

## Mid Devon District Council

# Non residential viability study to support Community Infrastructure Levy charging schedule

## Final Report



**This report has been prepared using data supplied by the council, the development industry and quoted published data sources. The assessments provide a review of the development economics of generic typologies and the results depend on the data inputs provided. Sources for the data inputs specific to individual sites are indicated in the annex. No responsibility whatsoever is accepted to any third party who may seek to rely on the content of the report unless previously agreed.**

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# 1 INTRODUCTION

- 1.1 The Community Infrastructure Levy regulations require the production of a charging schedule that sets out the rates that will be applied within each local authority area. This must be based on a robust evidence base to ensure that the proposed levels of CIL do not adversely impact on the economic viability of development.
- 1.2 Roger Tym & Partners were commissioned by Mid-Devon District Council in March 2011 to undertake a viability assessment for non-residential development to set out the evidence base to assist Mid-Devon District Council in setting their Community Infrastructure Levy (CIL). This work is intended to be used alongside other research into infrastructure requirements and residential viability.
- 1.3 This study does not seek to set the levy as this is for the local authority to determine and publish in their charging schedule. However it will make recommendations as to the type of development which should be considered and illustrate the impacts of setting a levy on development viability.

## 2 METHODOLOGY

- 2.1 Our approach to assessing viability is guided by a combination of documents and other evidence:
- The Community Infrastructure Levy Regulations, February 2010 and amended April 2011
  - Community Infrastructure Levy Guidance: Charge setting and charging schedule procedures, March 2010
  - The Community Infrastructure Levy: An Overview, November 2010
  - Advice from CLG's CIL team at the CIL Front Runners event
- 2.2 The legislation requires a charging authority to use appropriate available evidence to inform their charging schedule. Thus we aim to draw from published information supplemented through consultation with the development industry.
- 2.3 The fundamental premise is that the CIL must be set at a level that does not undermine the Core Strategy. Our starting point therefore must be to understand what overall level of charge would not compromise viability for most developments. To do this, it is necessary to understand the predominant land uses which have been developed over the last 5-10 years, along with a view of the land uses that are expected to represent the majority of change over the life of the Core Strategy.
- 2.4 As the CIL will be levied on planning permissions, as a starting point, it is appropriate that we consider potential CIL charges in terms of the Use Classes Order. For the purposes of this study we have broken down non residential development into the following categories based on use class:-
- A1 – A5 (shops, financial and professional services, restaurant, cafes, drinking establishments and hot food takeaway)
  - B1, B2 and B8 (business, industrial and storage and distribution)
  - C1 (hotels)
  - D1 – D2 (non residential institutions, assembly and leisure)
  - Sui Generis
- We have not considered any C3 residential uses as these are being considered within other evidence base reports.
- 2.5 Following this, it is then necessary to test whether it is appropriate to vary the CIL charge. Setting differential rates of CIL is not a requirement; however it is recommended that charging authorities may want to consider setting differential rates as a way of dealing with different levels of economic viability within the same charging area. This variation can be applied in a number of different ways. Most commonly this will be a variation by area or by development type. Our approach will consider both of these alternatives.
- 2.6 For any variation by area, it is important that the boundary of such a change is clearly justified. Use of existing policy boundaries is not acceptable without adequate justification that must demonstrate alternative levels of viability within those boundaries.

- 2.7 CLG has made it clear that any variation in the charge by land use type, must be clearly justified. Therefore, it is necessary to consider two things for each land use:
- i Whether it is necessary to vary the charge because the proposed level of charge is likely to make development of that land use unviable.
  - ii Whether the potential value capture from affordable higher charges for that use can be justified by way of an appropriate level of evidence.

### Method for assessing viability

- 2.8 The most commonly used method of assessing the viability of development is to undertake a residual development land appraisal. In essence, this involves the assessment of the value of the completed development (known as the Gross Development Value or GDV) and deducting the various development costs to calculate a residual land value.
- 2.9 This study will test viability using the residual method of appraisal in order to establish a land value once all associated development costs have been deducted. The testing will be conducted on a hypothetical typical site basis. Viability testing on a typical site basis has been adopted for the following reasons:
- The viability work for CIL is undertaken at a strategic planning level. It is impossible for this study to consider viability on a site-specific basis at this stage, given that there is currently insufficient data on site-specific costs and values, as site details have yet to be established. Such detail would also evolve considerably over the plan period. Site-specific testing would be considering detail in purely speculative/assumed scenarios, producing results that would be of little use for a study for strategic consideration.
  - As the study covers potential development in the entirety of Mid Devon – hypothetical typical site testing results are generic to any site across the District. The results enable Mid Devon to consider an appropriate levy for different uses on a strategic and long-term basis.
- 2.10 The relevant industry costs will be deducted from the GDV of the hypothetical typical site, in order to establish a residual development land value. This value will then be measured against benchmark local average comparable land values, established from the market in conjunction with the Valuation Office Agency.
- 2.11 The benchmark values reflect the level of value at which a landowner could be reasonably expected to sell. Therefore, following testing, if a resulting residual land value is higher than the established benchmark, development can be reasonably considered as being financially viable at the input values used within the residual valuation. In contrast, if a resulting residual land value is significantly lower than the established benchmark, then development at the respective input values can be considered to be less likely to be delivered and is subsequently a higher risk strategy towards delivery. Lower residual land values may restrict development, either due to the scheme simply being financially un-viable, or the residual land value is not sufficiently high enough for a landowner to willingly sell and release their land for development.

### **Establishing Gross Development Value (GDV)**

- 2.12 The Gross Development Value is the capital value of the completed development (i.e. the gross financial value of newly built development). Establishing the GDV of a typical or notional hectare of development land is the first stage of the residual valuation. In establishing the GDV of a typical development in Mid Devon, this study has conducted considerable market research through various data sources such as Focus and Council property registers as well as discussions with local agents. Given the significant variety in development types, this report has also considered historic comparable evidence for new values on both a local, regional and national level.
- 2.13 This study has measured value on a 'pound per square metre' basis, which is the most commonly used measure utilised in industry and is appropriate for application in viability testing.

### **Costs**

- 2.14 Once a GDV has been established, the cost of development (including developer profit) is then deducted. There are numerous detailed costs that can be considered as part of a residual development valuation. For the purposes of viability testing, the following costs and variables are some of the key inputs used within the valuation: -
- Developer profits
  - Build Costs
  - Professional Fees and Overheads
  - Finance
  - Marketing fees
  - Legal Fees
  - Acquisition costs
- 2.15 Further details of the costs and variables used as part of the viability testing are described in Appendix A

## 3 NON-RESIDENTIAL DEVELOPMENT IN MID-DEVON

### Introduction

- 3.1 This section of the report briefly reviews the key growth plans and indicators relevant in Mid-Devon. This provides an indication of what development might come forward and should be considered for CIL.

