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Affordable Housing Viability Study: Mixed Use PIL Working Paper

London Borough of Camden

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Introduction

This working paper provides the summary findings and recommended policy options that have emerged from the modelling on Mixed Use Payments in Lieu for Camden. The modelling forms an extension to the Affordable Housing Viability Study.

London Borough of Camden's Mixed Use Policy

The London Borough of Camden generally seeks mixed-use developments (including housing) across the borough where appropriate, but applies a target to development in specific areas. Within the Central London Area (the Camden boundary for which is identical to the Central Activities Zone), where more than 200 sq m of additional gross floorspace is proposed, 50% of all additional floorspace should be housing. This should be provided on-site, but where this cannot practically be achieved, an off-site contribution in the same area may be accepted. At the end of this cascade of options is a payment in lieu – though this is only likely to be applicable in exceptional circumstances. Where the gross additional floorspace of the residential element of mixed use schemes is greater or equal to 1,000 sq m, affordable housing will also be sought. The target for affordable housing in mixed-use schemes is 50% of the overall residential floorspace proposed.

Approach

This modelling exercise seeks to establish an applicable payment in lieu figure for office and residential mixed use schemes in the relevant office locations within the Central London Area of Camden (i.e. Kings Cross, Euston, Tottenham Court Road and Holborn), but excluding Hatton Garden. It is based on LB Camden's mixed use policy as described above.

The adopted approach for calculating a payment in lieu for mixed use schemes is based on the concept of 'value neutrality'. Through this any payment in lieu is set at a level that ensures the residual land value of a typical scheme subject to the payment in lieu is the same as if the target level of housing were provided on site. The approach therefore seeks to extract the financial benefit the developer would get from providing 100% office on site, as opposed to 50% of the floorspace as housing (including affordable housing where applicable).

A series of archetypes have been developed to cover the anticipated range of schemes where a payment in lieu of onsite housing provision is likely to be appropriate. Where appropriate, the policy requirement for affordable housing has been included. The archetypes reflect the fact that a payment in lieu will generally only be applicable in exceptional circumstances and for smaller schemes, where there is greater likelihood that there will be justifiable reasons why housing cannot be provided on site. The archetypes used are shown in Figure 1 below.

Figure 1: Mixed Use Archetype Characteristics (gross external area)

| Archetype | Total Floorspace (sq m) | Residential Floorspace (sq m) | Affordable Floorspace (sq m) | Affordable as % of Residential Floorspace |
|-----------|-------------------------|-------------------------------|------------------------------|---|
| A | 290 | 145 | 0 | 0% |
| B | 802 | 401 | 0 | 0% |
| C | 1,266 | 633 | 0 | 0% |
| D | 2,625 | 1,313 | 662 | 50% |
| E | 3,799 | 1,899 | 947 | 50% |
| F | 4,612 | 2,306 | 1,150 | 50% |

The viability model has been run for a 'policy on' scenario based on the total scheme floorspace being split between 50% office and 50% residential (including the affordable floorspace where applicable), and a scenario with 100% of the total scheme floorspace being office. The difference in residual land value between these two scenarios for each archetype reflects the value gain to the developer in not providing any housing on site. These value differences have been converted to £ per sq m figures, based on the amount of residential floorspace in the 'policy on' position. All floorspace figures are expressed as gross external area (GEA).

Assumptions for the residential elements are drawn from the Affordable Housing Viability Study for consistency. The assumptions used for the office elements reflect market reality over the period used in the previous residential modelling (i.e. are based on 2008 office values and 2006-08 build costs). It should be noted that, out of necessity, average costs and values have been used – which include assumptions on elements including building height and complexity, build periods and demolition. As costs and values are likely to vary on a site by site basis, it is advised that LB Camden use the Payment in Lieu figure as a starting point for negotiations and take account of the individual circumstances of applicable schemes.

