The Planning Inspectorate

Report to Merthyr Tydfil County Borough Council

by Mr Philip Staddon BSc, Dip, MBA, MRTPI

an Examiner appointed by the Council

Date: 20 February 2014

PLANNING ACT 2008 (AS AMENDED)

SECTION 212(2)

REPORT ON THE EXAMINATION OF THE DRAFT MERTHYR TYDFIL COUNTY BOROUGH COUNCIL COMMUNITY INFRASTRUCTURE LEVY CHARGING SCHEDULE

Charging Schedule submitted for examination on 30 October 2013

Examination Hearings held on 14 January 2014

File Ref: PINS/U6925/429/1

Non Technical Summary
This report concludes that, subject to three modifications, the Merthyr Tydfil County Borough Council Draft Community Infrastructure Levy (CIL)Charging Schedule provides an appropriate basis for the collection of the levy in the area. The modifications can be summarised: • That the residential CIL charge in the Lower Valley charging zone be reduced to £0 psm. • That the name of the 'Lower Valley' charging zone be inserted on the Residential Charging Zone plan (in place of 'Treharris and Trelewis') for clarity. • That the CIL charge for primary healthcare development be reduced to £0 psm. Subject to these modifications, the Council is able to demonstrate that it has sufficient evidence to support the schedule and can show that the levy rates would be set at levels that will not put the overall development of the area, as set out in its Local Development Plan, at risk.

Introduction

1. This report contains my assessment of the Merthyr Tydfil County Borough Council Community Infrastructure Levy (CIL) Charging Schedule in terms of Section 212 of the Planning Act 2008. It considers whether the schedule is compliant in legal terms and whether it is economically viable as well as reasonable, realistic and consistent with national guidance (Community Infrastructure Levy Guidance – DCLG – April 2013).

2. To comply with the relevant legislation the local charging authority has to submit what it considers to be a charging schedule that sets an appropriate balance between helping to fund necessary new infrastructure and the potential effects on the economic viability of development across the district.

3. The basis for the examination, on which Hearing sessions were held on 14 January 2014, is the submitted Draft Charging Schedule (DCS), which was published for public consultation between 25 July 2013 and 5 September 2013. The DCS was submitted for examination on 30 October 2013. The examination was undertaken jointly alongside the CIL proposals for Caerphilly County Borough Council. This report relates solely to Merthyr Tydfil CBC's published DCS.

4. The Council's CIL proposals include charges for residential development and for specified types of commercial development.

5. The residential CIL proposals relate to three defined geographical charging zones within which different CIL rates would apply. The 'Merthyr Tydfil' zone is in the north of the borough and includes the town of Merthyr Tydfil and its hinterland (but it excludes the northernmost part of the borough which falls within the Brecon Beacons National Park); in this zone the proposed CIL charge on new residential development is £25 per square metre (psm). The 'Mid Valleys' zone occupies the central part of the borough and includes the settlements of Troedyrhiw, Aberfan and Bedlinog; in this zone the proposed CIL charge would be zero rated i.e. £0 psm. The 'Lower Valley' zone occupies the southern part of the borough and includes the settlements of Treharris and Trelewis; in this zone the CIL charge would be £25 psm. A minor point, which I address through a recommended modification, is an inconsistency between the labelling used for the 'Lower Valley' in the text of the DCS and that used in the key to its charging zone map (where it is referred to as 'Trelewis and Treharris').

6. The Commercial CIL charges are not zoned and would apply throughout the borough. Five types of commercial development listed in the DCS would be zero rated for CIL purposes; these are offices; industrial; care / nursing home; hotels and cinema developments. CIL charges are proposed for three types of commercial development. First, 'A1 Retail Development' would incur a charge of £100 psm. Second, 'A3 Restaurants, Café & Drinking Establishments' would incur a charge of £25 psm. Third, 'D1 Primary Healthcare Development' would incur a £60 psm charge. A footnote on the DCS makes clear that other Class D1 developments would be excluded from the CIL charges.