### Recent Growth

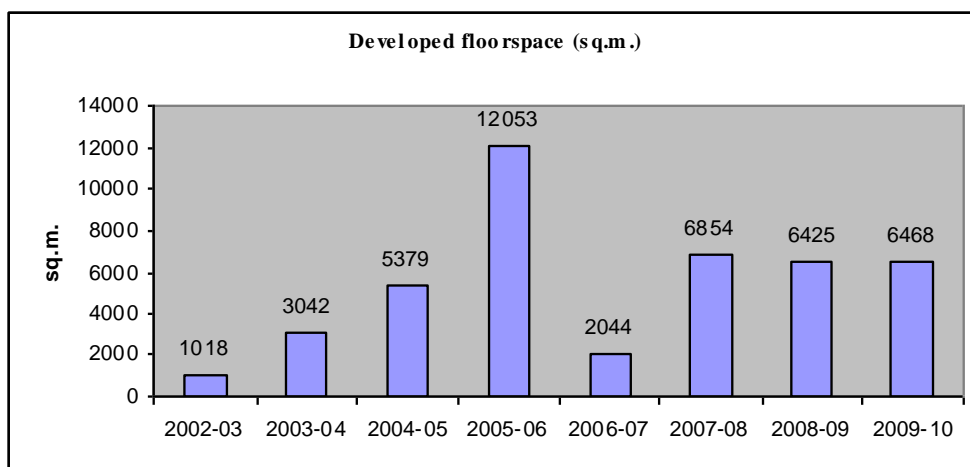
- 3.2 The adopted Core Strategy<sup>1</sup> notes that the district's population has risen by 24% between 1981 and 2004 to a total of 72,400 people, mainly as a result of in-migration. It also notes that the adjacent City of Exeter exerts an influence, with considerable out commuting to the city from the south of the district (32% of the working population in 2001) as well as many shopping trips. This relationship has an impact on the demand for certain types of non-residential premises in the district.
- 3.3 The adopted Core Strategy also notes that manufacturing is relatively important in Mid Devon (22% compared to 10% in the Exeter sub-region); that there continues to be a large number of employees in agriculture and forestry; and that land transport is an important sector.
- 3.4 Discussion with Council staff has indicated that previous supply of business park space has revealed demand for new employment space development. The 12 hectare Tiverton Business Park was entirely developed in four years after becoming available in 1987. The Tiverton Business Park amounts to 84% of the 14.3 hectares of employment land developed in Tiverton in the last 20 years. More recently the four hectare Mid Devon Business Park has been developed for industrial and warehouse units. We understand that in previous years the development of employment space has been constrained by a lack of available employment land in the district as a result of various Planning Inspector and Secretary of State decisions; and that this situation has now been resolved through the plan making process.
- 3.5 There has been recent convenience retail development in the district, including a new Tesco Extra in Crediton and a Tesco in Tiverton. The Council is beginning to develop plans to promote regeneration in Tiverton Town Centre which may result in the development of new retail space.
- 3.6 The most recent published Annual Monitoring Report for Mid Devon covers 2009-2010 and sets out the B and A use class development that has taken place:
- 6,468 sqm gross B class floorspace was created in 2009-10 of which:
    - 444 sqm was B1a
    - 1,044 sqm was B1c

<sup>1</sup> Mid Devon District Council, 2007, Core Strategy 2026



- 2,700 sqm was B1/B2
- 357 sqm was B2
- 546 sqm was B8
- 1,377 sqm was B1, B2 and B8
- 5,601 sqm gross A1 retail floorspace was created in town centres during 2009-10, with another 580 sqm under construction and 897 sqm in commitments
- 12ha of D2 leisure development was completed during 2009-10

3.7 The amount of B class development was similar to the two years prior to 2009-10 but around half of the peak 2005-06 total of 12,053 sqm.



Source Mid Devon District Council 2010 Annual Monitoring Report 2009-2010

## Planned Growth

3.8 The adopted Core Strategy sets out the planned growth in the district:

- 6,800 new dwellings (including 30% affordable dwellings) between April 2006 and March 2026 (390 pa 2006-16; then 290 pa 2016-26)
- 300,000 sqm of employment (B1-B8) floorspace (c. 14,700 pa). We note from the 2010 Annual Monitoring Report that 19,747 sqm has been delivered 2007-8 to 2009-10, leaving another 280,253 sqm to be delivered over the plan period
- 10,000 sqm of retail (A1) floorspace. We note from the 2007-8, 2008-9 and 2009-10 Annual Monitoring Reports that 12,830 sqm has been delivered with more in the pipeline

3.9 The planned growth in employment floorspace reflects the need for the additional 17,300 jobs required for self-sufficiency; and the retail floorspace requirement is informed by the separate retail study.

3.10 In spatial terms Tiverton, Cullompton and Crediton are the main foci for development, with Bampton playing a more limited role. There is reference to unmet demand for small and medium sized premises in market towns.

Table 3.1 Development Focus

Location	Average Annual Dwellings 2006-2026	Average Annual sqm Employment 2006-2026	Total Retail Sales sqm to 2016
Tiverton	145	6,000	3,900
Cullompton	95	4,000	2,650
Crediton	35	2,000	3,450
Bampton	10	400	
Elsewhere	55	2,300	
Mid Devon Total	340	14,700	10,000

Source: Mid Devon District Council, 2007, Core Strategy 2026

3.11 The Core Strategy plans for comparison retail development in Tiverton, Cullompton and Crediton, and for convenience retail development in Crediton.

3.12 The Core strategy also refers to an expected growth in tourism activity in the future as well as support for a Food Park (B2 and B8 with some B1 uses).

3.13 Discussion with Council staff has highlighted the following anticipated development:

*Tiverton Eastern Urban Extension*

- Contains a retail and employment space allocation
- Site not yet masterplanned
- Multiple landowners
- Planning application expected early/mid 2012

*Cullompton*

- Residential and employment land development
- A developer has been identified

**Discussion and conclusions**

3.14 This brief review of recent and future non-residential development confirms that there has been varied non-residential development in the district and that this includes A uses, and B1/B2/B8 uses. The plans for future development in the district are also likely to include these uses and therefore it is clear that they should be part of this study. We are aware that the Core Strategy target for A1 floorspace has already been exceeded but consider it likely that some additional A1 floorspace may come forward during the plan period (food retail in particular has been buoyant and could come forward in town centres) and so we have included it within this study.

3.15 We are not aware of any plans for new hotel development in Mid Devon but we note that it is traversed by major transport routes and that new hotel development could come forward.

