Peter Brett Associates LLP
Oxford Place, 61 Oxford Street
Manchester
M1 6EQ

t: 0161 245 8900
f: 0161 245 8901
e: manchester@peterbrett.com
w: www.peterbrett.com

Bolton Council

Community Infrastructure Levy (CIL): Non-residential Development Viability Study – Addendum Report

Final Report | March 2013

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1 INTRODUCTION

1.1 The consultation on Bolton Council's Preliminary Draft Charging Schedule (PDCS) took place from 21 September to 2 November. Peter Brett Associates (formerly Roger Tym & Partners) have been retained by Bolton Council to support them in refining the viability evidence as a result of consultation comments received.

1.2 This Addendum Report does not seek to repeat everything that was included in the preliminary draft stage report, but instead focuses on the key changes proposed to the approach to CIL for non-residential uses in Bolton, the structure of the proposed Charging Schedule and the viability assessments that underpin it.

1.3 The changes set out in this report seek to reflect:

- Emerging best practice and the conclusions of recent Examiner's Reports on CIL charging schedules;
- The most recent update for the Government's guidance on CIL and CIL (Amendment) Regulations 2012; and
- Comments received on the PDCS.

1.4 The key changes in approach and areas of additional evidence and/or clarification of approach that are set out in this report include:

- A revised approach to CIL charges on retail development, removing references to size thresholds and charge variation by zone;
- Clarification of the approach to land values to the per sq. m assessments of viability for non-residential uses; and
- Consideration of appropriateness of retaining the 'Base Charge' for development that is not covered elsewhere on the Charging Schedule.

2 APPROACH TO RETAIL CHARGING

Introduction

2.1 CIL charge rates can only vary where viability differs by reference to either: the ways buildings are used; or by geographically defined 'value zones'. The PDCS therefore proposed different charges for convenience and comparison retail development and drew a distinction between comparison retail development within Bolton Town Centre and out of centre comparison retail development.

2.2 Comments received through the consultation on the PDCS questioned the appropriateness of these distinctions. Some suggested that there was no clear way to define a differentiation between convenience and comparison use development, particularly where a building may provide an amount of both types of use.

2.3 The proposed lower charging zone for comparison retail development within Bolton Town Centre, reflecting the fact that land acquisition costs are likely to be higher, was also questioned by respondents.

2.4 Other comments stated that the PDCS did not take account of rural retail such as farm shops and village stores.

2.5 Recent Examiner's Reports on CIL charging schedules have supported the approach of charge differentiation between convenience and comparison retail development on the basis that they are considered to be different uses. Examiners have also supported differential charging zones for retail development within and outwith town centres, reflecting differences in viability between these areas, albeit that defining such zones required fine grained evidence to support a boundary that is defined by market evidence, rather than applying a policy boundary.

2.6 Nonetheless, having considered the comments received and the most recent revisions to the guidance, we think that the approach to charging for retail development as proposed in the PDCS could benefit from some simplification. We set out our revised approach below.

Revised Approach to Retail Charges

2.7 Given that there is clear evidence to support the fact that the costs and values, and the resultant viability of different types of retail development varies significantly, it remains the desire of the Council to reflect this in the way that CIL is levied. As such, it is necessary to define how different forms of retail development are used differently in order to justify charge variation.

2.8 As mentioned above, Charging Authorities may propose different charges where viability varies by reference to the way in which buildings are used (the word 'use' or 'used' being as normally defined, rather than by any reference to the Use Classes Order). Therefore, we set out below a series of definitions that describe how different types of retail development are used. Our consideration of the viability of each different type of use is then set out further below.

