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EAST RIDING OF YORKSHIRE COUNCIL

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ARUP

Local Plan Viability Assessment Commercial Analysis

Prepared on behalf of
East Riding of Yorkshire Council
January 2014

Contents

1 Introduction

1.1 PURPOSE

DTZ and Arup have been appointed by East Riding of Yorkshire Council (the Council) to prepare viability evidence to support the emerging East Riding Local Plan. This report presents findings from viability modelling work for commercial land uses. It provides viability evidence in support of the Council's emerging East Riding Local Plan.

1.2 EAST RIDING LOCAL PLAN VIABILITY CONTEXT

Once adopted, the East Riding Local Plan will represent the statutory development plan for East Riding. It will set out the scale and distribution of development that is proposed for East Riding between 2012 and 2029 and will provide the statutory basis against which all future development proposals will be assessed and determined.

The need for viability testing of the Local Plan has arisen as a result of the requirements of the National Planning Policy Framework (NPPF). The NPPF has strengthened the importance of viability in the planning process and particularly in respect of development plan preparation. In order to ensure viability and deliverability of Local Plans, the NPPF states:

"*Plans should be deliverable. Therefore, the sites and the scale of development identified in the plan should not be subject to such a scale of obligations and policy burdens that their ability to be developed viably is threatened. To ensure viability, the costs of any requirements likely to be applied to development, such as requirements for affordable housing, standards, infrastructure contributions or other requirements should, when taking account of the normal cost of development and mitigation, provide competitive returns to a willing land owner and willing developer to enable the development to be deliverable.*" Para 173

1.3 SCOPE AND OBJECTIVES

The aim of this assessment is therefore to establish whether the proposed standards imposed on development within the emerging East Riding Local Plan Strategy document are realistically viable on commercial schemes. The following policy in the January 2014 Proposed Submission version of the Strategy Document is tested in this report:

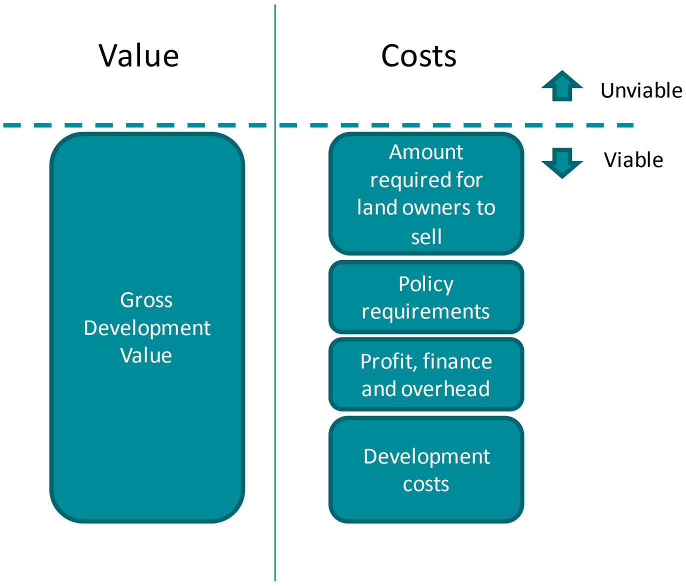
- Policy EC1: Supporting Growth and Diversification of the East Riding Economy, states that 'Key Employment Sites will be safeguarded from alternative uses.'. There are four key employment sites located at Melton, Capitol Park (Goole), Hedon Haven and Humber Bridgehead.

For the purposes of this report, we have not considered Hedon Haven in more detail due to the specialist nature of the site. This is a strategic analysis and whilst the archetypes have been designed to apply to the specific sites being tested, the assessments do not constitute appraisals of the individual sites in their entirety.

1.4 METHOD OF APPROACH

The publication of *Viability Testing Local Plans* by the Local Housing Delivery Group, May 2012, offers guidance for local authorities in assessing local plan viability in accordance with the NPPF. It underlines the importance of assessing the cumulative impact of policies on development viability and suggests a structured and transparent means of assessing viability. It recommends the use of an economic viability model based on a simple residual development appraisal whereby the impact of various policy standards can be quantified and assessed against the value of a development scheme. If the cumulative impact of all policy standards result in development costs exceeding Gross Development Value, then development is not viable.