3.16 While there has been Sui Generis development in the past and it is possible that there will be further such development in the future, by its nature it is very difficult to come to a clear view about timing, type and quantum.



## 4 TYPES OF NON-RESIDENTIAL DEVELOPMENT

### Introduction

4.1 Based upon the discussion of past and likely future non-residential development above we have generated a set of development typologies to test. In developing these we have also considered real examples of recent development in Mid Devon and the surrounding area. These have informed our assumptions in terms of appropriate values and costs to apply in our high level viability testing.

### Development Scenarios

4.2 The example developments to be tested in this viability study are set out below.

#### *A1 Retail*

4.3 We have based our A1 assumptions on three retail typologies:

- Supermarkets and large food stores – Edge of town development of gross 2,500 sqm with a site coverage of 40%
- Retail warehouses – Edge of town development of six retail warehouses totalling 10,000 sqm gross with a site coverage of 40%
- Town centre shops – Town or secondary centre retail of 300 sqm gross with site coverage of 80%

#### *A2 Financial and Professional Services*

4.4 We have included this use within the A1 use class assessment above, on the basis that subject to consent these uses are likely to occupy the same sorts of premises as many A1 town centre uses and therefore the viability will be covered by the assessment of the viability of A1 town centre uses.

#### *A3 Restaurants and Cafes*

4.5 Again we have included this use within A1 town centre retail above, on the basis that subject to consent these uses are likely to occupy the same sorts of premises as many A1 town centre uses and therefore the viability will be covered by the assessment of the viability of A1 town centre uses.

#### *A4 Drinking Establishments*

4.6 Again we have included this use within A1 town centre retail above, on the basis that subject to consent and licensing these use are likely to occupy the same sorts of premises as many A1 town centre uses and therefore the viability will be covered by the assessment of the viability of A1 town centre uses.

#### *A5 Hot Food Takeaways*

4.7 Again we have included this use within A1 town centre retail above, on the basis that subject to consent these uses are likely to occupy the same sorts of premises as many A1 town centre uses and therefore the viability will be covered by the assessment of the viability of A1 town centre uses.

### *B1 Business Offices*

4.8 We have used two B1 Office typologies:

- In town – 500 sqm with site coverage of 200% (development over 4 floors) with site coverage of 80%.
- Edge of town development of gross 2,000 sqm with 80 % site coverage (development over two floors).

4.9 The non-office B1 uses are covered by the B2/B8 uses discussed below.

### *B2 General Industrial*

4.10 We have used two B2 general industrial typologies:

- Edge of town industrial units of gross 1,500 sqm with site coverage of 40%. May include subdivisions into smaller workshop units.
- Edge of town industrial unit of gross 5,000 sqm with site coverage of 40%.

### *B8 Storage/distribution*

4.11 As per B2 General Industrial as in practice the activity will have the same types of premises as the larger B2 typology; i.e. warehouse of gross 5,000 sqm with site coverage of 40%.

### *C1 Hotels*

4.12 60 bedroom hotel of gross 2,800 sqm on two floors on an edge of town site with 80% site coverage.

### *D1 Non-residential Institutions*

4.13 Non residential institutions will vary from public sector or charitable institutions such as health centres, Children's Centres, libraries and museums through to commercial uses such as private sector child care facilities. Many of these will be charitable or public sector uses which are not viable in any commercial sense and we have not sought to test these. We propose that the majority of other development falling into this category will be similar to town centre shops – in that they are 'selling' services such as childcare.

### *D2 Assembly and Leisure*

4.14 Assembly and leisure also varies considerably but with common factors. We have tested two types of development which may come forward in Mid Devon:

- A mixed leisure scheme to include facilities such as cinema, bowling, health and leisure complex, gambling and associated eating and drinking establishments
- A stand alone commercial health and leisure facilities.

### *Sui Generis*

4.15 Sui Generis uses include theatres; houses in multiple occupation; hostels providing no significant element of care; scrap yards; petrol filling stations; shops selling and/or displaying motor vehicles; retail warehouse clubs; nightclubs; launderettes; taxi businesses; amusement centres; and casinos. The types of premises, value of uses and development

costs for premises accommodating these types of activity will vary considerably; and this means that Sui Generis uses cannot be treated in the same way as the other use classes.

- 4.16 Our approach to this issue has been to consider the types of premises and locations that may be used for Sui Generis and assess whether the costs and value implications may have similarities with other uses. We have also considered the likely developments within the plan period as a guide to whether more detailed work might be useful.
- **Theatres** – very few new theatres are being developed in the UK and the exceptions – such as Chester – are in locations with large catchments, an existing foundation of extensive artistic activity and a local authority with the means and inclination to pay. We do not consider it likely that a new theatre will be developed in Mid Devon during the plan period.
  - **Hostels** providing no significant element of care – these are likely to be either charitable or public sector uses such as probation hostels, half-way houses, refuges etc., or low cost visitor accommodation such as Youth Hostels. Our view is that the charitable uses are dependent upon public subsidy for development and operation, and therefore not viable in any commercial sense. Youth Hostels are operated on a social enterprise basis with small financial returns. Neither of these scenarios offer significant commercial viability.
  - **Scrapyards** – there may be new scrapyard/recycling uses in Mid Devon in the future, particularly if the prices of metals and other materials rise. Subject to consent these are likely to occupy the same sorts of premises as many B2 uses and therefore the viability will be covered by the assessment of the viability of B2 uses.
  - **Petrol filling stations** – we are aware that the recent new filling stations have generally been as part of larger supermarket developments, with independent filling stations closing. It seems unlikely that here will be significant new stand-alone filling station development in Mid Devon.
  - **Selling and/or displaying motor vehicles** - sales of vehicles are likely to occupy the same sorts of premises and locations as many B2 uses and therefore the viability will be covered by the assessment of the viability of B2 uses.
  - **Retail warehouse clubs** – these retail uses are likely to be in the same type of premises as the out of town A1 retail uses and covering the same purchase or rental costs. Therefore they are covered by this viability assessment.
  - **Nightclubs** – these uses are likely to be in the same type of premises as A1 town centre retail uses and covering the same purchase or rental costs. Therefore they are covered by this viability assessment.
  - **Launderettes** – these uses are likely to be in the same type of premises as A1 town centre retail uses and covering the same purchase or rental costs. Therefore they are covered by this viability assessment.
  - **Taxi businesses** – these uses are likely to be in the same type of premises as A1 town centre retail uses and covering the same purchase or rental costs. Therefore they are covered by this viability assessment.

