 High (£1,350 psf)	450	450	450	450
CIL Z1 Med (£995 psf)	N/V	N/V	450	450
CIL Z1 Low (£775 psf)	N/V	N/V	N/V	400
CIL Z2 High (£1,000 psf)	N/V	N/V	450	450
CIL Z2 Med (£785 psf)	N/V	N/V	N/V	450
CIL Z2 Low (£675 psf)	N/V	N/V	N/V	N/V
CIL Z3 High (£800 psf)	N/V	N/V	0	450
CIL Z3 Med (£675 psf)	N/V	N/V	N/V	N/V
CIL Z3 Low (£575 psf)	N/V	N/V	N/V	N/V

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Table 6.10.6: Site type 6 (50 flats)

Site type	T6 - 50 Flats			
	BLV1	BLV2	BLV3	BLV4
CIL Z1 High (£1,350 psf)	450	450	450	450
CIL Z1 Med (£995 psf)	N/V	N/V	450	450
CIL Z1 Low (£775 psf)	N/V	N/V	N/V	N/V
CIL Z2 High (£1,000 psf)	N/V	N/V	450	450
CIL Z2 Med (£785 psf)	N/V	N/V	N/V	N/V
CIL Z2 Low (£675 psf)	N/V	N/V	N/V	N/V
CIL Z3 High (£800 psf)	N/V	N/V	N/V	0
CIL Z3 Med (£675 psf)	N/V	N/V	N/V	N/V
CIL Z3 Low (£575 psf)	N/V	N/V	N/V	N/V

Table 6.10.7: Site type 7 (125 flats)

Site type	T7 - 100 Flats			
	BLV1	BLV2	BLV3	BLV4
CIL Z1 High (£1,350 psf)	N/V	N/V	450	450
CIL Z1 Med (£995 psf)	N/V	N/V	N/V	450
CIL Z1 Low (£775 psf)	N/V	N/V	N/V	N/V
CIL Z2 High (£1,000 psf)	N/V	N/V	N/V	450
CIL Z2 Med (£785 psf)	N/V	N/V	N/V	N/V
CIL Z2 Low (£675 psf)	N/V	N/V	N/V	N/V
CIL Z3 High (£800 psf)	N/V	N/V	N/V	N/V
CIL Z3 Med (£675 psf)	N/V	N/V	N/V	N/V
CIL Z3 Low (£575 psf)	N/V	N/V	N/V	N/V

Table 6.10.8: Site type 8 (250 flats)

Site type	T8 - 250 Flats			
	BLV1	BLV2	BLV3	BLV4
CIL Z1 High (£1,350 psf)	N/V	275	450	450
CIL Z1 Med (£995 psf)	N/V	N/V	150	450
CIL Z1 Low (£775 psf)	N/V	N/V	N/V	N/V
CIL Z2 High (£1,000 psf)	N/V	N/V	200	450
CIL Z2 Med (£785 psf)	N/V	N/V	N/V	N/V
CIL Z2 Low (£675 psf)	N/V	N/V	N/V	N/V
CIL Z3 High (£800 psf)	N/V	N/V	N/V	N/V
CIL Z3 Med (£675 psf)	N/V	N/V	N/V	N/V
CIL Z3 Low (£575 psf)	N/V	N/V	N/V	N/V

Table 6.10.9: Site type 9 (400 flats)

Site type	T9 - 400 Flats			
	BLV1	BLV2	BLV3	BLV4
CIL Z1 High (£1,350 psf)	N/V	350	450	450
CIL Z1 Med (£995 psf)	N/V	N/V	N/V	N/V
CIL Z1 Low (£775 psf)	N/V	N/V	N/V	N/V
CIL Z2 High (£1,000 psf)	N/V	N/V	N/V	N/V
CIL Z2 Med (£785 psf)	N/V	N/V	N/V	N/V
CIL Z2 Low (£675 psf)	N/V	N/V	N/V	N/V
CIL Z3 High (£800 psf)	N/V	N/V	N/V	N/V
CIL Z3 Med (£675 psf)	N/V	N/V	N/V	N/V
CIL Z3 Low (£575 psf)	N/V	N/V	N/V	N/V

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Sensitivity analysis: growth in sales values and increases in build costs

6.11 We have re-run our appraisals to test the impact that growth in sales values alongside inflation on costs might have on scheme viability and the consequential impacts on how increased levels of CIL might be absorbed by developments.

6.12 We have run two sensitivity analyses, the first assuming 10% growth in sales values alongside cost inflation of 5%, while the second assumes 20% growth in sales values alongside cost inflation of 10%. This represents medium term (5 year) growth and inflation but is not a prediction.