Figure 1.1: Viability testing – principles



DTZ's approach involves the analysis of a selection of hypothetical development schemes to reflect the wide range of circumstances in which development is anticipated to come forward in East Riding. DTZ has developed a spreadsheet economic viability model that allows a large number of development scenarios to be tested in this way, including sensitivity testing of key variables. The appraisals are carried out on a residual site value basis, whereby the impact of various policy standards is taken into consideration alongside other costs which are discounted from Gross Development Value to produce a residual site value. The site value is then tested against a benchmark to determine whether or not development is viable.

The RICS guidance note *Financial Viability in Planning* 2012 defines site value as follows:

"Site Value should equate to the market value subject to the following assumption: that the value has regard to development plan policies and all other material planning considerations and disregards that which is contrary to the development plan."

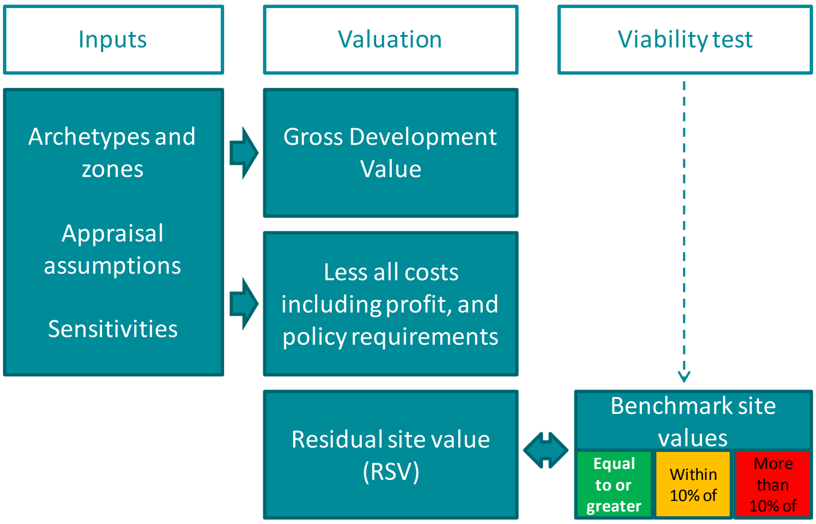
When undertaking Local Plan or CIL (area-wide) viability testing, a second assumption needs to be applied to the above:

"Site Value (as defined above) may need to be further adjusted to reflect the emerging policy / CIL charging level. The level of the adjustment assumes that site delivery would not be prejudiced. Where an adjustment is made, the practitioner should set out their professional opinion underlying the assumptions adopted. These include, as a minimum, comments on the state of the market and delivery targets as at the date of assessment."

Viability will be tested by the relationship of residual site values of hypothetical schemes against the benchmark. Where site values of the archetype scheme (including relevant cumulative policy impacts) is:

- Equivalent to or more than the benchmark, it will be recorded as green, and therefore regarded as viable
- Within 10% of the benchmark, it will be recorded as amber and therefore at risk of compromising land release
- More than 10% below the benchmark it will be recorded as red and therefore likely to compromise land release

Figure 1.2 Approach to viability testing



Where:

- Gross Development Value (GDV) represents the cumulative anticipated capital sales receipts from the development including any grants where applicable
- Development costs represent all the costs incurred by a developer in delivering the completed development scheme – site costs, build costs, contingencies, developer's profit, finance and all relevant professional, legal, sales/marketing fees and tax.
- Residual land value represents the difference between Gross Development Value and Development costs including profit.

1.5 CONSULTATION

A developer workshop together with survey questionnaire has been undertaken to inform the appraisal assumptions used in the appraisals. Attendees at the workshop were as follows:

Organisation
Persimmon Homes
ERYC (Valuation and Estates)
ERYC (Legal)
St Modwen
Linden Homes
Beal Homes
Wykeland
Micheal Glover
Hickling Gray
Hull City Council
Savills
Hickling Gray
ERYC (Bridlington Renaissance)
Lovel Developments
ERYC (Development Management)
North East Lincolnshire Council
ERYC (Housing Strategy)
Peter Ward Homes

Attendees at the meeting also include the project team from ERYC and DTZ.

1.6 CAVEATS

This report deals specifically with economic viability of selected hypothetical development schemes. It does not address the matter of either:

- Area wide development quantum / forecast; or
- Deliverability of land supply

These matters sit outside of the scope of this instruction and are being addressed by the Council as part of the wider evidence base supporting the Local Plan preparation.