- **Amusement centres** – these uses are likely to be in the same type of premises as A1 town centre retail uses and covering the same purchase or rental costs. Therefore they are covered by this viability assessment.
- **Casinos** – The Casino Advisory Panel has advised the Government where the one regional, eight large and eight small casinos should be located and the locations have not included Mid Devon. We are aware that generally casinos have been located in larger urban areas often as part of a destination hotel development; and it seems unlikely that this type of development will happen in Mid Devon. While an existing hotel in the District may add a small casino to its existing operation this will be part of the overall hotel viability.

## 5 DEVELOPMENT VALUES AND COSTS

### Introduction

- 5.1 This section of the report summarises the evidence available about the values of development. Within this section we also review the developer contributions from previous non-residential development, as this provides an indication of potential contributions.
- 5.2 We have also reviewed the costs, rents and yields of recent non-residential transactions in order to form a basis for a quantitative viability assessment. As noted earlier in this report, there have been a relatively small number of non-residential transactions within Mid Devon District<sup>2</sup> and so we have extended the scope to include transactions in analogous locations.

### Historic Developer Contributions

- 5.3 A review of past S106 contribution agreements for non-residential development in Mid Devon has revealed the following amounts.

**Table 5.1 Mid Devon Non-residential S106 Agreements**

Description of Development	Payment agreed	Obligations
Erection of a food store	£150,000	Highways; town centre improvements
Employment Development	£80,000	Highways
Erection of an extension	£2,500	Access improvements
Employment Development	£1,666	Public transport
Mixed use development	£300,000	Unknown
2 commercial units	£600	Recycling
Supermarket and employment	£1,500,000 – £2,300,000	Public transport; link road

Note separate agreements for the same developments have been amalgamated

- 5.4 The table above shows a variety of developer contributions negotiated over the past five years. The most recent set of consent relates to the development of the gross 5,500 sqm Tesco development in Crediton, suggesting that in round terms the contribution was £270 - £400 sqm. However it is clear that in general only limited levels of s106 contributions have been successfully negotiated, potentially indicating a low level of activity, probably caused by a historic lack of land supply and where there has been activity a limited scope to collect contributions for non residential development with the exception of retail. It should be noted

<sup>2</sup> We understand that the reasons include a lack of available employment land in the district as a result of various Planning Inspector and Secretary of State decisions, reducing the availability of significant employment sites.



that in the future some of these obligations may be considered as payable through CIL whilst others will remain as site specific s106 negotiated.

## Current Values

- 5.5 In establishing the GDV of a typical development in Mid Devon, this study has conducted considerable market research through various data sources such as Focus and Council property registers as well as discussions with local agents and developers. Given the significant variety in development types, this report has also considered historic comparable evidence for new values on both a local, regional and national level.
- 5.6 In general the markets are subdued at present. There have been limited transactions with deals at much lower prices than might have been obtained a few years ago at the height of the market. The current lack of new development also reflects low levels of occupier demand and a shortage of development finance. We have generally assumed that values will reach the highest levels obtainable in the current market which implies that finance will be available and that there is some confidence in occupier demand. To that extent, these assessments anticipate an improvement in market conditions. We believe this is justified because without it, very little development is likely to come forward in any event.
- 5.7 Table 5.1 illustrates the values established for a variety of non residential uses, expressed in square metres (sqm) of net rentable floorspace.

**Table 5.1 Use values**

Use	Value (per sqm)
Town Centre Office	£891
Business Park	£1,009
Warehouse B8	£697
Small Industrial B2	£760
Large Industrial B2	£697
Major Food Retail	£3,725
Retail warehouse/OOC	£1,900
Town Centre Retail	£1,366
Hotel	£1,604
Mixed leisure scheme	£1,769
Health and fitness	£1,425
Care Homes	£2,100

Source: RTP research

## Costs

- 5.8 We have based our build costs on BCIS data which has been adjusted to take into account build costs specific to Mid Devon and feedback from consultation with the development industry. We have also used high level cost estimates for external works, fees, marketing, contingency, finance, acquisition and developer profit. Further detail is within appendix A.

## Existing Use Values

- 5.9 Establishing the existing use value (EUV) of land and in setting a benchmark at which a landowner is prepared to sell to enable a consideration of viability can be a complex process. There are a wide range of site specific variables which effect land sales (e.g. position of the landowner – are they requiring a quick sale or is it a long term land investment). However, for a strategic study, where the land values on future individual sites are unknown, a pragmatic approach is required. Therefore as a starting point for non residential development we have looked at VOA data for agricultural land and serviced industrial land in areas in and around Mid Devon as well as any available transaction or sale price data. From this we have concluded that a benchmark figure of £500,000 per hectare is appropriate as a starting point. We have assumed that some higher value uses are likely to attract higher land prices as landowners will want to take advantage of the opportunity to capture some of the value.

## 6 DEVELOPMENT VIABILITY

### Introduction

- 6.1 This section sets out the assessment of non-residential development viability, based on the values and costs summarised in the previous section. This section also summarises the impact on viability of changes in values and costs, and how this might have an impact on the level of developer contribution.
- 6.2 It is important to note that the analysis considers development that might be built for subsequent sale or rent to a commercial tenant. However there will also be development that is undertaken for specific commercial operators either as owners or pre-lets. In these circumstances the economics of the development relate to the profitability of the enterprise accommodated within the buildings rather than the market value of the buildings.

### *B-class uses*

- 6.3 In line with other areas of the country our analysis suggests that for commercial B-class development it is not currently viable to charge a CIL. Whilst there is variance for different types of B-space, essentially none of them generate sufficient value to justify a CIL charge.
- 6.4 As the economy recovers this situation may improve but for the purposes of setting a CIL we need to consider the current market.

**Table 6.1 Industrial Development Viability**

	Small Industrial	Large Industrial
Net Development value/sqm	£716	£657
Net development costs/sqm (including land costs)	£1,089	£1,112
Residual value/sqm	-£373	-£456

**Table 6.2 Warehouse Viability**

Net Development value/sqm	£657
Net development costs/sqm (including land costs)	£1,204
Residual value/sqm	-£548

**Table 6.3 Office Viability**

	Town Centre	Out of Centre
Net Development value/sqm	£839	£951
Net development costs/sqm (including land costs)	£1,960	£1,956
Residual value/sqm	-£1,121	-£1,005

**A-class uses**

- 6.5 The viability of retail development will depend primarily on the re-emergence of occupier demand and the type of retail being promoted. For this reason we have tested different types of retail provision.
- 6.6 *Town centre and local retail* – the proposed regeneration of Tiverton town centre may result in the development of new retail space. We have tested developments within the town centre which could also be applied to all small retail developments under 500 sqm across the district. We also consider that on a strategic level in Mid Devon there is little difference between A1-A5 units with the exception of supermarkets and food retail over 500 sqm, which are considered separately. The residual analysis shows that this use is not currently able to support a CIL charge.