Within the modelling, the basis of calculating the contribution of affordable housing to scheme Gross Development Value (GDV) is the same as used in the Affordable Housing Viability Study, which pre-dated the introduction of Affordable Rent policies.

It should also be noted that in the main Affordable Housing Viability Study and previous Affordable Housing Payments in Lieu Working Paper a performance measure of 15% Internal Rate of Return (IRR) has been adopted¹. However, as the schemes tested here are of a smaller size, the consequent build periods (and therefore the time between outgoing costs and incoming revenues) are short, producing high typical IRRs.

For a developer to be interested in a scheme, a high IRR is not enough (especially for small schemes), as they would need to ensure they could achieve a minimum profit on their investment. Therefore, for small schemes especially, it is likely that in preference to achieving a set IRR%, a developer would require a 'profit on cost' of around 17.5% to invest in a scheme. This has therefore been used as the preferred measure to assess the viability of schemes in this paper. The 15% IRR measure has also been tested in the model as a sensitivity check and produces very similar final results.

¹ Internal Rate of Return (IRR) is an investment performance measure involving the discounted cash flow of a scheme i.e. it takes account of the timings of costs, revenues and the impact of necessary financing. It is therefore an important performance measure for large, longer term or more complex schemes.

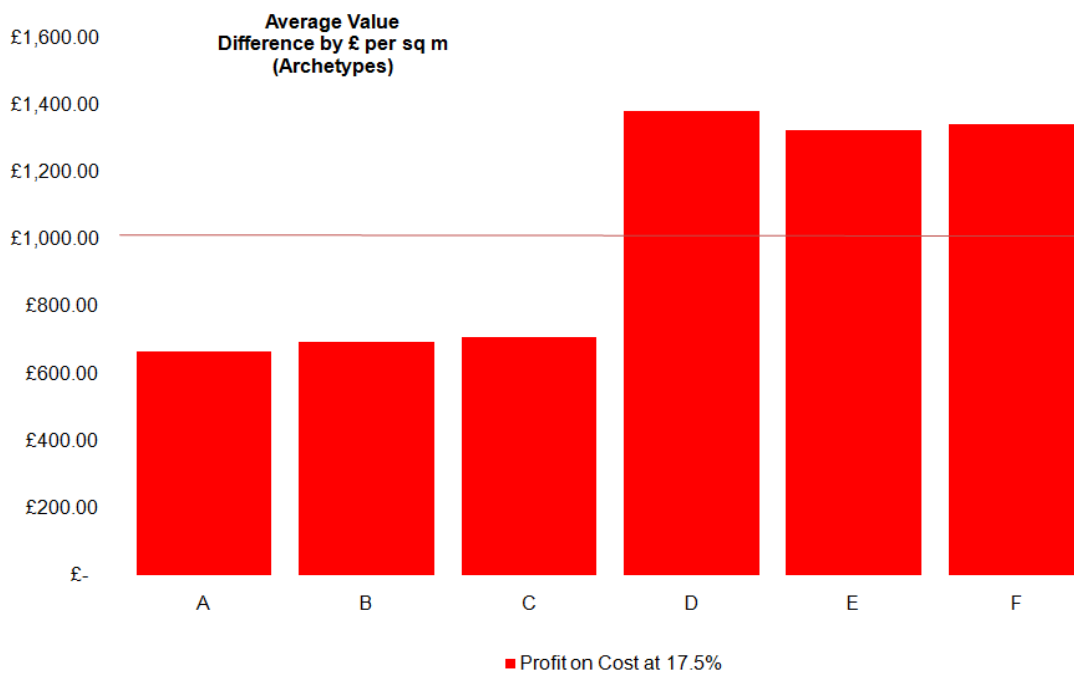
Analysis

Value differences have been produced across the above archetypes (taking an average across the four applicable value areas). The average value difference for each of the archetypes is set out below in Figure 2. This indicates a range of £665 to £1,378 per sq m (GEA) of residential floorspace, with an average figure across these archetypes of £1,018 per sq m. There are two distinct groups of archetypes (the smaller archetypes A, B & C, and larger archetypes of D, E & F), with very little difference within these groups, but significant difference between them. The average of Archetypes A, B & C is £688 per sq m, and for D, E & F is £1,348 per sq m. This difference is due to the requirement to include affordable housing for schemes with greater than 1,000 sq m of residential (i.e. D, E & F). This is also shown graphically below in Figure 3 (with the solid line indicating the average value across the archetypes).