It is also emphasised that the viability assessments undertaken as part of this instruction are indicative development appraisals only and are highly sensitive to the assumptions made. We have looked at sensitivities in attempt to cover the potential range of variations but we would underline that there remains a significant degree of uncertainty around many of the variables and that at an area wide level, generic viability appraisals are an approximate indicator only.

1.7 STRUCTURE OF REPORT

The remaining sections of this report include the assumptions used for the appraisals and the results for the commercial land use analysis.

2 Employment sites

2.1 SITE DETAILS AND DESCRIPTION

The three key Employment Sites that are proposed to be safeguarded for employment land use and are considered in this report are:

Capitol Park

Capitol Park comprises 62 ha of developable land close to Junction 36 of the M62. The site is owned by property investor Sterling Capital and is being promoted for B8 warehousing/distribution uses with the benefits of close motorway access. The site has experienced take up in recent years including Tesco distribution depot, Guardian Glass Float Manufacturing Plant and Drax Power Station accommodation, and has ERDF funding to complete the link road through the site.

The site also has consent for a 100 bed hotel, up to 1,050 sq m of A3-A5 floorspace and a 1,208 sq m car showroom.

Melton

Melton employment site is comprised of two separate employment land allocations originally identified as strategic sites in the former Humberside County Structure Plan:

- Melton Park (east of Brickyard Lane), developable area 44.59 ha, in the ownership of St Modwen, subject of a planning consent for B1, B2 and B8 use. The site is understood to be fully serviced including highways and utilities following the implementation of highway works via Monks Way to the A63
- Melton West (land between Gibson Lane and Lowfield Lane), developable area 21.5 ha, in the ownership of Wykeland Property Developments and being developed out for a combination of B1, B2 and B8 development.

Humber Bridgehead

Humber Bridgehead comprises two plots which together total a developable area of 19.36 ha. The development is being undertaken by Bridgeland Limited, a Wykeland company, in partnership with The Humber Bridge Board and Hessle Golf Course Company Limited. The first phase of development has recently been completed, with site infrastructure being part funded by the Yorkshire and Humber European Regional Development Fund (ERDF) Programme 2007 to 2013. The site is serviced amd located at the A164/A63 with good road accessibility.

2.2 DEVELOPMENT SCHEME ASSUMPTIONS

Evidence from the preliminary market assessment indicates that there are two principal geographical office markets operating in East Riding: the strategic employment locations which have potential for a single large HQ style occupier or and edge of centre pavilion style office. Scheme sizes selected for each reflect the potential for a large single tenant in the strategic location and a single phase of a smaller single / multi tenanted scheme in an edge of centre location. In practice these two variables are interchangeable, although the two scenarios are considered suitable to provide the range/parameters for the analysis.

Development appraisal assumptions have been selected based on our assessment of the market to reflect a 2 storey scheme:

	Size GIA sq m	Site cover	Gross to net
O1 Strategic Site	2000	40%	85%

Value Assumptions:

	Rent £psm	Incentives	Yield
O1 Strategic Site	156.00	24 months	8%

Cost assumptions:

	Build cost £sqm	Inc External
O1 Strategic Site	1111	1222

With regard to industrial schemes, we are of the view that there are three key development archetypes to be examined:

- Large warehouse – single 10,000 sq m unit
- Medium (suitable for B2/B8) – 1 x 5,000 sq m unit / 2 x 2,500 sq m units
- Small (local industrial) – 5 x 500 sq m units

Site cover is assumed to be 40% across these hypothetical schemes:

	GIA sq m	Site cover
I1 Small workshop B1c	2500	40%
I2 Medium B2/B8	5000	40%
I3 Large B8	10000	40%

Values and costs assumptions based on our assessment of the local market and following consultation through the developer stakeholder workshop and questionnaire feedback are as follows:

	Rent £psm	Incentives	Yield	Build cost £sqm	Inc External
I1 Small workshop B1c	65	12 months	9%	697	767
I2 Medium B2/B8	48	12 months	8%	457	503
I3 Large B8	45	12 months	6.00%	401	441

Other key assumptions are:

- Profit 15% of GDC
- Professional fees 10% of build costs
- Contingencies 3% of build costs
- Site and investment acquisition costs 5.8% on each
- Finance 6.5% pa rolled quarterly

- Abnormal costs excluded
- Letting agent fees 10% of rental value, letting legal fees 5% of rental value
- Investment agent disposal fees 1% of sales value, investment legal fees 0.25% of sales value.

