WEST OXFORDSHIRE COMMUNITY INFRASTRUCTURE LEVY (CIL) EXAMINATION

JOINT STATEMENT OF COMMON GROUND – LAND VALUES AND DEVELOPMENT FINANCE

PARTIES:

- West Oxfordshire District Council (WODC)
- Edgars on behalf of West Oxfordshire Developer Consortium (WDEV)
- Barton Willmore on behalf of David Wilson Homes (DWH)
- Savills on behalf of the North Witney Land Consortium (NWLC)

DATE: 05 January 2016
This joint statement of common ground has been prepared in the context of the West Oxfordshire Community Infrastructure Levy (CIL) examiner’s request for statements of common ground set out in a note circulated on 8 October 2015 (IN CIL 02).

This statement of common ground deals with a number of specific issues set out in Questions 7-9 of the note including:

- The role of land promoters in large development schemes and their expected profit of 10% - 20% of land value;

- The 25% discount to land values applied in the Council’s viability evidence to take account of the impact of CIL; and

- The use of a combination of equity/debt finance versus 100% debt financing.

7. Rep 19, section ix highlights the role of land promoters in large schemes and their expected profit of 10%-20% of land value. Does the Council accept that this role and cost needs to be taken into account in the appraisals of the SDAs? If so, how has this been done?

WODC note that in their representation to the CIL draft charging schedule, Savills (Rep 19) suggest that in determining the benchmark or threshold land value for larger site typologies, it is necessary to account for the costs and planning risk associated with site promotion. They consider that the development process should be split into two; a ‘promotion’ phase which includes promoters profit and a ‘delivery’ phase from which the house builder derives their profit.

For the second, delivery phase, Savills suggest the use of a 20% profit margin (note: this is consistent with the approach taken by AV). To account for the initial promotion phase, Savills recommend an adjustment is made to the benchmark land value in accordance with advice set out in the Harman Report¹.

Specifically they consider that because land promoters require 10% - 20% of the land value to reflect the risks they take, the benchmark land value that is applied to larger Greenfield sites (where the promotion of the site is most likely to have occurred) should be uplifted by a minimum 25% - 30%.

¹ Harman Report Appendix B Section 3
They suggest that the benchmark land value for the North Witney SDA should be in the region of £400,000 per net developable acre (compared to the £225,000 per net developable acre used by AV in their assessment.

Whilst WODC acknowledges the role of site promotion in relation to large strategic development sites, it does not accept that an additional increase should be applied to the assumed benchmark land values set out in the AV report (VIAB1) in order to take account of the costs and risks incurred by those site promoters.

Specifically, WODC considers that any promoters' profit will have already been adequately factored into its own assumed benchmark land value for strategic Greenfield sites in the District (£225,000 per net developable acre) which represents a significant uplift from the current agricultural values of the sites that have been appraised.

It is relevant to note that the appraisals which were undertaken by AV incorporate a number of initial upfront payments including professional fees (e.g. technical reports) the cost of which will in some instances be borne by the site promoter.

WODC observes that Savills made a similar representation in relation to the Taunton and Deane CIL draft charging schedule in 2013 and that the examiner in that case did not recommend any upward adjustment to benchmark land values, considering that the risks involved on large sites was already adequately reflected in the assumed profit margin of 20%.

WODC also notes that Savills made similar representations to the East Cambridgeshire District Council CIL draft charging schedule and the Bath and North East Somerset CIL charging schedule. In neither case did the examiner agree that an upward adjustment of assumed benchmark land values was necessary.

WODC also observe that in a separate representation, DWH (Rep 21) state that the actual level of TLV applied ‘is considered broadly reasonable’.

Savills are representing the North Witney Consortium which is a large strategic site for predominately residential development. Our key point of contention is the analysis of the Benchmark Land Value (BLV), the inclusion of promotion costs and an appropriate return for


a Promoter’s risk. Strategic sites, such as this, are delivered in the market in a two stage process. The first stage is the promotion stage, and the second phase is the housing delivery, where by the Housebuilder receives a profit for the sale of each house. It is imperative that the distinction is made between the two phases.