Figure 2: Average Value Difference by Archetype

| Archetype | Average Value Difference per sq m of Residential (£) |
|-----------|--|
| A | £ 665 |
| B | £ 693 |
| C | £ 708 |
| D | £ 1,378 |
| E | £ 1,325 |
| F | £ 1,341 |
| Average | £ 1,018 |

Figure 3: Graph of Average Value Difference by Archetype



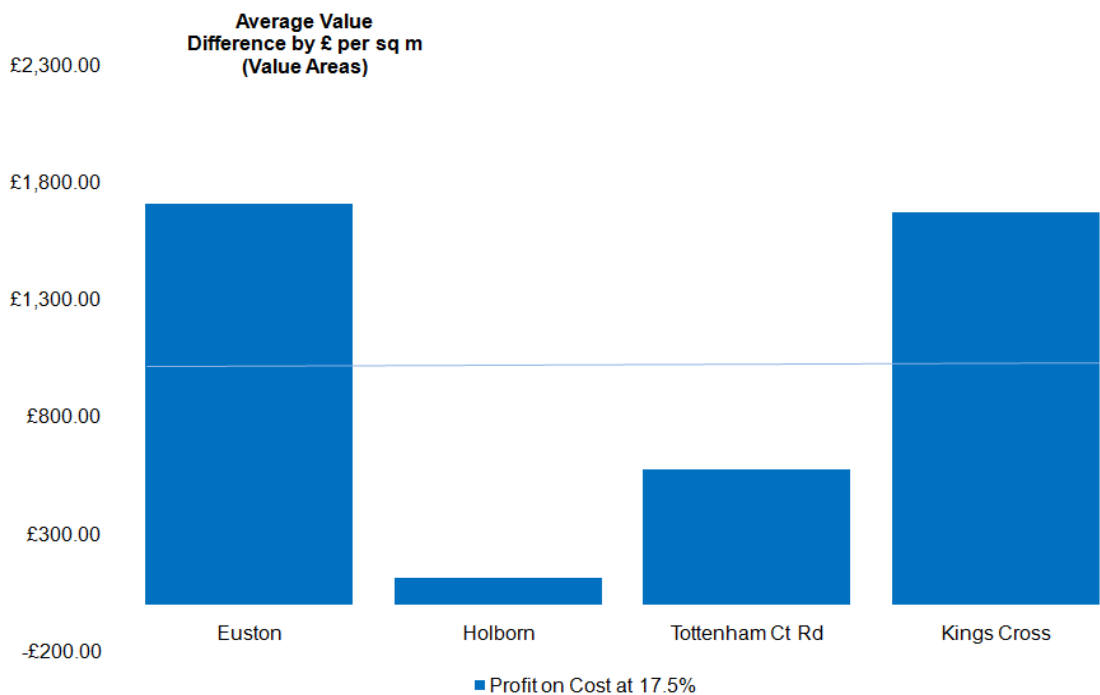
In addition to analysing the value differences for each archetype, the following analysis takes the overall average difference for these and examines how this changes across each of the four value areas. As Figures 4 and 5 below show, there is considerable variation across the value areas, with a range of £115 to £1,711 per sq m. It should be noted that this does not imply that Holborn or Tottenham Court Road are less viable areas for mixed use schemes. Rather, these areas generally command higher residential values and consequently the additional value generated from a 100% office scheme (compared to 50% residential) is much less than in areas of lower residential value. Indeed, the average residual land values for the archetypes under the 'policy on' scenario are higher in Holborn and Tottenham Court Road than Euston or Kings Cross. This difference does not therefore equate to an 'ability to pay'.