**Table 6.4 Town centre and local retail viability**

Net Development value/sqm	£1,287
Net development costs/sqm (including land costs)	£1,492
Residual value/sqm	-£205

- 6.7 *Retail warehouse* – although this market has been relatively flat in recent times, especially in terms of new build, there may potentially be more activity in the future. Whilst values have dropped the relatively low build costs mean that there is still value in these types of developments when there is occupier demand. Retail warehouse development could realise a levy of £100 per sqm and possibly more if the council believe the market will be strong in the near future.

**Table 6.5 Retail Warehouse Viability**

Net Development value/sqm	£1,791
Net development costs/sqm (including land costs)	£1,629
Residual value/sqm	£162

- 6.8 *Supermarket and large foodstores* - out-of-town convenience retail continues to be one of the best performing sectors in the UK. Leases to the main supermarket operators (often with fixed uplifts) command premium leases with investment institutions. Although there are

some small regional variations on yields, they remain generally strong with investors focussing primarily on the strength of the operator covenant and security of income. We would therefore suggest the evidence base for large out of town retail can be approached on a wider region or even national basis when justifying CIL charging. Following our appraisal on this basis in Mid Devon we believe there is scope for a significant CIL charge – say £250/sqm - without affecting viability.

**Table 6.6 Supermarket Viability**

Net Development value/sqm	£3,511
Net development costs/sqm (including land costs)	£2,913
Residual value/sqm	£598

### Leisure development

- 6.9 We have tested budget hotels, mixed leisure schemes and health clubs. Our high level appraisal of both these types of development shows that in the current market values are not sufficient to justify a CIL charge.
- 6.10 *Hotels* – hotel values are calculated on an equivalent rent based on the number of rooms multiplied by an investment yield. The rapid expansion in the sector at the end of the last decade was in part fuelled by a preference for management contracts or franchise operations over traditional lease contracts. The recession has curtailed the appetite from investors in management contract operations who prefer the security of lease related income even if this reduces the potential additional income from a performance related counterparts. Outside London (which has shown remarkable resilience to the recession) hotel development is being strongly driven by the budget operators delivering new projects through traditional leasehold arrangements with institutional investors. Room demand for budget operators is also driven by business occupiers as opposed to tourists. Therefore high occupancy in this sector is a more of a characteristic of major regional centres and transport routes rather than smaller market towns. The market for higher standard hotels remains difficult outside of the capital with the lack of access to finance curtailing development opportunities.
- 6.11 Our viability model is based on an out of town budget hotel scheme and in terms of Mid Devon it can be seen that there is not sufficient value realised to contribute to a levy.

**Table 6.7 Hotel Viability**

Net Development value/sqm	£1,512
Net development costs/sqm (including land costs)	£2,164
Residual value/sqm	-£652

- 6.12 *Mixed Leisure* - A mixed leisure scheme to include facilities such as cinema, bowling, health and leisure complex, gambling and associated eating and drinking establishments. Our

analysis shows that this sort of scheme is currently unlikely to be viable in Mid Devon and therefore not able to realise a CIL charge.

**Table 6.8 Mixed Leisure Viability**

Net Development value/sqm	£1,667
Net development costs/sqm (including land costs)	£2,370
Residual value/sqm	-£702

- 6.13 *Health and Fitness* - A stand alone commercial health and fitness facility is currently unlikely to be viable in Mid Devon and therefore not able to realise a CIL charge.

**Table 6.9 Health & Fitness Viability**

Net Development value/sqm	£1,343
Net development costs/sqm (including land costs)	£1,917
Residual value/sqm	-£574

### Other uses

- 6.14 *Care Homes* - In addition to the uses above we have tested the viability of care homes. There has been significant private sector investment in care homes in the recent past, fuelled by investment funds seeking new returns. However there have been concerns about the occupancy rates and the ability to sustain prices. The high level analysis suggests that care homes are unlikely to be viable in Mid Devon.

**Table 6.10 Care Home Viability**

Net Development value/sqm	£1,979
Net development costs/sqm (including land costs)	£2,291
Residual value/sqm	-£312

### Sensitivity test

- 6.15 To assist the council in setting their CIL charge we have undertaken a simple series of sensitivity tests for each development type. These have simply increased and decreased the GDV within our appraisals.
- 6.16 By increasing the values there is opportunity to set a higher rate for supermarket/food retail and retail warehouse type developments. However for all other types of development whilst they become more viable even a 20% increase in values will not enable a levy to be charged.
- 6.17 The decrease in values still allows for a charge to be set for supermarket development, while retail warehouse would no longer be able to sustain a charge.

6.18 We have also tested an increase in development costs – this could relate to a tightening of the construction industry, increase in building materials, higher design standards or environmental standards. An increase in costs of 10% still allows for a charge to be set for supermarket development, while retail warehouse would no longer be able to sustain a charge.

### What CIL rate should be charged?

6.19 The basis for setting a CIL rate needs to take account of:

- Setting a rate that will not affect the viability of most development. As a rule of thumb this suggests that the viability ‘headroom’ needs to be at least 15% of the development cost in order to be confident that viability will not be affected by additional costs of development<sup>3</sup>
- The need to raise funds to support the infrastructure necessary to support development in Mid Devon – the Council have undertaken separate work identifying the infrastructure required
- The need to have a clear and simple approach that is understood by the Council and the development industry

6.20 It is clear from the discussion above that the B-class uses are not able to sustain a CIL charge, nor are hotels, leisure developments, health and fitness or care homes. Therefore we recommend a £0 CIL for these uses.

6.21 Within A-class uses town centre retail is not able to support a CIL. While large format out of centre retail is viable the ‘headroom’ values are relatively small and just under 10% of total development costs. This means that the development is vulnerable to changes in values and build costs; and indeed the sensitivity tests show that development becomes marginal if these change. Therefore we recommend a £0 CIL charge for town centre retail and large format out of centre comparison retail.

6.22 Supermarkets demonstrate strong positive viabilities, with ‘headroom’ values just over 20% of development costs. As noted earlier in this report recent previous S106 payments from supermarkets have varied between £270 and £400 per sqm, clearly demonstrating that this sort of development is able to sustain a developer contribution. The development ‘headroom’ is just under £600/sqm for supermarkets and we are recommending a CIL of £300/sqm, which is within the contributions made in the recent past and 50% of the theoretical maximum amount.