For clarity, the AV study adopted a blended profit of 17%, opposed to the 20% as proposed by Savills through our previous representations. The profit of 17% is the return to the Housebuilder for the risks associated with stage 2. This profit does not represent a return for the Promoter.

It is normal in the market for Housebuilder’s to require a minimum of a 20% blended profit, and therefore it Savills opinion that the profit rate included in the AV is already below the market expectations, especially considering the changes in the Affordable Housing sector which have increased the risk and reduced the revenue when delivering affordable housing. To explain, the recent Budget (July 2015) announcement relating to the affordable housing sector has lead to the increased uncertainty for Registered Providers. The changes can be summarised as follows;

- An absolute rent reduction of 1% per annum on social and affordable rents until 2020;
- A Freeze on Local Housing Allowance (the housing benefit cap);
- A reduction in the benefit cap to £23,000 in London and £20,000 in the rest of the Country, from the current £26,000; and
- The abolition of Housing Benefit for under-21 and the end of Social Rents for Local Authority and Housing Association tenants who earn more than £30,000 (£40,000 in London).

As a result of the changes, we are aware of Registered Providers who are renegotiating Section 106 packages, as well as pulling out of contracts and reducing offers for affordable housing. This is again, supported by the recent letter to Local Authority Leaders and Chief Planning Officers in England, dated 9th November 2015 from Brandon Lewis which urges Local Planning Authorities to respond ‘constructively, rapidly and positively’ to requests to renegotiate Section 106 packages. This further supports the uncertainty and increased risk of delivering affordable housing. This has a twofold implication for developers, firstly the receipts for affordable housing will reduce, but the risk associated with the affordable housing has increased, and thus a lower profit rate is no longer applicable in the current market. On this basis, we strongly advise a blended profit rate of 20% is applied to all tenures.
Moving onto the second aspect, State 1 the Promotion phase, it is our thoughts that BLV’s for strategic sites should include an uplift for a Promoter’s profit. As detailed in our representation submitted to the Draft Charging Schedule (DCS) consultation (dated May 2015), the costs (and risk) of site promotion are rewarded as a percentage of the land value of the consented site when sold. It is typical for promoters to seek between 10-20% of the land value for their return, thus reducing the amount the landowner receives. The easiest way to reflect this profit is by increasing the BLV. It is our opinion that the BLV adopted in the AV report does not reflect this position, and is currently lower than the market for land values.

We note the AV study utilises net acres to assess the land value. By reviewing the AV appraisal for North Witney included as an Appendix to the Study it is possible to see the model assumes 82.78 net acres (33.5 net ha). There is no mention of the gross land value, or the assumed net to gross ratios. For sites of this scale, it would not be unreasonable for the gross to net deduction to be in the region of 50%. Assuming, it is 50% the adopted BLV would equate to only £112,000 per gross acre. This is extremely low, and is not reflective of strength of the local market in West Oxfordshire. As part of our representation to the DCS, we included evidence from land deals which we have been involved in. These are local transactions, and largely represent minimum prices in Option Agreements. These are therefore, the minimum receipts the landowner will receive when the consented site is sold, and the Promoter will have already have been paid an additional sum above this level. All of the evidence provided is above the BLV adopted and therefore Savills are extremely concerned the BLV for strategic sites is set too low.

In addition, Savills are concerned the current viability assessment shows the residual land value for the North Witney SDA below the BLV and thus the site already is at the margins of viability with a CIL rate.

8. The Aspinall Verdi Viability Study (AV) February 2015 (CIL 4, 4a, paragraph 5.121) discounts benchmark market land values by 25% to reflect the impact of CIL generally and in this regard follows the approach taken in the Examiner’s report for the Greater Norwich CIL. Is such a discount justified here, now that CIL is more well-known? Could it already be reflected in market values or is this further reduction reasonable? (This discount is also queried in rep 21, paragraph 3.17.)