6.13 See appendices 4 and 5 for the results of these sensitivity analyses. In some cases, there is no change, but in others the maximum CIL rate would increase as values increase. However, we would caution against attaching significant weight to these results as the future trajectory of house prices is inherently uncertain.

Sensitivity analysis on affordable housing percentage

6.14 All the results above reflect the Council's 35% affordable housing target, which is applied to individual schemes having regard to viability. In order to test the relationship between different affordable housing percentages and levels of CIL, we have run a series of sensitivity analyses which test the affordable housing percentage from 50% to 0%. The results at **Appendix 1** test 50%, 40%, 35%, 30%, 25%, 20%, 10% and 0%.

6.15 Given that affordable housing has a much more significant bearing on viability than CIL (with the latter having a much smaller impact on residual land value than the latter), the maximum CIL rate increases when lower affordable housing percentages are applied.

Suggested CIL rates

6.16 Although the results indicate that viability of residential development is currently challenging in certain locations and on certain types of development at full affordable housing policy levels, it is possible for the Council to continue to levy rates across all areas and increase the rates in the borough subject to allowing for a buffer or margin to address risks to delivery.

6.17 As previously identified we reiterate that it is important to consider that where a scheme is shown as unviable before the application of CIL, it will be other factors such as sales values and build costs that will need to adjust for the scheme to become viable.

6.18 We set out below a summary of the maximum residential CIL charges as indicated by the results of our appraisals in **Appendix 1**. We have then analysed the maximum borough CIL i.e. by deducting MCIL2 from the maximum CIL. From this we have then derived the potential CIL charges allowing for a 25% buffer from the maximum borough CIL, which we consider to be a reasonable margin to deal with the risks associated with site specific development and changes to the market.

Table 6.18.1 Table showing maximum CIL charges indicated by appraisals

Area	Max CIL indicated by appraisals[16] (£s per sq m)	Max Borough CIL indicated by appraisals (£s per sq m)	Potential Borough CIL after buffer (£s per sq m)	Existing Borough CIL charge Borough (£s per sq m) (*indexed charge*)
CIL Z1	£450	£390	£280	£200 *(£211.58)*
CIL Z2	£250	£190	£150	*£65 (£68.76)*
CIL Z3	£125	£65	£50	£35 (£37.03)

[16] Covering both Borough and Mayoral CIL requirements.

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Assessment - Commercial development

6.19 As there are existing CIL charges in place for certain types of commercial development in certain locations of the Borough, our testing considers whether there have been significant changes in viability that would give rise to an enhanced capacity for commercial development to absorb a higher CIL rate than currently levied. We have allowed for the MCIL2 rates in our commercial appraisals and therefore the **maximum rates stated below are net of the MCIL2 liability**.

Offices

6.20 The current charging schedule has a CIL charge of £90 per sq m (£95.21 per sq m indexed) on office development in the city fringe area and a nil rate elsewhere. We have undertaken research which has identified that rents have increased and yields moved in since the last charging schedule was examined in the City Fringe and North Docklands areas.

6.21 The results of our appraisals identify that:

- the City Fringe area could accommodate a significant increase with a maximum borough CIL rate of between £0 and £1,929 per sq m dependant on the current use of the site, however this is identified as being sensitive to changes in inputs, for example a shift in yield out by 0.25% would reduce the maximum CIL by circa £500 per sq m;
- the North Docklands area could accommodate a borough CIL charge of between £0 and £1,292 per sq m dependant on the current use of the site. However, as with the City Fringe results the maximum CIL rate is identified as being sensitive to changes in rents and yield e.g. the Maximum CIL rate drops by circa £350 per sq m where the yield increases by 0.25%; and
- in the South Docklands and Elsewhere it remains unchanged that no CIL charge can be levied.

6.22 Our appraisals of the office space in the City Fringe and North Docklands areas include al allowance for 10% of the floorspace to be delivered as affordable workspace as required by the Council's emerging Local Plan. We have applied a rent at 50% of the market rent and a higher yield of 6%.

6.23 We set out below analysis of the potential borough CIL charge, allowing for indexed Mayoral CIL and Crossrail S106 and a reasonable buffer taking into consideration the aforementioned sensitivity of the results.

Table 6.23.1 Table showing maximum and recommended CIL charges indicated by appraisals

Area	Maximum CIL indicated by appraisals[17] (£s per sq m)	BNPPRE Suggested Borough CIL (£s per sq m)	Existing Borough CIL charge Borough (£s per sq m) (*indexed charge)*
City Fringe	Nil - £1,929	£100	£90 *(£95.21)*
North Docklands	Nil - £890	£100	Nil *(Nil)*
South Docklands and Elsewhere	Nil	Nil	Nil *(Nil)*

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[17] Covering both Borough and Mayoral CIL requirements.