Defining different uses of retail development

2.9 We propose to define different uses of retail development as follows:

- **Supermarkets** – Supermarkets provide a very wide range of convenience goods, often along with some element of comparison goods also. Most customers use supermarkets for their main weekly shop, using a trolley to buy a large number of different products. The vast majority of custom at supermarkets arrives by car, using the large adjacent car parks provided.
- **Neighbourhood convenience stores** – Neighbourhood convenience stores tend only to provide a limited range of convenience goods. They largely cater for 'top-up shopping' for a small number of items that can be carried by hand or in a small basket. The vast majority of custom will access the store on foot and as such there are no large adjacent car parks.
- **Retail warehouses** – Retail warehouses are usually large stores specialising in the sale of household goods (such as carpets, furniture and electrical goods), DIY items and other ranges of goods. They can be stand-alone units, but are also often developed as part of retail parks. In either case, they are usually located outside of existing town centres and cater mainly for car-borne customers. As such, they usually have large adjacent, dedicated surface parking.
- **'High Street' comparison retail** – Town centre comparison retail development will usually involve redevelopment of existing buildings to provide new retail accommodation that better meets the demands of modern retail businesses. Typically such development will provide a wide range of unit sizes, including one or two large spaces for 'anchor tenants' and a much larger number of small spaces. They will typically have frontage on to areas of high footfall, aiming to capture the passing trade of shoppers on foot, who are also likely to visit other stores and other parts of the centre, many of whom will arrive in the centre by non-car modes.

Viability Assessments

2.10 Our assessment of development viability of each of the uses described above is set out in Table 2.1 below. Much of this assessment remains from the original assessment on the basis that the previous assessment covered both 'High Street' Comparison Retail and Retail Warehouses. These assessments have not changed. Similarly, the data on which the previous 'Convenience Retail' assessment was based principally related to supermarkets and is considered to remain robust. The change here is simply in the naming of that use of development and in how it is defined.

2.11 An additional viability assessment has been undertaken with respect to Neighbourhood Convenience Stores. Typically, rents for small local convenience stores are more likely to be in the range of £120 - £140 per sq. m, as opposed to £180-220 per sq. m for supermarkets. In addition, because the covenant strength of the operators of smaller convenience stores is lower, yields are likely to be materially higher than for supermarkets, reflecting the higher levels of risk involved. As such, a more appropriate yield assumption for this type of development is 8.5%, rather than the 5.5% assumed for supermarkets.

Table 2.1: Revised Retail Viability Assessment

		Town Centre Comp. Retail	Supermarkets	Retail Warehouses	Neighbourhood Stores
Rent		£300	£200	£140	£130
Yield %		7.75	5.25	7.50	8.50
Minus inducements	1	387	190	187	153
VALUES	2	**3,484**	**3,619**	**1,680**	**1,376**
COSTS	2				
Land + Purchase Costs	3	1,500	450	200	150
Basic Build Cost		800	1,100	600	600
External Works	4	80	132	72	72
Fees	5	106	123	67	67
Section 106/m²	6	0	100	50	51
Marketing & Sales		174	181	84	69
Contingencies	7	49	68	37	37
Interest	8	249	191	99	94
Margin	9	592	449	232	218
Total Cost Benchmark		**3,549**	**2,793**	**1,441**	**1,358**
Values - Costs		**-65**	**826**	**239**	**19**

1. A reduction of 10% of development value is made to reflect current market norms for rent free periods and other tenant inducements
2. All values and costs per m² unless stated
3. The total cost of purchasing land, including related costs. It is assumed that this will be higher in urban areas.
4. Works outside built structure. High for business parks where extensive servicing and landscaping is required. Usually negligible in town centres.
5. Fees are higher for smaller and/or more complex structures.
6. This covers site-specific infrastructure that is directly related to the development.
7. Contingencies at 5% of costs
8. Interest costs vary with the nature and length of a typical project.
9. Profit normally allowed at 20% on all costs and effectively assumed development is speculative.

2.12 Table 2.1 above shows the findings of the viability assessments. ‘High Street’ comparison retail development is not viable under current market conditions. As previously, Retail Warehouse development is shown to benefit from relatively healthy levels of viability showing a significant surplus over and above developer’s margin at 20% on cost. Similarly, the re-defined assessment of supermarkets also shows this form of development to be viable, with a large surplus even after allowing for developer’s margin.

2.13 The assessment of Neighbourhood Convenience Retail development shows its viability to be significantly more marginal, with only a very small surplus being produced that equates to just £19 per sq. m. We do not consider that this level of surplus provides adequate justification for the introduction of a specific CIL charge to be introduced for neighbourhood convenience stores.

