Winchester City Council – Non-Residential Community Infrastructure Levy Viability Study Representation on behalf of W.M. Morrison Supermarkets Plc.

21 May 2013

This representation has been prepared in the context of the consultation that Winchester City Council have launched in respect of their Community Infrastructure Levy Draft Charging Schedule (April 2013). We are instructed by W.M. Morrison Supermarkets Plc. to make representations on their behalf.

Introduction

Aspinall Verdi Limited, Chartered Surveyors are property regeneration and development consultants with direct experience of advising both public and private sector clients with respect to development viability, S106 and planning gain matters. The firm has a thorough understanding of property markets, valuation and development economics and delivery.

This representation has been prepared by Parm Dosanjh, BSc (Hons) DipTP MSc MRICS MRTPI. Parm is Regional Director at AspinallVerdi and is head of the London office. He has 15 years experience in the planning and development consultancy sector and has advised on projects throughout England.

This submission has been prepared to support further representations by Peacock & Smith town planning consultants for W.M. Morrison PLC.

For the purposes of these representations we have reviewed the following documents:

1. Adams Integra, Non-Residential Viability Study, Final Report, November 2012;
2. Adams Integra; Addendum Report Following Stage 1 Consultation, April 2013; and
3. Winchester City Council, Consultation on Draft Charging Schedule Document, April 2013.

General Comments

We note that an earlier consultation exercise has been undertaken and a number of points raised; however, we did not make representations on the Preliminary Draft Charging Schedule or the Viability Report as part of the initial round of consultation. We have therefore reviewed both the Viability Study (November 2012) and the Addendum Report (April 2013) and have a number of comments on the report, in particular the lack of an evidence base to support the assumptions in the report and also the methodology adopted for calculating the CIL Charge.

Prior to making specific comments in response to the consultation questions that have been raised we draw attention to the following:

1. The interrelationship of CIL and site specific S106 is critical to the commercial viability of larger development and regeneration projects such as food stores. In many cases the food store is linked to a wider development scheme or masterplan involving other uses and infrastructure such as roads. Therefore the preparation and inclusion of infrastructure elements to the Regulation 123 List needs to be clearly defined and understood to avoid double counting (known as 'double-dipping'). Typical 'site specific' S106/S278 costs that will be out with the Regulation 123 List should be factored into the CIL Viability Modelling.

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2. Request to be heard. Should any changes be made to the CIL Charging Schedule in relation to Use Class 'A' across the Authority area, then we would reserve the right to make representations and be heard

Specific Comments

The Consultation Document poses nine consultation questions. The following specific comments relate to the first question, '*are the assumptions made in the Economic Viability Assessment appropriate to inform the charges set out in the PDCS?*' The following representations have been made referring to the page numbers in the Adams Integra report.

Item (Page Number)	**Comment**
Section 1 – Introduction: Evidence Base (p4)	Paragraph 3 refers to the need to *'prepare evidence about the effect of the levy on economic viability in the district'*; at present there appears to be a lack of evidence to support the assumptions being made in the development appraisals and also in understanding the local market. We recommend that the market analysis (with sources of information) is appended to the viability report so that we can provided comment on whether the market evidence is relevant, appropriate and whether it supports the development appraisal assumptions.
Section 2 - Methodology: Viability Margins (p4)	We concur with paragraph 3 on page 4 regarding the sensitivity of residual appraisals and therefore it is essential that CIL rates are not set right up to the margins of viability.
Section 4 - Threshold Land Values (pp7-8)	We note that Adams Integra cite the RICS guidance note on 'Financial Viability in Planning' and we endorse that approach. The consultants have also referred to the need to adjust the Site Value *'to reflect the emerging policy / CIL charging level'* (Box 8 of the RICS guidance note). However, it is not clear from the remainder of the report whether this approach has been followed. Paragraph 6 on Page the consultants confirm that they have *'arrived at a range of threshold site values for the different uses from a broad judgement of comparable evidence from local market data, published reports and discussions with local agents.'* However, none of this market evidence is presented in the Viability Report and therefore we have been unable to comment on it. The second part of this paragraph goes on to state that, '*we have adopted the same method of allowing a 20% landowner premium on the site value used to provide a higher value considered necessary to encourage that landowner to bring the site forward for development*'. In this respect we would query the *same* as what approach? Also we would comment that site value as defined by the RICS (Box 7 of the RICS guidance) *equates to* Market Value and therefore this will already include any development value and/or hope value reflecting the prospect of some more valuable future use or development (subject to the full suite of planning requirements) to the extent that would be reflected in the market.