Industrial and warehousing

6.24 The current Charging Schedule has a nil rate on industrial development across the borough as a whole. Rents have increased and yields compressed since the previous CIL Viability Study, but cost increases have offset increased value to an extent.

6.25 Our appraisals of industrial and warehousing development are attached as **Appendix 6**. The schemes do not generate residual land values that exceed the existing use values. On this basis we recommend that the Council considers maintaining a nil rate on such uses.

Supermarkets and retail warehouse

6.26 The current Charging Schedule applies a rate of £120 per sq m (£126.95 per sq m indexed) on supermarket and retail warehouse development across the borough as a whole.

6.27 The results of our appraisals suggest that maximum CIL charge of between £0 per sq m and £401 per sq m can be levied. Adopting benchmark land value 2 indicates a maximum borough CIL charge of £203 per sq m. We would suggest the Council considers a Borough CIL charge of £130 per sq m which would allow for an appropriate buffer form the maximum CIL charge.

All other retail

6.28 The current charging schedule applies a CIL charge of £70 per sq m (£74.05 per sq m indexed) on retail development (except supermarkets and retail warehousing) in the city fringe and North Docklands area and a nil rate elsewhere.

6.29 The results of our appraisals have identified that:

- Prime retail in the City Fringe and North Docklands areas could accommodate a maximum CIL rate of between £0 per sq m and £892 per sq m; and
- Elsewhere it remains unchanged that no CIL charge can be levied.

6.30 Considering the maximum CIL rate indicated when measured against benchmark land value 2 of £230 per sq m we therefore suggest the Council considers a borough CIL charge of £100 per sq m in the City Fringe and North Docklands areas, which allows for a suitable buffer from the maximum CIL charge. Elsewhere in the Borough we recommend the Council maintains the existing nil CIL charge on such uses.

Hotel

6.31 The current Charging Schedule applies a rate of £180 per sq m (£190 per sq m indexed) on hotel development across the borough as a whole.

6.32 The results of our appraisals suggest a maximum CIL charge of between £0 per square metre and £2,577 dependant on the scheme and benchmark land value. We note that the maximum CIL rates vary significantly and given the results we suggest that the Council considers maintaining the CIL charge at £190 per sq m.

Student housing

6.33 The current Charging Schedule applies a rate of £425 per sq m (£449.62 per sq m indexed) on student accommodation development at market rents across the borough as a whole.

6.34 The results of our appraisals identify that with no affordable student accommodation (at the London Housing Supplementary Planning Guidance 2016 rental level) the maximum borough CIL charge (i.e. having already deducted MCIL 2) of £920 per sq m. Our appraisal allowing for 35% affordable student accommodation identifies a maximum borough CIL charge of £300 per sq m. Reducing the affordable student accommodation to 30% and 25%

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identifies maximum borough CIL charges of £426 per sq m and £535 per sq m respectively. Given this position we suggest the Council maintains the existing indexed student accommodation CIL charge.

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7 Strategic sites

7.1 We have run high level appraisals of 14 strategic sites selected by the Council to test the viability of key sites in the Borough which will be instrumental in the delivery of the STHLP's growth strategy.

7.2 The sites considered and their key features are summarised in Table 7.2.1 below.

Table 7.2.1 Details of strategic sites assessed

Site No.	Site name	Existing use	Gross Site size (ha)	Infrastructure requirement	Current ownership
1	Bishopsgate Goods Yard	Shoreditch High Street Overground Station; "Box Park" Football Pitches Vacant Land	4.24	1. Strategic Open space 2. Local Presence Facility 3. Leisure Uses – Football Pitches	Private
2	Bow Common Gas Works	Gas Works	3.94	1. Secondary School 2. Strategic Open Space	Private
3	Billingsgate Market	Wholesale Market	5.74	1. Secondary School 2. Open Space	Private
4	North Quay	Vacant land	3.48	1. Open space	Private
5	Vacant land adjacent to new Reuters Ltd server building	Vacant land	2.71	1. Primary School 2. Open space	Private
6	Limeharbour - Skylines Site	Industrial and office space	1.56	Primary School	Private
7	Marsh Wall East - Thames Key site	Offices	1.6	Primary School	Private
8	Marsh Wall West - Marsh Wall, Alpha Square	Medical centre Pub Business uses	0.4	1. Primary School 2. Health facility	Private
9	Millharbour - Mastmaker Road/ Lightermans Road Site	Education and Training Centre	0.97	Health Centre	Private
10	Crossharbour Town Centre	Supermarket, car parking	6.06	1. Local Presence Facility 2. Health Facility 3. Primary School	Private
11	Leven Road Gas Works	Active gas holders	8.56	1. Secondary School 2. Open Space	Private
12	Whitechapel South - Site bound by raven row	Warehouse Facility used for sports	1.39	None	Private
13	Millharbour South - 5, 6, 7, 8 Greenwich View Place	Secondary Offices	0.95	1. Primary School	Private
14	Marian Place Gas Works	Gas works	1.9	1. Strategic Open Space	Private