As explained at paragraphs 4.14 and 5.121 of the AV study (VIAB1) a 25% discount has been applied to benchmark land values across the District to take account of the future impact of CIL.
WODC maintains that the application of the 25% discount is fully justified and is consistent with best practice guidance as well as the approach taken elsewhere.

Guidance published by RICS⁴ ‘Financial Viability in Planning’ at paragraph 2.3.1 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 polices and all other material planning considerations and disregards that which is contrary to the development plan’.

It goes on to state at paragraph 2.3.2 that:

‘Any assessment of Site Value, however, will have regard to prospective planning obligations and the point of the viability appraisal is to assess the extent of these obligations while also having regard to the prevailing property market’.

And furthermore, at paragraph 2.3.3 that:

‘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’. (WODC emphasis)

WODC therefore considers that the approach taken is fully consistent with the RICS guidance.

It is also consistent with the approach taken by the examiner in relation to the Greater Norwich Development Partnership’s CIL draft charging schedule whereby it was concluded that a maximum discount of 25% from the benchmark land value would be reasonable to take account of the future impact of CIL.

It should be noted that the Council’s consultants AspinallVerdi applied the same 25% discount to benchmark land values in their viability assessment for Sandwell Metropolitan Borough Council’s CIL draft charging schedule where it was not contested by respondents and duly accepted by the examiner.

Whilst CIL is now better known, it is not yet in force in West Oxfordshire and indeed across Oxfordshire as a whole, only one authority currently has an adopted CIL charging schedule.

in place (Oxford City). As such, WODC does not consider that the impact of CIL is already reflected within typical benchmark land values for the District and that the 25% discount that has been applied to take account of the future impact of CIL once it has been formally introduced is fully justified.

As stated above, WODC observes that DWH in their representation (Rep 21) at paragraph 3.1 state that ‘the actual level of TLV is considered broadly reasonable’.

WODC note that DWH do not appear to question the use of a discount on land values to reflect the future impact of CIL but highlight the fact that the 25% discount that has been applied by AV is the maximum level recommended by the Greater Norwich inspector and that as such, a smaller reduction ‘could be considered’.

For the reasons set out above, WODC considers that the approach taken by AV is both reasonable and robust.

WDEV believe that an element of developer contribution, in either the form of affordable housing contributions or Section 106 agreements is already part of the land values locally. To reduce this further by 25% would artificially reduce the threshold land value.

The consortium would wish to highlight that in West Oxfordshire a large amount of the housing supply has been, and is identified in the emerging Local Plan to continue to be, reliant upon the delivery of small scale schemes on brownfield sites or redevelopment of existing houses and gardens across all parts of the District (paragraph 5.34 of the West Oxfordshire Local Plan 2031). These would ordinarily be constructed by small and medium sized local building companies of which the consortium represent a significant number.

In terms of the viability testing and the consequent 25% discount applied to benchmark values, consideration of the brownfield issue is found at paragraph 4.16 of the AV report Feb 2015. Here it can be seen that B2/B8 property +a premium has been used. It justifies this approach by using examples of other local authorities using this method and in particular Sandwell and Norwich. In the case of Sandwell clearly the value of residential property is significantly lower than in West Oxfordshire and there is a greater degree of B2/B8 properties which would presumably account for a significant level of housing supply.

In reality in West Oxfordshire, a large proportion of small projects of up to 10 houses, within both the rural and town areas of West Oxfordshire, will involve the demolition of an existing residential property as well as some B2/B8 uses. The existing residential value does not appear to be factored into the calculations and a reduction of 25% in these cases is not realistic. The 25% reduction in land value is therefore a serious concern to the consortium
and does not reflect the reality of development for these smaller and medium sized developers.

