BNP PARIBAS REAL ESTATE

Jonathan Quilter
Planning Policy
Brentwood Borough Council
Town Hall
Ingrave Road
Brentwood
CM15 8AY

[redacted]

Private & Confidential
9 November 2022

Dear Sir/Madam

Brentwood Borough Council – Community Infrastructure Levy Draft Charging Schedule

On behalf of St Modwen and S& J Padfield, we are writing with a holding objection in response to Brentwood Borough Council's (the Council) Community Infrastructure Levy (CIL) Draft Charging Schedule (DCS) in relation to Brentwood Enterprise Park (BEP). This is a holding objection with the aim of discussing BEPs position further with the Council.

Background
As you are aware we have submitted a planning application for BEP, a new commercial development on land to the south of the A127 and east of the M25, Brentwood, Essex, which comprises:

> *"Hybrid application seeking outline planning permission for M25 to B186 link road (Phase 2), and detailed planning permission for demolition of existing buildings and structures; ground works to enable creation of development plots; highways works including construction of new A127 overbridge, access from B186, estate roads, and construction of M25 J29 to B186 link road (Phase 1); erection of buildings for Class B8 (Storage & Distribution) and/or Class B2 (general industrial) use, with ancillary office space (within Class E); landscaping; infrastructure and enabling works including diversion of public rights of way."*

The application seeks permission for the following elements:

- Application for outline planning permission - M25 to B186 link road (Phase 2) - all matters reserved; and
- Application for full planning permission - Demolition of existing buildings and structures; ground works to enable creation of development plots; highways works including construction of new A127 overbridge, access from B186, estate roads, and

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construction of M25 J29 to B186 link road (Phase 1); erection of buildings for Class B8 (Storage & Distribution) and/or Class B2 (general industrial) use, with ancillary office space (within Class E); landscaping; infrastructure and enabling works including diversion of public rights of way.

In summary, the development will provide four buildings for Class B8 (Storage & Distribution) and/or Class B2 (general industrial) use, with ancillary office space.

As the 2018 Viability Assessment prepared by HDH Planning & Development identified, industrial development can be challenging in viability terms and this was recognised by a £0 levy attributed to the use with no differential for warehousing/logistics.

At Examination into the Local Plan, the Council suggested that all Brentwood Local Plan (2016-2033) allocations were viable. For BEP, this was based on s106 contributions only. Now the Local Plan is adopted, an updated viability assessment has been produced by the Council's consultant to support public consultation on the proposed CIL rates. This updated Viability Assessment (August 2022) also produced by HDH Planning & Development Ltd (the Assessment) uses BEP as a benchmark for distribution/logistics schemes with s106 contributions assessed at £13.247m or £118/sqm. Their latest appraisal puts the tipping point at which BEP becomes underwater at between £280-£300/sqm. On the basis of the inputs to the appraisal, the assumption would be that BEP can support both £118/sqm for s106 and a CIL charge.

The Council suggests that an increase in residual value since 2018 for distribution and logistics uses means they are now viable and capable of bearing CIL as well as s106 costs. The charging schedule therefore identifies these uses as being able to support a CIL rate of £140/sqm. This rate is reflective of the majority of the headroom above the s106 costs before the tipping point referenced above is met.

The Assessment recognises that BEP may or may not come forward prior to adoption of the CIL charging schedule. Whilst we hope planning permission will be granted for BEP before CIL comes in to force, there is prospect of slippage and therefore BEP risks being caught by the £140/sqm charge. In addition, major amendments to the scheme later on may also be caught. It is therefore important that St Modwen responds to the assumptions of viability made in the Assessment. They consider that whilst the s106 costs referenced are broadly correct, land values and development costs have changed significantly this year, and particularly in the last 2 months, and this substantially changes some of the inputs to the appraisal.

St Modwen consider that BEP should be exempt from CIL in the same way that Dunton Hills is, given both developments are providing significant s106 contributions as well as BEPs wider infrastructure benefits. If this can be agreed, St Modwen will withdraw their holding objection.

