

12 November 2013

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Sent by Email

Dear Matthew,

### **RE: Community Infrastructure Levy– Response to Examination Questions**

Further to our discussion at the Examination in Public the Inspector requested that the additional appraisals used to conclude the proposed rates by the Council are provided to him (see appendix 1) and that a further explanation of viability outputs was provided. In addition the Inspector wished to see the impact of applying a 20% on GDV approach to the appraisal results to understand that enough buffers included within the modelling to enable potential development opportunities to remain viable with the inclusion of CIL (see appendix 2). This letter and the attached appraisals set out the response to this request.

#### **Relationship of land value and profit.**

It is understood that under para 173-74 of the NPPF planning policy should not put the overall development across an area at serious risk and that developments must account for a competitive return to the Developer to ensure the development takes place and generate a land value sufficient to persuade the land owner to sell the land. LSH considered this from the land owner's perspective in the first instance, for a land owner to be incentivised to release land it seemed appropriate to apply land value benchmarks which would include enough scope for this to occur. If a developer were able to agree a better land transaction deal, then any surplus in viability would be passed to the Developer as additional profit. Furthermore, LSH included in their modelling, buffers in cost allowance, such as an additional 15% cost for abnormal and externals over and over the base build costs and contingencies to minimise risk to the developer.

In public consultation it became apparent that it was the view of a number of house builders that the return to be included in the viability should be circa 20% on GDV. However, the evidence provided to support this concluded that 20% on GDV was a "target rate", which is not the same as a profit achieved in a competitive environment, which will almost certainly be lower. Furthermore, target rates reflect the output return at the end of the development (accounting for market forces), not a competitive return required to outbid competition. This was exemplified in Barratt Homes achieving circa 20% on GDV on its developments in 2012. Given the market trend over this period was an increase in sale values and that this is an average, it seems reasonable to conclude that not all the schemes would achieved this level at acquisition or on completion.

LSH considered that a land value sufficient to persuade the sale of land will reflect the higher of either the residual of the proposed development or the residual of an alternative use. LSH considered a competitive return of 20% on cost, with allowances made in land value benchmarks and other assumptions in the model sufficient to enable a development to take place.

It is clear that if a developer is to make a "target rate" of 20% on GDV, then the available residual value, assuming all other costs remain equal, will impact the land value and vice versa; so that if the land value residual is to increase, and all else remains equal, the profit level will reduce. Market Value, as defined by the RICS, while reflect land transactions, which generally occur in a competitive environment, taking account of planning policy, such as affordable housing, Section

106 contributions or CIL. Therefore, LSH feel their approach to land values and profit returns reasonably consider RICS guidance.

**Viability appraisal explanation.**

Attached in appendix 1 and 2 are the various appraisals requested by the Inspector. The Inspector requested an additional explanation to that given at the examination in public, to support the approach taken. This is summarised in the table below:

Input Box	Commentary
Test / Scheme	This highlights the scheme being assessed and assumption associated with the scheme, such as density, land value, sales etc are drawn from the scheme assumption sheet.
Total residential units	This highlights the number of units being assessed and the density of the scheme. The assessment is based on a single hectare, but it also demonstrates the density and land value based on acres.
Land Value Benchmark	This is the assumed land value required to incentivise the land owner to release the site for development. The residual land value calculated in the model therefore ensures that this equals the land value benchmark by adjusting the potential CIL rate, once all other inputs are included.
Affordable Housing	This section demonstrates the affordable housing assumptions used both in proportion of overall affordable housing, mix and anticipated value per sqm. The floor area attributed to Affordable housing is excluded from the CIL calculations.
CIL Rate	This is the calculated CIL rate per sqm that can be achieved whilst enabling the residual land value to equal the land value benchmark. This is calculated to a number of decimal places, but rounded to the nearest whole figure.
Existing Floor space	Where a particular scheme is anticipated to include existing floor space, this is deducted from the calculable CIL floor area
Output Summary	Due to the size of the model this section, simply summarises Gross Revenue, Costs, Profit and land value.
Revenue and Standard Build Cost	<p>This section includes the proposed size mix of units, as well as the applied standard build cost and revenue. A premium is applied to the average sales data collected in stage 2, to reflect the anticipated improvement in value over second hand data collected. On flatted schemes costs and revenues are higher respectively and ground rents are also included.</p> <p>This section separates our affordable housing and private units, as the costs and revenues will vary between these two tenure types. Allowances are made for Gross to Net internal areas to calculate costs and revenues in accordance with RICS guidance.</p> <p>The section also applied a 4% over cost to the standard build to reflect code level 4. This equates to circa £4,000 per unit, which is estimate to be the current costs of delivering to Sustainability code 4. It is possible over time that this cost will reduce as economies of scale are reached with new technologies. It is also anticipated that cost reductions would be offset by a move to a higher code rating. But this can be reassessing as part of any future CIL review.</p>
Site Costs	<p>A number of assumptions are identified here as costs over and above those of the standard build; these costs have on the most part been applied to both affordable and private elements. These include:</p> <p><b>Professional fees:</b> An allowance of 12% has been include of standard build costs – However, it would be anticipated that many developers are</p>