In West Oxfordshire a significant proportion of the small and medium sized developers rely upon the redevelopment of existing residential property to create new homes. Appendix 1 of the Consortiums representation to the original CIL proposals and appended to their comments in February 2015, include a list of developments undertaken at that time. Of those listed Empire Homes and Willis Homes in particular have created 70% of their new homes on sites with an existing residential unit previously on the site-usually bought at a premium above market value of around 25%-30%. A notional lower price for the site (to take account of the suggested 25% reduction in existing land value for the CIL/affordable contribution) would not be possible as the existing land value for a house in West Oxfordshire is high and a seller would simply not sell to a developer at a discount. Essentially the sites are bought for development and very limited land based profit is accrued by the landowner. A reduction in the land value would simply not happen as the site would be sold on the open market or not sold at all. This in turn would prevent this source of housing supply from coming forward through the plan period.

On sites where more than 10 houses are proposed, or 5 in the AONB, this is of less concern as an element of viability testing pertinent to the site can take place, but where the CIL rates are fixed at £200psm and viability testing is not applicable, the Consortium consider that this source of housing delivery must be in significant doubt. In seeking to develop such sites they will essentially be forced out of the market by either competing home owners looking to buy a property to live in who can pay the market rate, or in the case of properties acquired privately, the landowner will not sell if there is not some incentive above the existing value.

In summary in the modelling and methodology used to test the viability of the CIL charging rate and sensitivity to it, it is considered unrealistic for the value of all sites to be discounted by 25%. It is however appreciated that a more sophisticated modelling is difficult. As such, and as the CIL rate will not be negotiable, a lower rate of £100psm for all sites should be applied in order to limit the real threat to the delivery of housing on small sites across the District, and to reflect the viability issues that these smaller sites will be subject to and upon which the Council rely for their housing supply.

The consortiums concern relates to this part of the AV methodology in relation to the reality of development in West Oxfordshire and specifically to the resultant non-negotiable £200psm rate for small developments.
Notwithstanding the concerns outlined above, WODC considers that the modelling of small residential schemes undertaken by AspinallVerdi is robust and reasonable.

The reality is that small residential schemes are likely to involve a variety of different types of site including greenfield and previously developed sites which may or may not have existing properties on the site. Site values are therefore likely to vary significantly and will in some cases be influenced by the particular expectations or aspirations of the individual landowner as well as the condition of any existing buildings.

It is not possible to model every potential eventuality through the type of modelling exercise undertaken by AspinallVerdi and Edgars acknowledge that more sophisticated modelling is difficult. AspinallVerdi have therefore sought to model a representative sample of residential typologies in order to come to an overall judgement on the ability of such schemes to contribute towards CIL and affordable housing.

They have modelled a number of smaller residential developments ranging from a single dwelling up to 15 dwellings. The majority of typologies are categorised as ‘greenfield’ although the 5 dwelling and 15 dwelling typologies also include a ‘previously developed’ scenario.

The rationale for the various typologies and the respective threshold land values (TLV) were set out in detail in the earlier September 2013 AV report (pp 75-78) and in the update report February 2015 (pp 55-56 and Appendix 1) and consulted upon. This has regard to values ‘per plot’ on the smaller typologies as well as values per acre/hectare.

Assumed threshold land values (TLV) for the greenfield typologies vary according to location (value area) and scheme size, ranging from £543,750 per acre / £38,389 per plot (15 house scheme – low value area) up to £1,500,000 per acre / £168,477 per plot (single dwelling – high value area – garden infill / greenfield). ‘Garden infill’ such as that referred to by Edgars is intended to be addressed through these ‘greenfield’ typologies reflecting the fact that the NPPF excludes private garden land from the definition of previously developed land.

The assumed threshold land value for the two previously developed land typologies (5 and 15 houses) is £600,000 per acre / £42,360 - £54,911 per plot (depending on density) which has been derived with reference to secondary B2/B8 existing use value plus a premium.

The Council considers that the Threshold Land Values that have been used are reasonable and justified. Whilst there will always be exceptions (e.g. a site with a particularly high existing value or a landowner with high expectations) it is not possible to model all possible scenarios and some broad assumptions inevitably have to be made.
The Council considers that the TLVs that have been used are reasonable and suitable for the purposes of Local Plan/CIL viability testing. They will not dictate actual offers that will be made for land in practical terms which will be dependent on a large number of factors.