Guidance on Setting CIL Rates

The Government publishes guidance on setting CIL rates as part of its Planning Practice Guidance. This sets out the following:

i) When deciding the levy rates, an authority must strike an appropriate balance between additional investment to support development and the potential effect on the viability of developments. (Paragraph: 010 Reference ID: 25-010-20190901)

ii) Authorities should show how "*their proposed levy rate (or rates) will contribute towards the implementation of their relevant plan and support development across their area*".

iii) The regulations allow charging authorities to apply differential rates in a flexible way, to help ensure the viability of development is not put at risk. (Paragraph: 022 Reference ID: 25-022- 20190901) 4 If the evidence shows that the area includes a zone, which could be a strategic site, which has low, very low or zero viability, the charging authority should consider setting a low or zero levy rate in that area. The same principle should apply where the evidence shows similarly low viability for particular types and/or scales of development. (Paragraph: 022 Reference ID: 25-022-20190901)

Delivering the Local Plan

The need to deliver employment development is central to planning policy in the Borough. The Council's Economic Strategy sets out a series of economic aims and strategic priorities which are reflected in the vision and strategic objectives of the Local Plan. These include Aims A1 and A2 which are to promote a mixed economic base and encouraging high value, diverse, employment uses to provide a significant number of skilled and high-quality jobs. Its first strategic economic priority P1 is to support business development and growth.

Securing economic growth has to, in part, be achieved by providing sufficient employment and industrial space. Whilst the amount of employment land allocations is broadly sufficient to ensure that the Council meets its overall forecast employment land needs up to 2033, BEP is a key strategic employment allocation (Policy E11) in contributing to these objectives. Sites like BEP are essential if the Council is to deliver its targets and therefore the Council, in setting CIL, should be careful not to put its viability at risk.

Viability Evidence

The CIL Guidance suggests that authorities should collaborate with developers to ensure that charging schedules are reasonable and supplement their viability work with evidence from them. Such information would constitute 'Appropriate Available Evidence' as defined in the section 211(7A) of the Planning Act 2008, which authorities are required to consider.

Whilst HDH recognise that modelling is never totally representative, they confirm the aim of the work is to broadly test the viability of sites likely to come forward over the plan-period. However, the assumptions in the Assessment for BEP are very different to those in St Modwen's most recent appraisal of the development for the reasons outlined below.

<u>The Distribution & Logistics Market</u>

In recent years the UK Industrial & Logistics market has seen an unprecedented level of rental growth as a result of a notable increase in demand following the onset of the Covid pandemic and the accelerated growth of e-commerce. Supply of new industrial and logistics property was not able to keep pace with demand due to supply chain constrictions and as a result of wider macro-economic trends. With such a strong occupier market and as a result of the supply and demand imbalance, record rental increases have been achieved across the UK. It is a consequence of the strong occupational market dynamics that the industrial and logistics investment asset class attracted a much deeper and broader pool of investors and this increased demand had resulted in a significant lowering of investment yields over the last two years to June 2022. However, the most competitive, prime end of the market that generated the strongest pricing has been significantly influenced by the volume of US private equity, REITs and overseas investors all of whom use a degree of debt finance whether upon acquisition or at a corporate level. The depth of investor competition attracted to the growth characteristics of the sector combined with the long term low interest rate environment that has been prevailing for the last decade has directly contributed to the record low yield levels achieved and largely priced out most of the domestic institutional fund market.

As we approached the end of Q2 2022, we began to witness the impact of various economic and geo-political headwinds primarily the output from the war in Ukraine and strong inflation affecting build costs and consumer spending and resulting in a 'cost of living' crisis. Far more impactful for investment pricing though was the rapid increase in interest rates. Whilst the BoE interest rate has risen from 0.1% to 3.00%, swap rates and borrowing costs for commercial investors saw a dramatic shift from less than 1% a year ago to over 4% in September as lenders factored in further rises. With the weight of debt-driven investors underpinning the strongest pricing, there is consequently a direct impact on market pricing arising from the rapid shift in finance costs impinging on forecast returns which still need to be targeted to meet investor requirements. Kwasi Kwarteng's mini budget in September exacerbated the issue and was the catalyst to widely reported turmoil in the financial markets with 5 year swap rates rising to over 5% and 10 year gilts rising to over 4%. Jeremy Hunt's subsequent installation as Chancellor and retracting the tax measures previously proposed under Truss and Kwarteng's tenure, has provided some settling of market rates but the economy has weakened with a recession now being the consensus outlook. Furthermore, with swap rates remaining over 4%, all in finance for real estate funding is in the region of 6% to 7% and with gilt rates now trending around 3.5%, property yields have had to rise to reflect a satisfactory risk margin over finance costs and other financial asset classes.