	<p>achieving 6-8% on non-bespoke scheme, therefore there is an element of buffer in this assumption.</p> <p><b>Abnormals/ Externals:</b> 15% of costs have been applied which is in effect a development cost buffer to ensure any additional costs can be supported. If these costs are not included, then the generated sum is effective profit.</p> <p><b>Marketing Costs:</b> 3% of revenue for marketing costs have been allowed for which, are significantly over what would be anticipated for many of the schemes assessed.</p> <p><b>Disposal Costs:</b> 1.75% of private sales revenue has been applied to represent disposal costs for private units. This fee is in excess of anticipated sales agent fees anticipated on most schemes.</p> <p><b>Contingency:</b> An additional 55 contingency has been applied to the build costs to cover potential build costs variations and surplus over the build period.</p>
Section 106	An allowance equating to £2,000 per unit has been included for anticipated S106 contributions over and above CIL contributions. This is based on assessing previous S106 agreements and splitting out costs not associated with potential infrastructure items.
CIL Rate	This sum is calculated on the private floor space only. The CIL can be inputted manually as a rate or calculated based on the surplus when the residual land value equals the land value benchmark.
Finance costs	An allowance of 7% of 100% of the costs has been assumed. However, calculated sum is reduced to reflect an s-curve of required debt over the development period.
Profit	<p>An allowance of 20% on cost for Private units and 6% on Affordable units has been included to reflect a competitive return to the developer. This particularly takes account of the potential savings which could be made in the acquisition price and other buffered assumption.</p> <p>As part of the exercise requested by the Inspector the models were also run where private return was set at 20% on GDV.</p>
Land Purchase	The residual value of revenue, less costs and profit is regarded as the gross land value, before costs. Additional costs are deducted off the land value, such as interest, stamp duty, purchaser costs and planning fees to deliver a net residual land value. The Residual Land Value is then compared to the land value benchmark.

### CIL Buffer.

A further point raised by public consultation and again raised by the Inspector at the Examination in Public was that he wished to be satisfied that there was sufficient buffering within the modelling. LSH initial response on buffering was to highlight that a number of assumptions had been included over and above standard costs; including in the land value and development costs. It was further clarified at the Examination in Public that the individual CIL rates achieved in the viability modelling were over and above the CIL rates proposed for the Authority. LSH, however, felt the allowances made within the assumptions used should be given more weight than an arbitrary discount to the achieved rates. The Inspector requested the viability appraisals for the various areas identified in the Stage 2 report to understand better the assumptions used and the potential buffer to the CIL rates proposed by the Authority (appendix 1).

### Viability appraisal outputs.

Table 1 in Appendix 3 sets out the results achieved for the various assessed schemes, which it was deemed best, reflected the type and density of development across the authority. It is apparent that all the schemes, based on the assumptions proposed in the Stage 2 report, achieve rates above those proposed by the authority.

Table 2 in Appendix 3 sets out the results of applying a 20% return on GDV, with the knock on impact on land values taken into account. In short the buffer within the model has been shifted from land value to profit. For the purpose of this exercise to estimate a residual land value based on 20% GDV, a simple residual model was run (for results see appendix 4). Sales values were assumed the same as the original appraisals, although build costs and contingencies were increased beyond those used in the original appraisals. A buffer was then applied to the residual land value of 20% to ensure a competitive return to the land owner is maintained. The assumptions do not include any CIL costs, but do make a full Section 106 allowance of circa 15% of the standard costs. This equates to circa £7,000 per unit, which reflects average current S106 costs. Clearly if the costs were higher, then it could be assumed that land value would decrease, however LSH are satisfied that these values are reasonable to demonstrate the impact of applying a return of 20% GDV to the developer.

Table 2 (appendix 3) highlights that whilst the land value has reduced to account for the redistribution of value in the increase in profit return, they remain above the minimum alternative land value benchmark of £1.6m for industrial use (with the exception of high density development scenarios in Borehamwood). However, high density schemes in Borehamwood are anticipated to fall within the Elstree Way Corridor which will be set at a zero CIL. Therefore, if this approach was taken then the assessed schemes would be able to support the proposed CIL rates and achieve a target rate of 20% on GDV for the developer and reasonable land value to the developer.

Through the public consultation it has been highlighted that the return to the developer should be higher than that proposed as a competitive return in the appraisals. However, it is the opinion of LSH that sufficient buffers have been allowed for throughout the appraisals and proposed CIL rate to enable a competent developer to potentially achieve a higher target rate return than that applied to represent a competitive return in the model. Furthermore, LSH have evidence that the included buffers built in represent the risk which Savills proposed should be presented in the return to the developer.

Furthermore by way of example, appendix 5 demonstrates that the scheme can achieve a CIL rate in excess of £120 in Borehamwood (£135 psqm), even if the original land value is applied along with a return on GDV of 20%. This has been achieved by reducing the professional fees to 8%, abnormal to 5%, 1.5% disposal costs and marketing costs to 1%. This demonstrates there is sufficient buffering in the assumptions used to enable a competitive return to the land owner and developer given the adoption of the proposed CIL rates.

I trust this explanation of the individual elements of the appraisals used, the output presented for the original assessment and the impact of adjusting the profit return to 20% on GDV. I hope I sufficiently demonstrated that the proposed rates of £120 psqm and £210 psqm are wholly reasonable and that sufficient buffer has been built into the appraisals to ensure that the proposed CIL rates will not materially impact the delivery of the Core Strategy objectives.

In conclusion LSH consider appropriate evidence has been use to conclude that the implementation of the proposed CIL rates of £120 psqm and £210 psqm will not put overall development across the Authority at serious risk and that the assumptions used account for a land value sufficient to incentivise the sale of land and a competitive return to ensure that development takes place.

Yours sincerely,



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Appendix 1: Original viability appraisals.  
Appendix 2: Appraisals @ 20% GDV.  
Appendix 3: Appraisal summaries.  
Appendix 4: Land Value Calculations for 20% on GDV.  
Appendix 5: Appraisals @ 20% GDV with cost buffers removed.