Methodology

7.3 We have used *Argus Developer* ("Argus") to undertake the high level appraisals of developments on the 14 strategic sites. Argus is a commercially available development appraisal package in widespread use throughout the development industry. It has been accepted by a number of local planning authorities for the purpose of viability assessments and has also been accepted at planning appeals. Banks also consider Argus to be a reliable tool for secured lending valuations. Further details can be accessed at www.argussoftware.com

7.4 Argus is essentially a cash-flow model. Such models all work on a similar basis:

- Firstly, the value of the completed development is assessed.
- Secondly, the development costs are calculated, including either the profit margin required or land costs. In our appraisals we include profit as a development cost.

7.5 The difference between the total development value and total costs equates to the residual land value ("RLV"). The model is normally set up to run over a development period from the date of the commencement of the project until the project completion, when the development has been constructed and is occupied.

7.6 The cash-flow approach allows the finance charges to be accurately calculated over the development period. This approach can accommodate more complex arrangements where a number of different uses are provided or development is phased.

7.7 In order to assess whether a development scheme can be regarded as being economically viable, with a given level of planning obligations, it is necessary to compare the RLV that is produced with a benchmark land value. If a development generates a RLV that is higher than the benchmark it can be regarded as being economically viable and therefore capable of providing a greater quantum of obligations. However, if a development generates a RLV that is lower than the benchmark, it should be deemed economically unviable and the quantum of planning obligations would need to be reduced until viability is achieved.

7.8 The approach taken to appraising the larger sites (Bishopsgate Goods Yard, Billingsgate Market, Crossharbour Town Centre and Leven Road Gas Works) is based on the assessment of an un-geared and ungrown IRR assuming a fixed land cost (the identified benchmark land value). For long term projects of this nature it would not be unreasonable for a developer / landowner to measure profitability on this basis.

Inputs

7.9 Further details of the schemes tested and the inputs adopted in the appraisals for the 14 sites are set out clearly in **Appendix 7**. The Council have also commissioned WTP to provide advice on the base build costs, policy extra over costs and likely abnormal costs associated with the redevelopment of the 14 strategic sites. This is set out at **Appendix 1**.

Viability Benchmarks

7.10 We have undertaken an assessment of the existing use values ("EUVs") of each of the sites, using either pro-rata values from the benchmark land values identified in section 4 or an assessment of the existing floorspace and uses on the site (See appendix 7). In order to encourage the landowners to bring the sites forward for development we have added a premium of 20% to the value. The benchmark land values that result from this assessment are shown in Table 7.10.1 below.

Table 7.10.1: Viability benchmarks

Site No.	Site	Existing Use Value (£ millions)
1	Bishopsgate Goods Yard	£30.333
2	Bow Common Gas Works	£28.186
3	Billingsgate Market	£41.064
4	North Quay	£24.896
5	Vacant land adjacent to new Reuters Ltd server building	£19.387
6	Limeharbour - Skylines Site	£42.265
7	Marsh Wall East - Thames Key site	£59.900
8	Marsh Wall West - Marsh Wall, Alpha Square	£7.681
9	Millharbour - Mastmaker Road/ Lightermans Road Site	£10.532
10	Crossharbour Town Centre	£56.167
11	Leven Road Gas Works	£30.619
12	Whitechapel South - Site bound by raven row	£32.990
13	Millharbour South - 5, 6, 7, 8 Greenwich View Place	£43.778
14	Marian Place Gas Works	£13.592

Appraisal results allowing for proposed Borough CIL and MCIL2 rates

7.11 Table 7.11.1 below shows the residual land value for each site taking into account the proposed Borough CIL and MCIL2 rates against the viability benchmark, whilst Table 7.11.2 identifies the ungrown IRR for the four large sites tested.