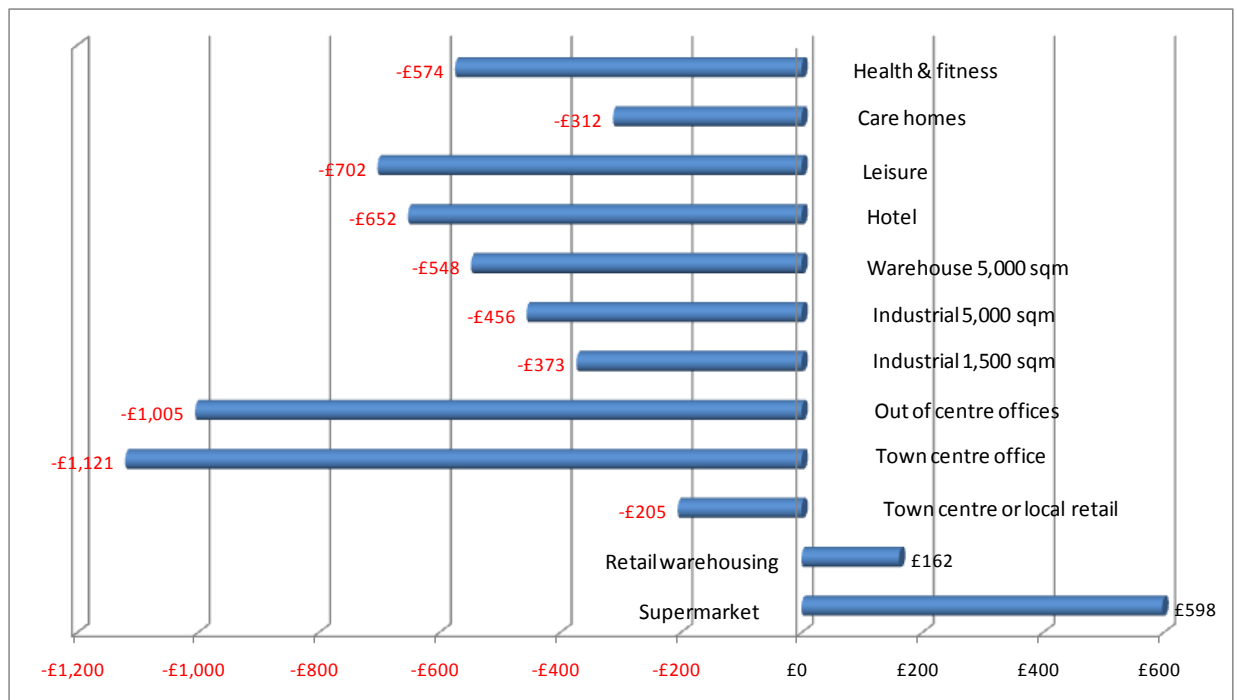
### Summary

6.23 The viability assessment indicates that the only types of development likely to produce values sufficient for a CIL charge will be supermarkets. This assessment is borne out by the amount and type of S106 payments agreed in the recent past in Mid Devon.

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<sup>3</sup> This rule of thumb is an RTP guideline to take account of the fluctuations in values and development costs

**Figure 6.1 Residual value per sqm in Mid Devon Summary**



6.24 The sensitivity testing suggests that:

- A fall in values or an increase in costs of 10% will reduce the viability of retail warehouses to the extent that they will not be able to realise a CIL charge. However supermarkets will still be able to pay
- It will take a rise in values of at least 20% before other uses start to become viable but even then they may not be able to pay CIL

6.25 Even though the assessment suggests that the other types of non-residential development are not commercially viable in Mid Devon, there may still be development. This will include premises being developed to pursue core business activities, as opposed to developing premises for rent or sale.

6.26 The recommended rates for CIL on non-residential development in Mid Devon are £0 with the exception of supermarkets, where we recommend a CIL of £300/sqm in recognition of the strong viability of this type of development.



## APPENDIX 1

### Assumptions

## Assumptions

1. The CIL will be levied on planning permissions so it is appropriate that the CIL charge is set for land uses as defined in the Use Classes Order and sub divided when appropriate.
2. The fundamental premise is that the CIL must be set at a level that does not undermine the Core Strategy. Our starting point therefore must be to understand what overall level of charge would not compromise viability for most developments. To do this, it is necessary to understand the predominant non residential land uses which have been developed over the last 5-10 years, along with a view of the land uses that are expected to represent the majority of change over the life of the Core Strategy.
3. Following this, it is then necessary to test whether it is appropriate to vary the CIL charge. This variation can be applied in a number of different ways. Most commonly this will be a variation by area or by development type. Our approach will consider both of these alternatives.
4. For any variation by area, it is important that the boundary of such a change is clearly justified. Use of existing policy boundaries is not acceptable without adequate justification that must demonstrate alternative levels of viability within those boundaries.
5. CLG has made it clear that any variation in the charge by land use type must be clearly justified. Therefore, it is necessary to consider two things for each land use:
  - i Whether it is necessary to vary the charge because the proposed level of charge is likely to make development of that land use unviable.
  - ii Whether the potential value capture from affordable higher charges for that use can be justified by way of an appropriate level of evidence.

## Approach and Methodology

6. The most commonly used method of assessing the viability of development is to undertake a residual development land appraisal. In essence, this involves the assessment of the value of the completed development (known as the Gross Development Value or GDV) and deducting the various development costs to calculate a residual land value.
7. This study will test viability using the residual method of appraisal in order to establish a land value once all associated development costs have been deducted. The testing will be conducted on a hypothetical typical or notional development basis. Viability testing on a typical/notional site basis has been adopted for the following reasons:
  - The viability work for CIL is undertaken at a strategic planning level. It is impossible for this study to consider viability on an actual site-specific basis at this stage, given that there is currently insufficient data on site-specific costs and values. Such detail would also evolve considerably over the plan period.
  - As the Study covers potential development in the entirety of Mid Devon – hypothetical typical or notional hectare testing results are generic to any site across the District. The results enable Mid Devon to consider an appropriate levy for different uses on a strategic and long-term basis.

8. The relevant industry costs will be deducted from the GDV of the hypothetical typical or notional site, in order to establish a residual development land value. This value will then be measured against benchmark local average comparable land values, established from the market in conjunction with the Valuation Office Agency. This includes an allowance for an uplift to incentivise bringing a site forward development, and reflects the likelihood that landowners will want to charge higher prices for development that they know will have higher values.
9. The benchmark values reflect the level of value at which a landowner could be reasonably expected to sell. Therefore, following testing, if a resulting residual land value is higher than the established benchmark, development can be reasonably considered as being financially viable at the input values used within the residual valuation. In contrast, if a resulting residual land value is significantly lower than the established benchmark, then development at the respective input values can be considered to be less likely to be delivered and is subsequently a higher risk strategy towards delivery. Lower residual land values may restrict development, either due to the scheme simply being financially un-viable, or the residual land value is not sufficiently high enough for a landowner to willingly sell and release their land for development.