7. This report is structured under the headings (in bold) of the main issues that I identified through the examination. I draw conclusions after exploring each issue.

Is the charging schedule supported by background documents containing appropriate available evidence*?*

Local Development Plan

8. The Merthyr Tydfil Local Development Plan (LDP) was adopted in 2011. It seeks to respond to problems linked to the decline of traditional industries and sets out a clear strategy, which first seeks to reduce outmigration and stabilise population levels by 2011, followed by a period of enhanced growth for the remainder of the plan period to 2021.

9. The LDP's spatial strategy seeks to direct growth into a hierarchy of three growth areas. The Primary Growth Area (PGA) in the north of the borough is centred around Merthyr Tydfil. The Secondary Growth Area (SGA) in the south of the borough includes the settlements of Trelewis and Treharris. The Other Growth Areas (OGA) covers the mid valleys area and its village communities which include Aberfan, Merthyr Vale, Bedlinog and Troedyrhiw. Policy BW13 of the LDP allocates land for 'approximately 3964 new dwellings', which is

slightly above the assessed requirement. The plan makes land allocations in line with its growth hierarchy with the vast majority (3134 units or 79% of the total) in the PGA, and the remainder in the SGA (580 units or 15%) and the OGA (250 units or 6%). This approach is consistent with the Wales Spatial Plan (WSP) that identifies Merthyr Tydfil as one of the 'Primary Key Settlements' in the sub-region. The site allocations have a strong brownfield emphasis, with about three quarters of the allocated sites being previously developed land. The LDP's Affordable Housing target is modestly set at 260 units in the plan period, split between the PGA (200 units), the SGA (30) and the OGA (10 plus 20 anticipated from the rural exceptions policy).

10. There is no shortage of employment land in the Council's administrative area. The LDP allocates 27.52 hectares, spread throughout the borough but with an emphasis on locations in main settlements and with access to the core highways network. This represents a significant over allocation on the LDP assessed requirement of 9.2 hectares, providing flexibility and choice in meeting future employment needs. A regeneration scheme focused on Merthyr Tydfil town centre is being progressed, and this supports the LDP's approach to employment / commercial development.

Infrastructure planning evidence

11. The Council's CIL evidence included an Infrastructure Report (February 2013) which refreshed and updated the comprehensive infrastructure evidence used to support the LDP. The report sets out a comprehensive range of physical, social and green infrastructure that the Council has identified as necessary to support planned growth. Some of the largest projects relate to strategic transportation schemes including major rail and road schemes that will improve accessibility and support planned growth. The overall assessed cost of all of the identified infrastructure is circa £208 million, of which circa £117 million is currently unfunded. i.e. there is a substantial infrastructure funding gap.

12. In developing its CIL proposals the Council used this assessment of infrastructure needs to distil a draft CIL Regulation 123 list. It has included the highway network identified in the LDP, strategic public transport infrastructure, strategic drainage, schools, waste, leisure and sports facilities.

13. There was some discussion at the hearing sessions about the inclusion of strategic water infrastructure on the draft Regulation 123 list. This matter is beyond the scope of my examination, but, in general, I share the Council's view that such infrastructure has its own, separate, funding regimes and in particular circumstances where development might be facilitated by such projects (and none were specified), the potential use of S.106 legal agreements is usually an alternative.

14. The Council estimates that its draft CIL proposals could generate circa £5.5 million from its proposed residential CIL charges along with an unspecified, but much lower, amount from its commercial development CIL charges. This is

clearly only a small (4.7%) proportion of the estimated infrastructure funding gap. Whilst a significant gap would remain, the CIL charges would make a positive contribution to funding important infrastructure required to help support planned sustainable growth.

Economic viability evidence

15. The Council, along with the neighbouring authorities of Caerphilly CBC and Rhondda Cynon Taff CBC, commissioned District Valuer Services to undertake an economic viability study to inform and help define its CIL proposals. The main study was supplemented by some further viability testing evidence, published just before the Hearing sessions. This collective of economic viability study evidence is hereafter referred to as the 'EVS'.