Table 7.11.1: Appraisal results of smaller sites with 35% affordable housing, proposed Borough CIL and MCIL2 rates

Site No.	Site/scenario	Residual Land Value (£ millions)	Viability Benchmark (£ millions)	Surplus / deficit against benchmark (£ millions)
2	Bow Common Gas Works	-£17.522	£28.186	-£45.71
5	Vacant land adjacent to new Reuters Ltd	£10.808	£19.387	-£8.58
6	Limeharbour – Skylines Site	£18.690	£42.265	-£23.58
7	Marsh Wall East – Thames Key Site	£50.600	£59.900	-£9.30
8	Marsh Wall West – Marsh Wall, Alpha Square	£15.293	£7.681	£7.61
9	Millharbour – Mastmaker Road	£36.930	£10.532	£26.40
12	Whitechapel South – Site bound by Raven Row	£18.757	£32.990	-£14.23
13	Millharbour South – 5,6,7,8 Greenwich View Place	-£6.599	£43.778	-£50.38
14	Marian Place Gas Works	-£44.830	£13.592	-£58.42

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Table 7.11.2: Appraisal results of large sites with 35% affordable housing, proposed Borough CIL and MCIL2 rates measured using IRR

Site No.	Site/scenario	Fixed Land cost (£ millions)	Ungrown and ungeared IRR achieved
1	Bishopsgate Goods Yard	£23.472	21.79%
3	Billingsgate Market	£31.775	22.54%
4a	North Quay (as previous)	£24.896	21.75%
4b	North Quay (25% Residential)	£24.896	22.62%
10	Crossharbour Town Centre	£56.167	13.25%
11	Leven Road Gas Works	£30.619	4.28%

Assessment and Suggested CIL rates

7.12 We have undertaken an assessment of each of the strategic sites identified by the Council, applying the applying the CIL liability that the sites would incur, based on the suggested CIL charges as set out in section 6 of this report. We have also allowed for MCIL2. See **Appendix 7 and 8** for a copy for the results and appraisals of the testing and sensitivity testing undertaken.

7.13 With respect to the larger sites we appreciate that developers often suggest that they are targeting an IRR of 20%, however, it has been our experience on large schemes in London that this is often based on grown IRRs given the long term nature of such schemes. Further, we are aware of developers having agreed to proceed with developments identified as generating IRRs of 13% (ungrown). On this basis we are of the opinion that the large majority of the sites tested can viably deliver the suggested CIL rates along with the emerging STHLP policy requirements.

7.14 With respect to the sites identified as being unviable we highlight that the majority although unviable at 35% affordable housing are deliverable where the Council's affordable housing policy is applied flexibly. Site 7 Marsh Wall East - Thames Key is identified as being deliverable with between 25% and 30% affordable housing. For sites 5 Vacant land adjacent to new Reuters Ltd, 6 Limeharbour - Skylines and 12 Whitechapel South – Site bound by Raven Row and 14 Marian Place Gas Works, the results of our sensitivity testing has identified that they are deliverable with between 20% and 25% affordable housing.

7.15 Three of the sites identified as having challenging viability are gas works site (2 Bow Common Gas Works, 11 Leven Road Gas Works and 14. Marianne Place Gas Works). These sites are identified as having challenging viability regardless of CIL i.e. it is not CIL that is impacting on the viability of these sites. Given the nature of the existing use on the sites these sites incur significant abnormal costs. On the advice of WTP we have included an allowance of £260 pa square metre of gross site area for site remediation works based on their experience of the costs associated with decontamination of similar gasworks sites in London. We have also included allowances of £100 per square metre of gross site area for demolition costs, removal costs of £1 million per existing gasholder and £18 million for the retention of two gasholders on Site 14 Marianne Place Gas Works. This amounts to abnormal costs of £16.184 million, £33.816 million and £26.840 respectively. We have assumed a worst case scenario in our testing in that we have allowed for the full EUV plus a 20% premium of the site as well as the demolition and decontamination of the site being paid by the developer. In reality a developer is likely to take these costs into consideration in bidding for the site or alternatively and more often than not, the landowner will bear the cost of the decontamination, delivering a clean site to the market and recovering the costs through a higher purchase price than would otherwise have been achieved.

7.16 Our sensitivity testing has identified that Site 2 Bow Common Gas Works and Site 14 Marianne Place Gas Works sites are unviable regardless of the Council's policies i.e. it is not CIL and or the requirement for affordable housing which is making the sites unviable, rather it is the significant abnormal costs associated with the regeneration of these sites.

7.17 With respect to Site 11 Leven Road Gas Works, our sensitivity testing has confirmed that where the decontamination of the site is assumed to be carried out by the landowner and the full EUV plus 20% premium is paid, the site can deliver between 5% and 10% affordable housing.