2.14 Table 2.2 below, seeks to establish the maximum possible charge rates, consistent with maintaining the viability of development for those uses shown to produce significant surpluses. This is the theoretical 'ceiling' of viability from which proposed charges must draw down in order to take account of potential market changes and sites where costs may be higher and/or values lower than is typical.

Table 2.2: Revised Retail Maximum Charge Assessment

		Supermarkets	Retail Warehouses
Rent		£200	£140
Yield %		5.25	7.50
Minus inducements	1	190	187
VALUES	2	**3,619**	**1,680**
COSTS	2		
Land + Purchase Costs	3	450	200
Basic Build Cost		1,100	600
External Works	4	132	72
Fees	5	123	67
Section 106/278	6	100	50
CIL @ maximum		**498**	**86**
Marketing & Sales		181	84
Contingencies	7	68	37
Interest	8	191	99
Margin	9	449	232
Total Cost Benchmark		**3,291**	**1,527**
Surplus/Deficit		**328**	**153**
Surplus/Deficit % on cost		**10.0%**	**10.0%**

2.15 The assessment shows maximum charge rates of £86 per sq. m for retail warehousing; £328 per sq. m for supermarkets.

3 APPROACH TO LAND VALUE

3.1 For non-residential uses, we use a simple high-level assessment of the costs and values associated with developing a range of uses, based on a model that considers a single sq. m of development. The value is a function of prevailing rental levels, capitalised using an assumed yield relevant to the use and the location, less the value of any likely inducements such as rent free periods.

3.2 Development costs take account of land acquisition costs, construction costs and a range of other factors, with assumptions based on market evidence and industry standard ‘norms’, as appropriate.

3.3 Clearly, development proposals for a particular site are unlikely to see every sq. m of the site covered by development, and the degree of site coverage and density of development will vary from one site to the next.

3.4 For clarity, and reflecting the high-level nature of the assessment, the assumed land values used per hectare are as follows:

- Town Centre Offices - £500,000 per Ha;
- Business Park Offices £400,000 per Ha;
- Industrial - £400,000 per Ha;
- ‘High Street’ Retail - £15m per Ha;
- Bars, Restaurants & Café’s - £7.5m per Ha
- Supermarkets - £4.5m per Ha;
- Retail Warehousing and ‘Big Box’ Leisure - £2m per Ha;
- Neighbourhood Retail - £1.5m per Ha; and
- Hotels - £750,000 per Ha.

4 APPROPRIATENESS & IMPACT OF THE 'BASE CHARGE'

4.1 The CIL regulations state that Charging Authorities must balance the need to maintain viability of development with the need to fund infrastructure investment. Speculative development of new office and industrial development, amongst others, were shown by the viability assessments in the original study to be unviable in current market conditions. That said, some development of these uses may well take place, where pre-lets are agreed, or by owner occupiers for example, for which the development economics would be somewhat different.

4.2 The principal test for CIL to be considered at examination is whether the Council has struck what it believes to be an 'appropriate balance' between the need to fund the infrastructure required to enable growth with the need to maintain the viability of the bulk of planned growth.

4.3 On this basis, a small 'base charge' for other forms of development not specifically mentioned elsewhere in the charging schedule was proposed in the PDCS. Given the viability evidence, any such a charge would have to be at a level where it is unlikely to be the determining factor as to whether a development takes place or not. Our advice was that any such a '*de minimis*' base charge should be pegged at a ceiling of 1% of the cost of development of the lowest cost development – industrial – which equates to approximately £10 per sq. m. The Council proposed a rate of £5 per sq. m in the PDCS.

4.4 Concerns have been raised during the consultation period with regard to the 'base charge' as proposed. In addition, since the preparation of the PDCS, revised guidance covering CIL has been published by CLG, some of which is relevant to the consideration of this issue. The guidance states at para 39 that:

'If the evidence shows that their area includes a zone or use of development of low, very low or zero viability, charging authorities should consider setting a low or zero levy rate in that area or for that use (consistent with the evidence).'

4.5 It could be considered that a £5 per sq. m 'base charge' that equates to less that 0.5% of the total development costs of the very cheapest form of development is in line with this guidance and falls within what could normally be described as a 'low' rate. Our assertion is that a charge at this level would not be a determining factor as to whether development takes place or not and will therefore not materially impact on viability. As such, this approach could be considered to be in line with principal test as set out at para 4.3 above.