With regard to benchmark site values, the VOA Property Market report (January 2009) indicates that industrial land in the Hull area is £480,000 per ha (£194,000 per acre). Across the East Riding, values for industrial land have been observed to vary from between 173,000 per ha (£70,000 per acre) to £494,000 per ha (£200,000 per acre). With regard to office land values, there has been very little office development in East Riding in recent years and where it has been consented or delivered, it often forms part of a larger mixed use development and therefore the land values attributable to office use are difficult to disaggregate.

We have selected three separate site value benchmarks to apply to these sites:

- £480,000 per ha (£194,000 per acre)
- £308,900 per ha (£125,000 per acre)
- £247,000 per ha (£100,000 per acre)

2.3 SENSITIVITIES

We have selected sensitivity ranges for the employment uses based on a range of potential variation in rents and yields over the timescale of the plan period (15 years). To do this we have analysed achieved figures over the last property cycle from 1988 to 2007 to reach both a high and low point for the next potential property cycle over the course of the plan period. These two appraisal variables, in addition to current values, enable both an upside and downside to be considered against the proposed policies.

The annual mean figure of achieved yields and rents across Yorkshire and Humber for each year was taken from the Investment Property Databank (IPD). IPD is Europe's leading property performance benchmarking company. The highest and lowest rent and yield for each sector was taken. Rents were converted into real prices by discounting for RPI observed through period. Yields, which reflect the relationship between capital value and income as a percentage, do not need to be discounted. The outputs present the following sensitivities:

	Yields		Rents	
	High	Low	High	Low
Office	11.8	5.7	128.00%	83.00%
Industrial	12.4	6.5	128.00%	89.00%

For clarification, the high value sensitivity results indicated below are based on the low yield and high rent and the low value sensitivity results vice versa[1].

We would caveat that these scenarios should be interpreted as sensitivities, not as a prediction or forecast of future market conditions, and therefore care must be taken in their interpretation in terms of viability results.

[1] The lowest yield in the industrial scenario is above that which has been used for current values in the large B8 archetype, which assumes an institutional strength covenant. Therefore in the high value scenarios, the yield of 6% has been retained.

2.4 RESULTS

The results are presented as residual site values that are then benchmarked against the above site thresholds in accordance with the methodology outlined in Section 1.

Table 2.1: Current market position

				Site value benchmark £ per ha		
Scheme		**Size (ha)**	**Residual value per ha**	**£247,000**	**£308,900**	**£480,000**
O1	Office	0.5	-£1,013,860			
I1	Ind Sm	0.625	-£1,366,061			
I2	Ind Med	1.25	-£508,236			
I3	Ind Larg	2.5	£257,984			

Table 2.1 shows that in current market conditions applying the above appraisal assumptions, the residual site values generated for the archetype schemes are mostly unviable with the exception of the large industrial scheme at the lower site value benchmark. The office and small and medium sized industrial scheme archetypes produce a negative land value, and whilst the large industrial archetype produces a positive site value, this is only viable if land can be secured at £247,000 per ha (£100,000 per acre).

Table 2.2 below displays divergent residual appraisal results for the high and low value scenarios respectively. The results are not benchmarked against a site values due to the unreliability of predicting future suitable land value thresholds. Therefore, in this table, no traffic light indicators are ascribed.

For the high value sensitivity, the residual results show that as would be expected, in peak market conditions, there is a return to viability with positive residual land values indicated across all of the archetypes. However it should be noted that these results are not benchmarked against a threshold site value and their future delivery will be subject to land owners' willingness to release their land which will be linked to their expectations of site value.

For the low value sensitivity, a worsening of market conditions results in schemes becoming even less viable than they currently are.

Table 2.2: Sensitivities

Scheme		**Size (ha)**	**High value sensitivity (residual value per ha)**	**Low value sensitivity (residual value per ha)**
O1	Office	0.5	£2,899,690	-£3,166,892
I1	Ind Sm	0.625	£366,912	-£2,173,040
I2	Ind Med	1.25	£558,584	-£1,317,464
I3	Ind Larg	2.5	£883,344	-£1,101,408

In summary therefore, the modelling of these hypothetical development schemes indicates that development viability is currently very marginal, but with a return to peak market conditions, development of most employment land typologies is likely to be viable, albeit land release will remain sensitive to individual site owner's expectations.