7.18 The results of our updated appraisals on Site 13 Millharbour South - 5, 6, 7, 8 Greenwich View Place identify the proposed development to be unviable regardless of CIL and or the requirement for affordable housing in the current market.

7.19 The proposed borough CIL, which will deliver much needed infrastructure to support the growth envisaged by these sites, has been identified as being no more than circa 5% of scheme costs (see table 7.18.1 below). This is considered to be a very small part of a development's cost and should not be the determining factor as to whether or not a development goes ahead.

Table 7.18.1 Analysis of Borough CIL as a percentage of development costs

Site No.	Site/scenario	LBTH CIL	Costs excluding LBTH CIL	CIL as a % of costs
1	Bishopsgate Goods Yard	£28,191,229	£1,093,629,417	2.58%
2	Bow Common Gas Works	£1,425,684	£199,821,005	0.71%
3	Billingsgate Market	£47,765,374	£1,444,502,280	3.31%
4a	North Quay	£39,677,307	£1,359,953,115	2.92%
4b	North Quay	£35,835,306	£1,283,743,188	2.79%
5	Vacant land adjacent to new Reuters Ltd server building	£7,608,522	£219,672,606	3.46%
6	Limeharbour - Skylines Site	£10,351,518	£469,187,343	2.21%
7	Marsh Wall East - Thames Key site	£7,323,344	£537,560,811	1.36%
8	Marsh Wall West - Marsh Wall, Alpha Square	£10,254,072	£449,859,819	2.28%
9	Millharbour - Mastmaker Road/ Lightermans Road Site	£4,921,644	£243,535,350	2.02%
10	Crossharbour Town Centre	£27,933,594	£673,801,917	4.15%
11	Leven Road Gas Works	£4,462,878	£541,136,070	0.82%
12	Whitechapel South - Site bound by raven row	£1,786,348	£333,272,611	0.54%
13	Millharbour South - 5, 6, 7, 8 Greenwich View Place	£3,082,227	£255,516,221	1.21%
14	Marian Place Gas Works	£5,757,570	£335,189,266	1.72%

7.20 In light of the above findings, we recommend the Council considers maintaining the proposed CIL rates across the Borough as they are not deemed to be of a sufficient magnitude that is likely to threaten the development of the strategic sites and as a result *"undermine the deliverability of the plan"* (NPPF paragraph 34) and NPPG Paragraph: 038 Reference. Further, we consider that the proposed approach "strike(s) an appropriate balance between the desirability of funding infrastructure from the levy and the potential impact upon the economic viability of development across (the Council's) area." (NPPG Paragraph 008).

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8 Conclusion and recommendations

8.1 The NPPF states that the cumulative impact of emerging local planning authority standards and policies *"should not undermine the deliverability of the plan".* This report reviews the CIL rates in the Council's Charging Schedule, adopted on 1 April 2015. The study takes account of the cumulative impact of the Council's current planning requirements, in line with the requirements of the NPPF and the Local Housing Delivery Group guidance 'Viability Testing Local Plans: Advice for planning practitioners'. In addition, we have reflected the impact of the emerging Mayoral CIL2.

Key findings and suggested revisions to CIL rates

8.2 The key findings of the study are as follows:

- The results of this study are reflective of current market conditions, which will inevitably change over the medium term. It is therefore important that the Council keeps the viability situation under review so that policy requirements can be adjusted should conditions change markedly. Since the 2013 Viability Study was completed, there has been an improvement in sales values, which has been partially offset by an increase in build costs. The net result is a degree of improvement in viability and increased capacity to contribute towards local infrastructure.

- As was the case in the 2013 Viability Study, some schemes tested were unviable due to market factors, rather than the impact of the Council's policy requirements. These schemes will not come forward until changes in site specific market conditions and their current unviable status should not be taken as an indication that the Council's requirements cannot be accommodated on other schemes. It reflects the increasing viability of commercial development, with some existing forms of commercial generated higher values than residential development, reducing pressure for commercial buildings to be redeveloped for alternative (residential) use.

Residential

- In many cases, schemes can accommodate the Council's affordable housing requirement at a level of circa 35%, with the capacity to make CIL payments increasing with lower affordable housing proportions.

- Our appraisals indicate that the Council's currently adopted rates of CIL could increase without adversely impacting on viability of developments. The currently adopted and suggested CIL rates are summarised in Table 8.2.1. We also set out an analysis of the proposed CIL charge as a percentage of the development costs.