The value areas are best fit aggregates of smaller areas with similar sales values, and there is likely to be considerable variation within each value area. While this allows a comparison of the broadly differing areas, it does not provide a firm basis for policy differentiation on an individual area basis.

Figure 4: Average Value Difference by Value Area

| Archetype | Average Value Difference per sq m of Residential (£) |
|-----------------|--|
| Euston | £ 1,711 |
| Holborn | £ 115 |
| Tottenham Ct Rd | £ 575 |
| Kings Cross | £ 1,672 |
| Average | £ 1,018 |

Figure 5: Graph of Average Value Difference by Value Area



Source: DTZ, 2011

Recommendations

From the above analysis of the archetypes, there are two distinct bands of value differences – Archetypes A, B and C with an average value difference of £688 per sq m, and Archetypes D, E & F with an average value difference of £1,348 per sq m. There is also little difference in values within these two bands. The analysis by value area suggests that all areas show strong residual land values for both purely office and mixed use schemes, but with a variety of value differences between these scheme types – with the results not justifying a payment in lieu figure that differs by area.

Given this and the above analysis, there are three policy options that could be adopted as the basis for a payment in lieu figure:

- Set a payment in lieu figure based on the average figure for all archetypes, with a willingness to negotiate this down for schemes which involve residential floorspace requirements below 1,000 sq m, depending on their individual circumstance. While this would likely result in a potentially greater payment in lieu income, it would also require greater council time and resources to negotiate and administer these payments. A recommended payment in lieu figure based on this is **£1,000 per sq m GEA** of the on-site housing requirement.
- Set two payment in lieu figures – one for schemes which involve residential floorspace requirements below 1,000 sq m and one for schemes which involve residential floorspace requirements of 1,000 sq m or greater. Due to the very small variation within these categories seen in the modelling, this approach would likely ensure that the vast majority of schemes subject to a payment in lieu would continue to be viable under the policy. It would also keep as many schemes as possible close to a 'value neutral' position as possible. However, this approach may miss gaining as much payment from developments as other options. Recommended payment in lieu figures based on this approach are **£700 per sq m GEA** of the on-site housing requirement for schemes which involve residential floorspace requirements below 1,000 sq m, and **£1,350 per sq m GEA** of the on-site housing requirement for schemes which involve residential floorspace requirements of 1,000 sq m or greater.
- Set out in policy the criteria for when a payment in lieu for mixed use schemes would be appropriate and the method for calculating the figure, and determine payments on a scheme by scheme basis when it is deemed appropriate. While this approach would allow the council to extract the exact value difference for each individual schemes, this is likely to require significant council time and resources. It also fails to provide the council or developers with any certainty in advance of planning application as to expected levels of payments.

DTZ recommend adopting the second approach of setting a payment in lieu figure for schemes which involve residential floorspace requirements below 1,000 sq m and a separate figure for schemes which involve residential floorspace requirements of 1,000 sq m or greater. This takes into account the differential in value created by Camden's affordable housing requirement, and is justified by the small range of value differences within each of these two categories of schemes.

Floorspace Conversion

To calculate payment in lieu amounts, the applicable GEA on-site residential floorspace (as required by the Mixed Use Policy) should be multiplied by the preferred payment in lieu figure per sq m of GEA (as above). Where only a Gross Internal Area (GIA) figure is known, this needs to be converted to GEA. In line with the main Affordable Housing Viability Report, the modelling has assumed that the gross internal build areas are 80% of the gross external area for flats and 95% of the gross external area for houses. Therefore, the following multipliers should be used to convert GIA floorspace to GEA:

- Flats: $GEA = GIA \times 1.25$
- Houses: $GEA = GIA \times 1.053$