### Costs

10. Once a GDV has been established, the cost of development (including developer profit) is then deducted. There are numerous detailed costs that can be considered as part of a residual development valuation. For the purposes of viability testing, the following costs and variables are some of the key inputs used within the valuation: -
  - Developer profits
  - Build Costs
  - Professional Fees and Overheads
  - Finance
  - Marketing fees
  - Legal Fees
  - Land Stamp Duty Tax
11. Further details of the costs and variables used as part of the viability testing can be seen in the following section.

### Sensitivity Analysis

12. In order to test different variables, this study has adopted a 'sensitivity analysis' approach to viability testing. In essence, the same residual valuation appraisal is undertaken numerous times, however, within each valuation a specific input/variable (such as the GDV) is altered, either positively or negatively, in order to gauge the influence on the resulting residual land value. This therefore provides a tool to explore and provide commentary on what levels of input are viable or not. Sensitivity analysis has also allowed the study to establish viability in different economic/market environments by testing under different GDV levels.

## Assumptions and Variables

13. We have outlined below details of the assumptions made throughout our viability testing, as well as details of the different testing variables used. This sub section also outlines the various sources of the inputs/variables as well as detailing which are subject to sensitivity analysis.

### Density

14. Table 1 sets out the assumed densities for each development type:

**Table 11 Density assumptions**

Development Type	Site Coverage	Storeys
Supermarket	40%	1
Retail warehousing	40%	1
Town centre or local retail	80%	1
B1 office town centre	80%	2
B1 office out of centre	40%	2
B2 industrial 1,500 sqm	40%	1
B2 Industrial 5,000 sqm	40%	1
B8 warehouse 5,000 sqm	40%	1
Hotels	50%	2
Assembly/leisure	50%	2
Care homes	50%	2
Health & fitness	80%	1

### Developer Profit

15. The developer's profit is the expected and reasonable level of return a private developer can expect to achieve from a development scheme. This figure is based as a percentage of the total Gross Development Value (GDV) of the development.

**Table 12 Developer profit**

20% of GDV
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16. The developer profit variables have been established through a reflection of anticipated returns for residential development, which have been tested with the development industry as part of this work and through similar studies.

### Build Costs

17. Build cost inputs have been established from the RICS Build Cost Information Service (BCIS) at values set at the time of this study (current build cost values), adjusted through discussion with the development industry. The build costs are entered at a pound per square metre rate at the following values shown in Table 3. We have also made an allowance for external works.

**Table 13 Build cost by development type**

Use	Build costs	External works
Town Centre Office	£1,300	10%
Business Park	£1,250	10%
Large Industrial	£600	10%
Warehouse	£672	10%
Small Industrial	£570	10%
Major Food Retail	£1,145	10%
Retail warehouse/OOC	£700	10%
Town Centre Retail	£810	10%
Hotel	£1,310	10%
Mixed Leisure	£1,440	10%
Care Homes	£1,316	10%
Health & Fitness	£1,141	10%

18. We have not made any explicit allowance for design or environmental standards within the baseline tests, as a review of the evidence<sup>4</sup> indicates that there are not necessarily cost implications if the requirements are built into the design at an early stage. The sensitivity tests do allow for an increase in development costs.

**Professional Fees, Overheads**

19. This input incorporates all professional fees associated with the build, including: architect fees, planner fees, surveyor fees, project manager fees. The Professional Fees variable is set at the following rate:

**Table 14 Professional Fees**

12% of Build Cost
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20. This variable has been applied to the valuation appraisal as a percentage of the total construction cost. This figure is established from discussions with both regional and national developers as well as in house knowledge and experience of industry standards.

**Finance**

21. A finance rate has been incorporated into the viability testing to reflect the value of money and the cost of reasonable developer borrowing for the delivery of development. Again this figure is established from discussions with the development industry.

<sup>4</sup> In particular the Building Schools for the Future programme required environmental standards and the review of the implications demonstrated that when (for example) BREEM standards were included at a late stage there were cost implications, if the original design included these aspects the cost implications were small or not evident.

**Table 15 Finance cost**

7.5% of Build Costs

### *Marketing Fees*

22. This variable is based on the average cost of marketing for a major new build development site, incorporating agent fees, 'on site' sales costs and general marketing/advertising costs. The following rate is applied to the valuation appraisal as a percentage of the GDV and is established from discussions with developers and agents

**Table 16 Marketing fees**

4% of GDV

### **Establishing Gross Development Value**

23. The Gross Development Value (GDV) is the capital value of the completed development (i.e. the gross financial value of newly built development). Establishing the GDV of a development is the first stage of the residual valuation. In establishing the GDV of a typical development in Mid Devon, this study has conducted considerable market research through various data sources such as Focus and Council property registers as well as discussions with local agents. Given the significant variety in development types, this report has also considered historic comparable evidence for new values on both a local, regional and national level.

### *Rental values*

24. The levels of rent will reflect factors such as location and general strength of the property market at the point when development is let/sold. Based on our market analysis, we have assumed the following rental values for the different development types:

**Table 17 Rental values**

<b>Use</b>	<b>Value (per sqm)</b>
Town Centre Office	£891
Business Park	£1,009
Warehouse B8	£697
Small Industrial B2	£760
Large Industrial B2	£697
Major Food Retail	£3,725
Retail warehouse/OOC	£1,900
Town Centre Retail	£1,366
Hotel	£1,604
Mixed leisure scheme	£1,769
Health and fitness	£1,425
Care Homes	£2,100

*Yields*

25. The property 'yield' is critical to the value of property; when deciding whether to invest in property at all an investor will compare it against other competing investment opportunities such as company shares or government bonds or 'gilts' and also the different risks involved in each case. In the case of property the overall return or yield required by investors from property investments ranks between bonds which often offer higher initial income and lower risk, but little prospect of value growth; and shares where a higher overall return is justified by a lower initial return and higher risks.
26. A higher yield in a development appraisal will reflect one or both of the following key factors:
  - Lower rental growth prospects
  - Lower security of income (such as tenants with a weaker covenant, shorter leases and more sub-division of floorspace are anticipated).
27. Our yields have been derived from a combination of published information from Focus, local agents, regionally and nationally published trends.

**Table 18 Yields**

Use	Yields (%)
Town Centre Office	8.0
Business Park	8.0
Warehouse B8	7.5
Small Industrial B2	7.5
Large Industrial B2	7.5
Major Food Retail	5.1
Retail warehouse/OOC	7.0
Town Centre Retail	8.0
Hotel	6.1
Mixed leisure scheme	8.0
Health and fitness	7.0
Care Homes	6.1

28. The GDV is then calculated through a capitalisation of rental values using yields, and against sales values where available (although this is much more limited dataset).