Table 8.2.1 Table showing suggested changes to residential CIL charges

Area	Existing Borough CIL charge Borough (£s per sq m) (indexed charge)	Suggested Borough CIL after buffer (£s per sq m)	Proposed CIL as % of Development Costs
CIL Z1	£200 (£211.58)	£280	1.9% - 4.7%
CIL Z2	£65 (£68.76)	£150	1.3% - 2.9%
CIL Z3	£35 (£37.03)	£50	0.5% - 1.1%

Commercial

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- In the City Fringe and North Docklands, rents for both offices and retail developments have increased and our appraisals indicate that these uses, including affordable workspace, will be able to absorb a CIL rate of £100 per sq m.
- Viability of retail and office markets outside the City Fringe and North Docklands have not changed sufficiently to warrant any changes to the adopted rates.
- Rents and yields of supermarkets and retail warehouses have improved since the adoption of the Charging schedule and appraisal identify that such uses should be able to support an increased CIL charge of £130 per sq m.
- Industrial and warehousing have seen increases in rents and a reduction in yields, partly as a result of a lack of available supply, however our appraisals identify that this does not generate a surplus above the benchmark land values and in this regard we recommend the Council maintains its existing nil charge on such uses.
- Market conditions for student housing and hotels have not changed significantly since the adoption of the Charging Schedule and we recommend no changes to the rates for these uses.
- The currently adopted and suggested CIL rates are summarised in Table 8.2.2. We also set out an analysis of the proposed rate as a percentage of the total scheme costs.

Table 8.2.2 Table showing suggested changes to Commercial CIL charges

Use and Location	Existing Borough CIL charge Borough (£s per sq m) (indexed charge)	Potential Borough CIL after buffer (£s per sq m)	Proposed CIL as % of Dev Costs
Office in City Fringe	£90 *(indexed - £95.21)*	£100	1.46%
Office in North Docklands	Nil	£100	1.67%
Retail in City Fringe and North Docklands	£70 *(indexed - £74.05)*	£100	1.45%
Supermarkets and retail warehouses	£120 *(indexed - £126.95)*	£130	3.13%

<u>Strategic Sites</u>

- Our assessment of the identified strategic sites has concluded that the majority of the sites can viably support the Borough's proposed CIL. With regard to the sites identified as being unviable, we note that the majority the sites are in fact deliverable with between 20% - 30% affordable housing and that the CIL Charge does not have a significant impact on the viability of these schemes i.e. at a nil CIL charge these schemes would not be viable at 35% affordable housing with no CIL. That is that CIL is not making the schemes unviable, it is rather site or scheme specific issues.
- Of the four sites identified as having the most challenging viability three of these are gasworks sites which incur significant abnormal costs. Once again we would highlight that CIL is not the determining factor making these sites unviable, i.e. on three of the four sites adopting a nil CIL rate and 0% affordable housing would not result in the developments generating residual land values above the identified benchmark land value.
- To demonstrate this position we have undertaken an assessment of the proposed Borough CIL liability calculated for each of the strategic sites and compared this to the total development costs. This has identified that the proposed CIL rates result in a liability that is no more than 5% of development costs. In fact, in the four schemes

where viability is identified as being most challenging, CIL amounts to no more than 1.12% of development costs. Further, on the schemes identified as being unviable at 35% affordable housing but viable with between 20% and 30% affordable housing CIL is no more than 1.68% of development costs (see Table 7.18.1).

- In light of our findings we recommend that the Council considers maintaining the proposed CIL rates across the Borough and to Strategic Sites as they are not deemed to be of a sufficient magnitude that is likely to threaten the development of the strategic sites and as a result *"undermine the deliverability of the plan"* (NPPF paragraph 34) and NPPG Paragraph: 038 Reference. Further, we consider that the proposed approach "strike(s) an appropriate balance between the desirability of funding infrastructure from the levy and the potential impact upon the economic viability of development across (the Council's) area." (NPPG Paragraph 008).

8.3 We summarise in Table 8.3.1 below the suggested updated CIL charging schedule rates.

Table 8.3.1: Suggested rates for LB Tower Hamlets' Updated CIL Charging Schedule

Development Type	Suggested CIL Rate per sq m (GIA) of Development		
	Zone 1	Zone 2	Zone 3
Residential	£280	£150	£50
	City Fringe & North Docklands		Rest of Borough
Offices and Retail (Except Convenience Supermarkets/ Superstores and Retail Warehousing)	£100		Nil
	Borough Wide		
Convenience Supermarkets/ Superstores and Retail Warehousing	£130		
Hotel	£190		
Student Housing Let at Market Rents	£450		
Student Housing Let at Below Market Rents	Nil		
All other uses	Nil		

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Appendix 1 - WT Partnership Build Cost Advice

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Appendix 2 - Residential appraisal results (Affordable Rent, Tower Hamlets Living Rent, London Living Rent and Shared Ownership) at base costs and values