	Referring to the appraisals within the appendices (see below) and the sixth paragraph on page 7 of the Viability Study report, the consultants have not it seems adopted the RICS approach, but in fact adopted an Existing or Current Use Value approach + a premium of 20%. The RICS guidance specifically states that the CUV is not recommended (paragraph 3.4.1) and emphasises the importance of comparable market evidence (see Box 13 and paragraphs 2.2.3, 3.4.7, 3.4.9, 4.2.1) (see further comments below).
Section 5 - State of the Market (pp8-9)	We note the comments about the state of the market and yields, however, the report does not draw together any quantitative evidence as input assumptions to the appraisals and the majority of the analysis is generic and not Winchester focused. It is important to demonstrate some market context and evidence for the appraisals. Such evidence also needs to support the zoning that is being proposed.
Section 7 - Different Charging Zones (p9)	We note that the Consultants have identified 'that Winchester and the motorway corridors command the highest commercial property values in the District.' However, although reference is made to research this has not been presented and therefore we cannot comment on the appropriateness of different charging zones.
Section 8 - Development Inputs (p10)	We note the overarching assumption that *'the landowner has judged that the current notional building does not optimise the best use for the site and a higher value can be obtained such as by increasing the density….because of the lack of demand for the existing building due to such issues as age, quantity, layout or amenities.'* This is part of the existing use value approach. However, this is a very theoretical approach and is <u>not</u> how the market *actually* works in practice. We recommend that more weight is attributed to the benchmark market values of the sites for particularly uses as opposed to the benchmark existing uses (which themselves are based on 'mini' residual appraisals (see further comments below). From a review of the commercial development appraisals the consultants have assumed in all cases that the site value is based on a building which is 50% of the size of the proposed building. They also adopt a much lower rent and a 'softer' yield – with no market evidence/justification presented for such rents or yields. As stated this is an arbitrary formulaic approach which does not reflect market reality. The lower rent and higher yield for existing uses than for the planned new floor space together with the size differential results, by definition, to a gross increase in value (before development costs) which is generating 'viability' and supporting the proposed CIL level. This approach is arbitrary and contrived and does not reflect how the market *actually* works for development sites. For example, in a built up town centre it may be appropriate to redevelop a 6 storey office building with another 6 storey office building (not one double the size). Furthermore, this approach does not address the circumstance where say an old industrial site is being acquired for redevelopment for a retail

	or leisure scheme, which could be of a similar size. Also it does not take into account the fact that landowners will reflect the full development value in their aspirations. Landowners are likely to "hold out" until they have explored their potential returns fully, and may not sell the site if the proposed returns are below their expectations. In the case of retail developments, landowners are likely to hold out for the highest value and are unlike to accept a reduction in their land value for CIL. Equally a landlowner would consider Alternative Use value and across Winchester residential land values can be high and thus it is reasonable to assume that a landowner would secure the highest value for their site. In reality a developer would need to acquire a site of sufficient size to accommodate the development contemplated – including aspects such as landscaping, circulation and car parking. Allowances therefore should be made using a market value benchmark for development land and appropriate planning assumptions for site size/density. In summary this approach is flawed and needs to be fundamentally reviewed.
Section 9 – Development Types (PP10-11)	It is not clear how the Consultants have taken into account developments in the local market to inform the development types i.e. does the proposed retail units reflect policy or retail need/market requirements. How has the unit size of 30,000 sqft been selected? Paragraph 5 (p11) states that the Consultants *'believe that there is sufficient 'fine grained' evidence that demonstrated that certain retail categories within the A1 Use Class are sufficiently viable to support A CIL charge and others are not.'* Please could this 'fine grained evidence' be provided so that we can provide comment on this conclusion? Paragraph 3 (p12) the consultants recommend a charge of £120 per m2 – there is no evidence to demonstrate that this figure achieves an appropriate balance i.e. what sensitivity analysis has been undertaken to test whether the retail schemes can sustain this rate?
Appraisal (Appendix 6)	Appraisal 6 we make the following observations in respect of the appraisals: • It is not clear from the report how the rate of £103 psf (converted to £1,108.28 psm) has been arrived at. We have consulted BCIS and the median figure for hypermarkets/supermarkets between 1,000 and 7,000 sqm is £1,179 psm and the mean £1,134 psm (adjusted for Winchester area). These figures are in excess of the level selected (e.g. £1,108.28 psm). • The yield at 4.75% is too strong and should be based on market evidence around 5.25% - 5.75%. • We cannot reconcile the Community Infrastructure Levy which is based on £120 psm but shown in the appraisal at a total of £1,800,000. There appears to be a mistake in the appraisal in that the £120 relates to per sqm whereas the appraisal is based on per sqft. The figure at 30,000 sqft (2,788 sqm) at £120 psm should be £334,572 not £1,800,000. Furthermore if the assessment of CIL is based on 50% of net additional space (i.e.