The primary consideration is the extent to which small-scale schemes (including those with existing uses present) would be able to support the proposed CIL rate of £200m². In this regard the viability results contained in the AV study suggest this can be achieved noting that no affordable housing is assumed on these schemes.

Taking as an example the 5 house ‘greenfield’ typology in the high value area (Scheme 7) this would generate a GDV of £2.6m with total development costs (including developers profit) of £1.62m resulting in a gross residual land value of £0.99m and a net residual land value of £0.86m. Allowing for a TLV of £0.68m this would leave a positive surplus of £0.18m and thus significant scope for negotiation.

Similarly, the 8 house ‘greenfield’ typology in the medium value area (Scheme 14) would generate a GDV of £2.9m, with total development costs of £2.06m resulting in a gross residual land value of £0.83m and a net residual land value of £0.73m. Allowing for a TLV of £0.51m this would leave a positive surplus of £0.2m and thus significant scope for negotiation.

With regard to the 5 house previously developed typology in the high value area (Scheme 10) the GDV would be £2.6m with total development costs of £1.64m resulting in a gross residual land value of £0.97m and a net residual land value of £0.85m. Allowing for a TLV of £0.27m this would leave a positive surplus of £0.57m and thus significant scope for negotiation.

Edgar’s and the consortium do not believe that the issue of existing dwellings being demolished for residential development has been addressed in the SoCG. It is factually incorrect to state that Edgars refers to garden infill plots when they refer in evidence specifically to a figure of 70% of developments built on sites which previously had a house upon them. The WODC statement merely reiterates the AV report findings. It is factually correct to state that the AV report does not actually take any account of this development typology, and the brownfield (using B2/B8 uses) and greenfield options do not reflect the TLV from this very specific existing high value land.

Taking the example used by the Council above of the 5-unit typology (7) in the high value area. This assumes a greenfield site and a TLV of £680,000. However, a house on a site of ½ acre in such a high value area would itself be worth more than this threshold value. The
AV expected value of one five bed dwelling on a fifth of this plot size is over £600,000, in the typology example. One house on a larger plot would be worth significantly more. Therefore assuming that the site did have a house on it already, it is clear that this typology does not accurately reflect the TLV for redevelopment. In short such a proposal would not come forward for development and would be sold for private sale or perhaps replacement on a one for one basis. The development in this instance would simply not take place.

The example of a 5 house previously developed typology in the high value area (Scheme10) seeks to highlight that the TLV would be £270,000, therefore leaving scope for negotiation. The point here is there can be no negotiation on CIL rates and the value of a house on land is significantly more than employment uses. Therefore, if instead of a B2 use the use was as a house then the scenario would be exactly as stated above.

The argument applies equally to all the typologies highlighted above by the Council where the TLV would be lower than the value of a house on such a plot of land.

The redevelopment of houses for greater density residential development is an identified form of housing supply by the consortium in its evidence, WODC do not dispute this contribution. The contribution of windfall sites is a recognised source of supply in the draft Local Plan. The AV report does not test this form of development and therefore suggesting the CIL regime is based on robust and reasonable assumptions is factually incorrect. In short the Council have offered no evidence or reasonable justification for excluding this scenario which leads to a TLV and a CIL figure above that which the market can afford and with no recourse to negotiate.

From a general perspective and in the consortiums view the land/plot values WODC are suggesting do not factually exist and haven’t done so for many years. There is no factual basis for plot levels as low as that stated. Land in WODC cannot be found at these values.

DWH as stated in their representations continue to question the discount applied to land values to account for the impact of CIL. Should the Inspector find that viability is likely to be marginal for certain areas/typologies as we suggest in our representations, we feel that the Council will need to justify the use of the maximum level of discount suggested by the Inspector in Greater Norwich.