4.6 Nonetheless, we have sought to test the impact of the proposed base charge below, by undertaking sensitivity analyses on potential levels of base charge (at £0, £5 and £10 per sq. m) on speculative office and industrial development.

Table 5.1: Base Charge at £0

		Town Centre Office	Business Park Office	Industrial
Rent		£110	£110	£55
Yield %		9.50	8.50	8.75
Minus inducements	1	116	129	63
VALUES	2	**1,042**	**1,165**	**566**
COSTS	2			
Land + Purchase Costs	3	50	40	40
Basic Build Cost		1,300	1,200	550
External Works	4	130	120	55
Fees	5	172	132	61
Section 106/278	6	0	10	10
CIL		0	0	0
Marketing & Sales		52	58	28
Contingencies	7	80	73	33
Interest	8	165	150	72
Margin	9	390	355	168
Total Cost		**2,339**	**2,138**	**1,016**
Surplus/Deficit		**-1,297**	**-973**	**-451**
Surplus/Deficit % on cost		**-55.44%**	**-45.51%**	**-44.34%**

Table 5.2: Base Charge at £5

		Town Centre Office	Business Park Office	Industrial
Rent		£110	£110	£55
Yield %		9.50	8.50	8.75
Minus inducements	1	116	129	63
VALUES	2	**1,042**	**1,165**	**566**
COSTS	2			
Land + Purchase Costs	3	50	40	40
Basic Build Cost		1,300	1,200	550
External Works	4	130	120	55
Fees	5	172	132	61
Section 106/278	6	0	10	10
CIL		5	5	5
Marketing & Sales		52	58	28
Contingencies	7	80	73	33
Interest	8	165	150	72
Margin	9	390	355	168
Total Cost		**2,344**	**2,143**	**1,021**
Surplus/Deficit		**-1,302**	**-978**	**-456**
Surplus/Deficit % on cost		**-55.54%**	**-45.64%**	**-44.61%**

Table 5.3: Base Charge at £10 (as proposed)

		Town Centre Office	Business Park Office	Industrial
Rent		£110	£110	£55
Yield %		9.50	8.50	8.75
Minus inducements	1	116	129	63
VALUES	2	**1,042**	**1,165**	**566**
COSTS	2			
Land + Purchase Costs	3	50	40	40
Basic Build Cost		1,300	1,200	550
External Works	4	130	120	55
Fees	5	172	132	61
Section 106/278	6	0	10	10
CIL		10	10	10
Marketing & Sales		52	58	28
Contingencies	7	80	73	33
Interest	8	165	150	72
Margin	9	390	355	168
Total Cost		**2,349**	**2,148**	**1,026**
Surplus/Deficit		**-1,307**	**-983**	**-461**
Surplus/Deficit % on cost		**-55.63%**	**-45.77%**	**-44.88%**

4.7 The introduction of a £5 base rate, as opposed to a zero rate, would have an impact on viability (the deficit/surplus expressed as a percentage of total development costs) of between 0.1% and 0.27%. At £10 per sq. m, the range of impacts on viability is between 0.19% and 0.54%. The different impacts of the various potential base charges are summarised below:

Table 5.4: Base Charge Sensitivity Analysis Summary

Potential Base Rate	Deficit Level Increase
Zero charge	-
£5	0.1 – 0.27%
£10	0.19 – 0.54%

4.8 In addition to the above, it should also be noted that recent Examiner's Reports on CIL have considered charging schedules that include a similar charge covering 'all other forms of development', most recently in Norwich. In his conclusions on the non-residential aspects of the Charging Schedule, the Examiner stated that:

'The Councils have tried to be realistic in terms of achieving a reasonable level of income to address an acknowledged gap in infrastructure funding, while ensuring that a range of

development remains viable across the area. For non-residential development this objective has been met'.

Conclusion on appropriateness of the Proposed Base Charge

4.9 On the basis of our consideration of the revised guidance, the impact of the base charge on viability and the findings of recent Examiner's Reports on CIL charging schedules that include a similar approach, we consider that the Council's approach is an appropriate response to the viability evidence that balances the need to fund the infrastructure required to enable growth, with the need to maintain development viability.