	30,000 sqft) then at £120 psm the CIL payable would be £167,286. • No allowance for on-site S106's and S278 agreements is made to avoid 'double-dipping' (double counting of S106 and Regulation 123 List infrastructure). Given the scale of a development of this type it is reasonable to make significant allowances for "local S106" and S278 infrastructure. For retail schemes this cost cannot be ignored as such costs are common and significant. Without such an allowance the margins of viability can be easily exceeded. • In addition there are likely to be substantial other site assembly costs, holding costs, interest over an extended timeframe, retail planning fees and abnormal costs which could equate to this figure and more. • Professional fees of 10% have been used. We would support the use of 12% given the complexity of such retail schemes. Planning, site assembly and other costs for a larger retail scheme are significant and 10% is too low. • We note that an allowance of 1.5% for External costs is included in the appraisal. We considered this to be insufficient given the scale and complexity associated with supermarket developments, it would be normal to make an allowance in the order of 10-15%. For example, no allowance has been included for car parking associated with the foodstore. • No letting and legal fees have been included, normally these are included at 5% of the first year's rent. • It has also been noted that the developer's profit is based on the preceding development cost items, but exclude the land acquisition costs set out below. It is normal practice to include these other costs. Therefore the allowance made for developer's profit is too low. We would suggest that the developers profit level for the retail foodstore option is increased to 25% on cost based on: - Developer's site assembly risk; - Holding costs and timescales to secure returns can be very long; - Funding costs and risks where even for prime supermarket developments, bank finance is scarce and requires developers to contribute large amounts of equity; - Planning costs and risks. • We would suggest that the developers profit level for the retail [supermarket] typology is increased to 25% on cost based on: developer's site assembly risk; holding costs and timescales to secure returns can be very long; funding costs and risks where even for prime supermarket developments bank finance is scarce and requires developers to contribute large amounts of equity; planning costs and risks (some of which could be abortive).

	• In addition we cannot reconcile the Land Surplus in the Land Value box. The net Development Value is stated to be £7,726,218 and the Total Development Costs are £7,347,105, including £1.8m CIL (see above). The difference is £379,113, not £801,572. Based on the above residual land value of £379,113 (note finance and other acquisition costs need to be deducted) less the existing site acquisition costs plus a premium of 20% at £279,329, the Surplus at the bottom of the appraisal is therefore £99,784 (£379,113 - £232,774) which is substantially less viable than £466,133 shown on the Appraisal. • Furthermore, this final figure is labelled 'Surplus available to fund CIL' but CIL is already included above (at £1.8m – which in itself is incorrect). This is unclear and it is not transparent how the figures within the appraisal are reconciled. • Appendix 4 – Retail Convenience, many of the above comments are also relevant to the appraisal at Appendix 4, in particular the methodology adopted to calculate the surplus.
Final Comments	The CIL for retail at £120 psm is noted. It is not clear how this has been arrived at within the Appraisal.
	Table 1 – Representation Comments

Summary and Conclusions

We are pleased to have been given this opportunity to comment on the Winchester CIL proposals and would like to register our interest in receiving details of the revised Charging Schedule prior to examination.

The work undertaken to date has been substantial, however in our view makes several optimistic assumptions. Further work and revisions are needed in order to reflect the observations above and particularly:

1. Market evidence needs to be presented to verify the assumptions made within the report on rents, values and development typologies etc.
2. The Appraisal(s) in Appendix 4 and 5 need to be checked and re-presented to make them clear and transparent as to the calculations that have taken place. For example there appears to be a mistake in the appraisal in that the £120 relates to per sqm whereas the appraisal is based on per sqft. The figure at 30,000 sqft (2,788 sqm) at £120 psm should be £167,286 not £1,800,000.
3. The EUV needs to be reconsidered as the most appropriate measure for calculating the surplus for CIL over development land Market Value benchmarks.
4. We would expect some sourced market evidence and rationale for the appraisal inputs, such as rents (CUV) and values. We would recommend that these be included so that a key aspect of the CIL calculation is clearly evidenced.
5. Appropriate allowances need to be made with regard to S106/S278 which inevitably would form part of a larger retail development in addition to CIL. Such charges would be incurred to deal with 'site specific' issues and avoid 'double-dipping'.

6. We would suggest an increased level of developers' profit to reflect the risks involved in retail development. The level of developers' profit should be increased from 20% to 25%.
7. We would support the use of 12% (not 10%) professional fees given the complexity of such retail schemes.
8. Sensitivity analysis needs to be undertaken to demonstrate the impact that a decrease in rent, weakening in the yields and increase in build costs would have on the surplus available for CIL. The findings of this analysis should inform the buffer and the CIL charging rate.

Contact details

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