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Appendix 3 - Residential appraisal results (Affordable Rent, Tower Hamlets Living Rent and Shared Ownership) at base costs and values

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Appendix 4 - Residential appraisal results (Affordable Rent, Tower Hamlets Living Rent, London Living Rent and London Living Rent) at base costs and values

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Appendix 5 - Residential appraisal results (Affordable Rent, Tower Hamlets Living Rent, London Living Rent and Shared Ownership) at +10% sales values and +5% build costs

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Appendix 6 - Residential appraisal results (Affordable Rent, Tower Hamlets Living Rent, London Living Rent and Shared Ownership) at -5% sales values

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Appendix 7 - Commercial appraisal results

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Appendix 8 - Strategic sites testing results

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Details of Strategic sites

No.	Site name	Existing use	Site size (ha)	Infrastructure requirement	Current ownership	Basis of EUV	Rounded EUVs
1	Bishopsgate Goods Yard	Shoreditch High Street Overground Station; "Box Park" Football Pitches Vacant Land	4.24	1. Strategic Open space 2. Community Use Facility (e.g. Idea Store or Archives Facility)	Private	Vacant Land/Open Storage at £7,193,520 per Ha based on 90% of site cover at £4 per sq ft @ 6.5% and 20% premium.	£23,472,000
2	Bow Common Gas Works	Gas Works	3.94	1. Secondary School 2. Strategic Open Space	Private	Vacant Land/Open Storage at £7,193,520 per Ha based on 90% of site cover at £4 per sq ft @ 6.5% and 20% premium.	£21,811,000
3	Billingsgate Market	Wholesale Market	5.74	1. Secondary School 2. Open Space	Private	Vacant Land/Open Storage at £7,193,520 per Ha based on 90% of site cover at £4 per sq ft @ 6.5% and 20% premium.	£31,775,000
4	North Quay	Vacant land	2.22	1. Open space	Private	Vacant Land/Open Storage at £7,193,520 per Ha based on 90% of site cover at £4 per sq ft @ 6.5% and 20% premium.	£12,289,000
5	Vacant land adjacent to new Reuters Ltd server building	Vacant land	2.71	1. Primary School 2. Open space	Private	Vacant Land/Open Storage at £7,193,520 per Ha based on 90% of site cover at £4 per sq ft @ 6.5% and 20% premium.	£15,002,000
6	Limeharbour - Skylines Site	Industrial and office space	1.56	Primary School	Private	Rent of £20 per sq ft capitalised at 6.5% and 20% premium.	£42,265,000
7	Marsh Wall East - Thames Key site	Offices	1.60	Primary School	Private	Rent of £20 per sq ft capitalised at 6.5% and 20% premium.	£43,773,000
8	Marsh Wall West - Marsh Wall, Alpha Square	Medical centre Pub Business uses	0.40	1. Primary School 2. Health facility	Private	Rent of £15 per sq ft capitalised at 7% and 20% premium.	£5,982,000
9	Millharbour - Mastmaker Road/ Lightermans Road Site	Education and Training Centre	0.97	Health Centre	Private	Rent of £15 per sq ft capitalised at 7% and 20% premium.	£8,202,000

No.	Site name	Existing use	Site size (ha)	Infrastructure requirement	Current ownership	Basis of EUV	Rounded EUVs
10	Crossharbour Town Centre	Supermarket, Car parking,	6.06	1. Idea Store 2. Health Facility 3. Primary School	Private	Rateable Value rental Value adopted and capitalised at 4.5% allowing for 20% premium.	£56,167,000
11	Leven Road Gas Works	Active gas holders	8.56	1. Secondary School 2. Open Space	Private	Vacant Land/Open Storage at £7,193,520 per Ha based on 90% of site cover at £4 per sq ft @ 6.5% and 20% premium.	£23,693,000
12	Whitechapel South - Site bound by raven row	Warehouse Facility used for sports	1.39	None	Private	Rent of £8.50 per sq ft capitalised at 6.75% and 20% premium.	£26,045,000
13	Millharbour South - 5, 6, 7, 8 Greenwich View Place	Secondary Offices	0.95	1. Primary School	Private	Rent of £20 per sq ft capitalised at 6.5% and 20% premium.	£31,992,000
14	Marian Place Gas Works	Gas works	1.9	1. Strategic Open Space	Private	Vacant Land/Open Storage at £7,193,520 per Ha based on 90% of site cover at £4 per sq ft @ 6.5% and 20% premium.	£13,592,000

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Appendix 9 - Strategic Sites Appraisals

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Appendix 10 - Proposed CIL Maps

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