It should be emphasised that care is required in the interpretation of these figures and DTZ is aware that there are a number of precedents of recent commercial development actually taking place on sites in East Riding (such as at Melton and Humber Bridgehead) in current market conditions. The difference could be explained by minor variation in key variables such as profit levels, finance and rents which can have a significant effect on the outcomes. However, the appraisal assumptions used are considered to best represent the general prevailing market conditions.

2.5 INTERPRETATION

Clearly, the modelling of the above archetypes only provides an indication of the likely viability of typical schemes given the availability of a serviced plot of employment land in East Riding. Each of these archetypes is considered an appropriate benchmark for the type of scheme that can be expected to come forward on the three subject sites (Bridgehead being focused on office accommodation and Melton and Capitol Park primarily on industrial and warehousing uses).

It should be highlighted that site abnormals – such as any site specific site preparation, infrastructure or S106 obligations – have been excluded. For the sites that have been considered, this is a reasonable assumption since each is understood to be fully serviced which the site value benchmarks reflect.

The other significant consideration is whether there is likely to be adequate occupier demand throughout the Local Plan period, during the phase(s) in which market conditions are at a level to support development viability, to facilitate the take up of all of the developable area of the three sites. It is beyond the scope of this report to consider broader employment land supply and requirement issues across the District, however, DTZ understands that a comprehensive employment land review has recently been undertaken by East Riding Council which has informed the proposed safeguarding of the three subject strategic sites.

In addition, in terms of site specific take up, the Council has provided the following evidence of relatively significant development rates at each of the three sites recently:

- At Melton a total of 19.05ha of employment land has been taken up since 2007 (when a grade separated junction was completed which removed the significant highways constraint affecting this site). This equates to an average of 3.18ha per annum
- The first phase of development at Humber Bridgehead began in April 2013, taking up 1.41 ha of land
- Since 2000 44.89 ha of land has been developed for employment uses At Capitol Park, 44.89 ha of land has been developed for employment uses since 2000 (though since 2009 further development has been constrained until phase 2 of the link road is in place, for which ERDF funding has now been granted, and a planning application for the remainder of the site is pending consideration)

In summary therefore, the above analysis indicates that development viability of employment land uses on the three subject sites may be compromised in the short term due to the currently challenging economic conditions, however it is noted that development has come forward even in current market conditions in these locations despite this. In the event of a return to better market conditions, it is likely that development for B1, B2 or B8 uses will again become viable for the mainstream development sector. As the subject sites are readily available it is anticipated that these sites will be well placed to experience good levels of take up in improved market conditions, despite some remaining constraints such as Capitol Park's Phase 2 link road (which is due to start construction later this year following public sector investment).

3 Conclusions

3.1 CONCLUSIONS

The financial modelling contained within this report highlights the difficulties relating to development viability across all employment use classes in most locations in the East Riding of Yorkshire at the current time.

With regard to the Key Employment Sites, the appraisals indicate that viability of development is likely to be compromised in current market conditions in many cases. There are certain circumstances where commercial development has recently taken place, as is demonstrated by recent developments at Melton and Bridgehead. However, whilst these schemes have undoubtedly done well to get off the ground in the current economic climate, the assessment contained within this report indicates that they have bucked the trend, and that mainstream speculative commercial development schemes are likely to continue to struggle to be viable in the short term.

With the benefit of an improvement in market conditions over the medium to long term, there is potential for a more general return to viability in the office and industrial development markets. It is considered reasonable to assume that there will be an improvement in market conditions over the course of the East Riding Local Plan's period to 2029, consistent with recent property cycles. The sensitivity scenarios applied in this report demonstrate the potential for such a return to viability, and in view of the favourable location, form and availability of the strategic sites examined, there is considered to be realistic prospect of viable commercial development on these sites over the period to 2029.

The cumulative scale of the three key sites is such that in order to be entirely built-out over the fifteen year period, they will need to experience a level of take up that is consistent with the average rates of take up observed on these employment sites over the last fifteen years. The achievability of such take up rates will be subject to broader demand and supply dynamics in the East Riding Employment market – a matter that requires a level of assessment that is beyond the remit of this exercise. Together with the uncertainty over whether, when and by how much market conditions will improve, this suggests that care needs to be taken in how employment land policies are structured.