Savills are concerned about the source of the 25% discount. The figure is stated to have been included in the Greater Norwich Development Partnership’s CIL draft charging schedule, however the rationale of the inclusion of a 25% is not explained for WODC is not explained or justified.
Market land values already take into consideration planning policy requirements including historic Section 106 contributions and affordable housing policies. Savills would expect that the CIL levy is not set above historic Section 106 levels and therefore there should be limited need for land values to adjust, particularly by 25% which is a significant sum. This is further supported by the AV Local Plan and CIL Update Viability Study (February 2015) which provides in Section 10.11 the viability results for the SDA’s. In this table, AV show the residual land value for each SDA on two scenarios the first assuming that CIL is paid and therefore site specific S106 payment of £10,000 per plot is adopted. The second scenario is based on no CIL, but a higher Section 106 payment of £16,000.

Assuming that the two scenarios are based on reasonable Section 106 assumptions, the residual land values for all SDA are only marginally different, therefore demonstrating that land values do not need to be adjusted downwards by 25% as CIL is not higher than the previous Section 106 system. On this basis, Savills strongly advise the removal of the 25% deduction in land values to reflect the impact of CIL.

9. For each of the 4 large strategic schemes appraised in the AV study, Equity Finance is assumed to cover 40% of net cost. Is it only these 4 schemes where this approach is taken? What does this mean in practice for the developer? Is it a reasonable assumption? What, in broad terms, would be the difference in valuation if there was 100% debt financing? Is the assumed interest rate reasonable (see rep 19, section viii)?

In their representation, Savills (Rep 19) observe that the appraisal of the North Witney SDA provides for 40% of the scheme to be financed through equity and that as a matter of general practice, residual appraisals should be undertaken on the assumption of 100% debt finance.

As such, Savills consider that by only calculating the costs of finance on 60% of the scheme, this serves to hugely underestimate the cost of finance across the lifespan of the development.

Savills calculate that the finance costs applied to the North Witney SDA are £1.38m which equates to 0.6% of the overall total costs and that typically, based on similar schemes which should be in the region of 3-8%. They therefore suggest that the North Witney SDA appraisal is re-run on the basis of 100% debt finance to reflect the high upfront infrastructure costs over the lifespan of the development.
By way of clarification, WODC can confirm that the North Witney Appraisal set out in the AV study (VIAB1) assumes a ratio of 60% finance to 40% equity funding. This approach has been applied to all four of the Strategic Development Areas (SDAs) assessed in the study.

It has not however been applied to the generic scheme typologies set out in the report which use a simpler cash flow model based on 100% debt finance.

WODC acknowledges that conventional residual appraisals often assume 100% debt finance however the Council considers this to be an unrealistic proposition in the current development climate for the four larger strategic sites modelled in the assessment. In short, any developer who has no equity would be unable to run a viable business. Various types of funding will often be required and if a developer uses the equity already existing from earnings within the company or raises equity finance, the risk accepted is much less than that involved with debt finance.

It is also the case that it is now much more difficult to obtain 100% debt funding and that equity and debt can no longer be considered in isolation. A report produced by CBRE in 2014 states that as senior debt has contracted for development, the burden on equity has increased and that there is a defined need to be able to source funding from various channels, filling the gap between debt and equity.

For complex schemes such as the North Witney SDA there may be other sources of funding that need to be taken into consideration, for example The Homes and Communities Agency, Large Sites Infrastructure Programme.

The report states that where senior debt is available (i.e. certain locations and schemes) it is now constrained to lower leverage points and that whilst until 2007 up to c.90% loan-to-cost was regularly achievable (up to 100% in special cases) this has stabilised at 50% – 65%.

WODC therefore considers that the combination of equity/debt financing assumed in the AV study is justified and reasonable.

WODC’s consultants have advised in relation to the North Witney SDA that an assumption of 100% debt financing would have a significant impact on the identified residual land value of c. £150,000 per net acre, reducing it to less than £100,000 per net acre.

In terms of the interest rate applied (7%) WODC considers this to be reasonable and observe that Savills in their representation (Rep 19) also support the use of a finance rate of 7% (see Section viii page 38).

http://www.cbre.co.uk/portal/pls/portal/docs/1/54757841.PDF
WDEV do not agree with the logic used by WODC with regards to 100% debt finance. If a scheme is not actually 100% debt financed there is still an opportunity cost to that equity which is used to finance a project, and as such assuming finance costs on only 60% is considered incorrect in financial terms. Furthermore whilst 100% of finance may not be received from conventional bank sources peer to peer funding for example still has a cost associated with it.