The outcome of the significant changes to the landscape for investment property is a 30% reduction in capital values in the industrial and logistics sector. Prime yields have shifted from 3.25% to 5.25% in a 3 month period. Far more significant is the impact on land values for industrial and logistics development which have generally reduced by 60% to 65% since June 2022. This is a consequence of not only the outward yield shift on the GDV but the compounding effect of considerable inflation on construction and infrastructure costs as well as higher finance rates and increased risk margins applied through all aspects of development appraisals. These aspects all effectively put the BEP appraisal under pressure at this current time and the Council should revisit the assumptions they have made.

Detailed Appraisal Considerations

It is recommended that the Council and HDH speak with St Modwen's team to understand the implications of these changes but that these macro issues together with the detailed appraisal points below indicate that BEP should be exempt from CIL. Some detailed questions/observations on HDH's appraisal assumptions in the Assessment for BEP are set out below:

Revenue

Please can HDH provide clarification regarding the build-up of their capital value per sq/m of £2,800 in terms of assumed rent and yield?

Project Programme

The appraisal provides no indication of the project programme and as a result is unclear what assumptions have been made in relation to construction duration/sales or units and the cashflow timings. The project programme will impact upon the finance costs.

Buyers Costs

The appraisal makes an allowance for purchaser's costs of the value of the completed units at 4.5% (£14,170,716). This allowance is understated as Stamp Duty Land Tax for the completed units (value £314,904,800) is 5% equating to a cost of £15,732,740. A sales agent fee of 1% and a sales legal fee of 0.8% should be added equating to a total purchaser's cost of £21,413,526. The purchaser's costs in the appraisal are therefore understated by £7,242,810.

Construction Costs

The appraisal does not stipulate which cost rate from the BCIS database has been adopted despite a cost of £865 per sq/m being adopted in the appraisal. We therefore request that HDH provide clarification regarding the adopted cost rate. Similarly, the servicing costs assumption of £275k per net developable acre (NDA) as set out in HDH's appraisal are too low.

Infrastructure & Abnormals

Where does the cost for infrastructure at 15% and abnormals at 5% of base build costs come from? The appraisal has a figure of £14,591,789 for infrastructure costs. In our assessment of the BEP scheme, these costs are significantly higher at £116m.

Contingency
The appraisal provides an allowance of 5% for a contingency which totals £2,936,597. However, the total sum only reflects 2.5% of the base, infrastructure and abnormal costs. A 5% contingency should total £5,873,467.

Commercial Letting and Legal Fees
The appraisal does not adopt an allowance for commercial letting and legal fees which are typically 15% of the first year's rent for letting fees and 5% of the first year's rent for letting legal fees.

Finance
The appraisal adopts a finance rate of 6% and we consider that this finance rate is low in light of the Bank of England's increase to the base rate of 3%.

Summary and Conclusions
BEP is a key strategic employment allocation. It also delivers strategic infrastructure works which facilitate the delivery of other Local Plan allocations. Land values and development costs for distribution and logistics uses have changed significantly this year. These changes together with HDH's significant under estimation of the infrastructure costs for BEP demonstrate that BEP cannot support CIL as well and the Council should revisit the assumptions they have made. There is also a prospect of double counting if CIL is directed to paying for strategic infrastructure which the s106 is already contributing to. A special case should be made for BEP to be exempt from CIL, in the same way that Dunton Hills is.

This holding response has been produced to allow for the Council to reconsider the approach to BEP and St Modwen would welcome a meeting to discuss the issues raised in this letter.

Yours sincerely

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Caroline McDade
Senior Director