*Legal Fees*

29. This input represents the legal costs to a developer in the acquisition of land and the development process itself. The input is incorporated into the residual valuation as a percentage of the residual land value at the following rate:

**Table 19 Legal fees**

1% of Residual Land Value
---------------------------

30. We have also considered the cost of finance for the acquisition of the development land and this is subsequently reflected as a rate deducted from the residual land value:

**Table 20 Acquisition finance**

10% of Residual Land Value
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31. The rates chosen to reflect the commercial interest costs at which a financial institution would reasonably lend, is based on general long-term trends. All additional costs associated with land finance have also been included within the percentage.

**Land Tax**

32. A Stamp Duty Land Tax is payable by a developer when acquiring development land. This factor has been recognised and applied to the residual valuation as percentage cost against the residual land value at the following rate:

**Table 21 Land tax**

A S 4% of Residual Land Value (highest rate is used for testing purposes)
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**Residual Land Value**

33. After systematically removing the various costs and variables detailed above, the result is the residual land value. In order to ascertain the level of likelihood towards delivery and the level of risk associated with development financial viability, the resulting residual land values are measured against a benchmark value which reflects a value range that a landowner would reasonably be expected to sell/release their land for development.
34. The benchmark range has been established through research, of the 2009 – 2011 average ‘alternative use values’ based on typical B1, B2 and B8 industrial use development land values.



**Table 22 Benchmark levels for development types**

<b>Use</b>	<b>Assumed land price/ha</b>
Town Centre Office	£500,000
Business Park	£500,000
Warehouse B8	£500,000
Small Industrial B2	£500,000
Large Industrial B2	£500,000
Major Food Retail	£1,200,000
Retail warehouse/OOC	£500,000
Town Centre Retail	£600,000
Hotel	£500,000
Mixed leisure scheme	£500,000
Health and fitness	£500,000
Care Homes	£500,000

***Assumptions and variables notes***

35. All variables, inputs and values detailed and used within the viability testing is for illustrative and indicative guidance only. Some variables and values fall under areas of the market where there is no formal published research or information – this study has therefore had to identify and establish some variables, inputs and values through holding discussions with property professionals who are active in the Mid Devon, regional and national property market, as well as utilising our own experience and knowledge in the development sector.

## APPENDIX 2

### Sensitivity test

Baseline	Supermarket	Retail warehousing	Town centre or local retail	B1 office town centre	B1 office out of centre	B2 industrial 1,500 sqm	B2 Industrial 5,000 sqm	B8 warehouse 5,000 sqm	Hotels	Assembly/leisure	Care homes	Health & fitness
Values/sqm	£3,511	£1,791	£1,287	£839	£951	£716	£657	£657	£1,512	£1,667	£1,979	£1,343
Development costs/sqm (inc. EUV + uplift)	£2,913	£1,629	£1,492	£1,960	£1,956	£1,089	£1,112	£1,204	£2,164	£2,370	£2,291	£1,917
Residual Value/sqm inc. allowance for EUV + uplift)	£598	£162	-£205	-£1,121	-£1,005	-£373	-£456	-£548	-£652	-£702	-£312	-£574

Sensitivity - + 10% on Values	Supermarket	Retail warehousing	Town centre or local retail	B1 office town centre	B1 office out of centre	B2 industrial 1,500 sqm	B2 Industrial 5,000 sqm	B8 warehouse 5,000 sqm	Hotels	Assembly/leisure	Care homes	Health & fitness
Values/sqm	£3,862	£1,970	£1,416	£923	£1,046	£788	£722	£722	£1,663	£1,834	£2,177	£1,477
Development costs/sqm (inc. EUV + uplift)	£2,913	£1,629	£1,492	£1,960	£1,956	£1,089	£1,112	£1,204	£2,164	£2,370	£2,291	£1,917
Residual Value/sqm inc. allowance for EUV + uplift)	£949	£341	-£76	-£1,037	-£910	-£301	-£390	-£482	-£501	-£536	-£114	-£440

Sensitivity - + 20% on Values	Supermarket	Retail warehousing	Town centre or local retail	B1 office town centre	B1 office out of centre	B2 industrial 1,500 sqm	B2 Industrial 5,000 sqm	B8 warehouse 5,000 sqm	Hotels	Assembly/leisure	Care homes	Health & fitness
Values/sqm	£4,213	£2,149	£1,544	£1,007	£1,141	£859	£788	£788	£1,814	£2,001	£2,375	£1,612
Development costs/sqm (inc. EUV + uplift)	£2,913	£1,629	£1,492	£1,960	£1,956	£1,089	£1,112	£1,204	£2,164	£2,370	£2,291	£1,917
Residual Value/sqm inc. allowance for EUV + uplift)	£1,300	£520	£52	-£953	-£814	-£230	-£324	-£416	-£350	-£369	£84	-£305

Sensitivity -10% on Values	Supermarket	Retail warehousing	Town centre or local retail	B1 office town centre	B1 office out of centre	B2 industrial 1,500 sqm	B2 Industrial 5,000 sqm	B8 warehouse 5,000 sqm	Hotels	Assembly/leisure	Care homes	Health & fitness
Values/sqm	£3,192	£1,628	£1,170	£763	£865	£651	£597	£597	£1,374	£1,516	£1,799	£1,221
Development costs/sqm (inc. EUV + uplift)	£2,913	£1,629	£1,492	£1,960	£1,956	£1,089	£1,112	£1,204	£2,164	£2,370	£2,291	£1,917
Residual Value/sqm inc. allowance for EUV + uplift)	£279	-£1	-£322	-£1,197	-£1,091	-£438	-£515	-£607	-£789	-£854	-£492	-£696

Sensitivity +10% on Costs	Supermarket	Retail warehousing	Town centre or local retail	B1 office town centre	B1 office out of centre	B2 industrial 1,500 sqm	B2 Industrial 5,000 sqm	B8 warehouse 5,000 sqm	Hotels	Assembly/leisure	Care homes	Health & fitness
Values/sqm	£3,511	£1,791	£1,287	£839	£951	£716	£657	£657	£1,512	£1,667	£1,979	£1,343
Development costs/sqm (inc. EUV + uplift)	£3,204	£1,792	£1,641	£2,156	£2,151	£1,198	£1,223	£1,324	£2,380	£2,607	£2,520	£2,109
Residual Value/sqm inc. allowance for EUV + uplift)	£306	-£1	-£354	-£1,317	-£1,200	-£482	-£567	-£668	-£868	-£939	-£541	-£766