In summary, WDEV consider that:

1. A 25% discount on benchmark values artificially lowers the threshold land values which already anticipate some contribution to either affordable housing or Section 106 contributions, and is particularly inappropriate for the significant number of developments which are created through the redevelopment of existing property.

2. There is insufficient buffer incorporated into the proposed CIL rates particularly for the developments liable for £200psm.

3. The CIL rates of £200psm for the smaller development in particular will affect the deliverability of small scale housing development across West Oxfordshire and therefore will limit this supply of housing, relied upon in the emerging West Oxfordshire Local Plan.

4. The Council’s assumptions regarding finance costs on only 60% is financially incorrect.

Savills strongly contest the viability model for strategic sites running on 60% debt finance and 40% equity. It is an industry standard that all development sites are assessed on 100% debt finance. This is consistent with assessing any development site (Brownfield, Greenfield, small, medium or strategic) for any purpose (viability, accounts, loan security).

We set out below the reasons why the assumption of 60% debt finance and 40% equity is incorrect.

Firstly, development appraisals are undertaken assuming 100% debt finance to reflect the opportunity cost of the ‘equity.’ Whilst in practice a developer may invest their equity into a scheme, there is a loss of income as the equity could be invested elsewhere. The 100% debt finance therefore provides a cost for the capital spent. This point is re-enforced in the RICS Valuation Information Paper 12 Valuation of Development Land (March 2008) which states:

“An allowance is to be made to reflect the opportunity cost of the monies, even if the developer is funding the project internally, on the assumption that the completed fully let and
income producing development is to be sold, or long-term finance obtained on its transfer to the developer’s investment portfolio.” (Paragraph 6.21)

This is further supported by the RICS Guidance Note Financial Viability and Planning which states:

“Viability appraisals generally assume that projects are fully funded by borrowing money. This is often referred to as 100 per cent gearing. Even where the funder has provided only part of the finance debt and the developer has used his own funds for the balance (equity), the appraisal should reflect the total cost of the funding.” (Paragraph E.3.3.7.2)

The above statements support that it is industry standard to reflect 100% debt finance, which in turn reflects the opportunity cost of investing equity into a scheme.

Secondly, WODC state that in reality debt levels are much lower in the current market reflecting senior debt funder’s requirement for lower loan to value ratios. Whilst this may be reality, many developers do utilise mezzanine funding, and other funding sources which often assist with topping up the funding streams from the senior debt to achieve higher loan to values. The mezzanine or alternative funding streams often comes at higher rates to reflect the risk of being a second legal charge. Whilst slightly more crude, this allows an assumption of 100% debt finance to average across the development to a rate more in keeping with 7%.

In summary, Savills strongly contest that assuming 60% debt and 40% equity is appropriate as it is not reflective of industry standards when assessing development sites. Guidance provided for Surveyors states that 100% debt finance is generally assumed. In addition, Savills are concern that the current assumptions has lead to a considerable underestimation of the finance costs of the development which is subsequently inflating the residual land value leading to an increased viability position for a site.

Further Savills comment that in the above statement by WODC their consultants have advised that in relation to the North Witney SDA that an assumption of 100% debt financing would have a significant impact on the residual land value, and if the viability assessment was re-produced assuming 100% debt finance, the residual land value would be below £100,000 per net acre. This is considerably below the benchmark land value demonstrating the difficulty, due to the site specific costs associated with the delivery of the site, of the North Witney SDA to support a CIL rate.
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| West Oxfordshire District Council | Edgars on behalf of the West Oxfordshire Developers Consortium | Barton Willmore on behalf of David Wilson Homes |
Signed:

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Name:
Elizabeth Foulkes

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Position:
Associate

__________________________

Date:
5 January 2016

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Savills on behalf of the North Witney Land Consortium