16. The EVS used a residual valuation model to test the viability of residential and commercial development schemes. In essence, this involves taking the end value of development and deducting a range of costs (building, land, overheads, fees, profit etc.) to determine the surplus (or deficit) that may exist to support a CIL charge.

17. The EVS testing related to actual development sites, albeit that they were anonymised to avoid prejudicing future developer / council negotiations. The three commissioning authorities identified a total of 69 sites of various sizes (big and small) and types (brownfield / greenfield) that they expected to be representative of developments that would deliver their LDP strategies. In the case of Merthyr Tydfil CBC, the EVS tested 8 residential sites (greenfield and brownfield) ranging from 10 units up to 110 units. The sites were spread across the borough with three each in the north and south, and two in the central area. Ten commercial developments were also viability tested, ranging from a small restaurant up to a 10 hectare employment development.

18. Clearly, such modelling involves making a wide range of assumptions about appraisal inputs. For residential development scenarios, this includes making assumptions about factors such as land costs, build costs, fees, densities, housing mix, affordable housing content, contingencies, sales values, profit levels etc. For the commercial development types, similar assumptions were made but with assumed rents and yields being the key value determinant (rather than sales values). Each modelling appraisal undertaken was bespoke for the individual site / development scheme tested, resulting in an output of 69 appraisals across the study area, 18 of which were within Merthyr Tydfil CBC's administrative area.

19. Although many of the modelling assumptions used in the EVS were uncontested and conformed to industry standards, there were some challenges to assumptions made about key components, and some others where I make some observations relevant to this CIL examination. I summarise these below.

<u>Land values</u>

20. The EVS employs the use of 'benchmark land values' to set an assumed price

at which a landowner will release the site for development. In the case of active sites (i.e. with an existing use) this will include a premium, over the existing use value. The DVS sets these benchmarks using available evidence and professional opinion and they are expressed as values per imperial acre. For sites in the north and south of the borough the benchmark values ranged from £150,000 - £200,000 per acre, although in the central area the values used were lower with a range of £100,000 - £125,000 per acre.

21. At the joint examination Hearing sessions there were some challenges to assumed land values used although these related mainly to the Caerphilly CBC area, where examples of higher levels were claimed. I am satisfied that the values employed by the Council are reasonable for CIL viability testing purposes.

<u>Profit levels</u>

22. The profit levels assumed on commercial developments are unchallenged and appear reasonable. However, the use of 17.5% of Gross Development Value (GDV) as the profit assumption on private market housing (and 4.76% on affordable housing) was challenged by the development industry as being too low. It argued for 20% profit on GDV (and 6% on affordable housing), stating that this was more appropriate. It cautioned against using comparisons drawn from England where house builders perceived development risk to be lower and rewards higher. In response, the Council felt that whilst 20% on GDV was appropriate immediately after the 2007 fall in the market, a lower 'base allowance' of 17.5% was more appropriate today, now that market stability had returned. I have weighed the merits of both arguments and consider that the Council's adopted profit rate is not unreasonable for modelling purposes, subject to it being considered 'in the round' in the context of other allowances and viability 'buffers'. I return to this later.

<u>Housing sales values</u>

23. Sales value evidence was derived from real world transactions drawn from the District Valuer's access to Stamp Duty and Land Tax returns. There did not appear to be any dispute from the development industry about assumed sales values in the Merthyr Tydfil CBC area. I consider that the rates used were reasonable.

<u>Build costs, external works and fire sprinklers.</u>

24. Base build costs were drawn from BCIS median average costs, adjusted to the locality. However, there was considerable debate, and some dispute, over the allowances that ought be added to house building costs to reflect external works, abnormals and the Welsh Government's requirement for fire sprinklers in domestic properties from January 2016. The Council's approach involved the addition of a default 17.5% to baseline build costs to cover external works (15%) and sustainability features (2.5%). The development industry argued for the addition of a higher figure of 27% for external works, reflecting the primarily brownfield nature of the LDP's sites which may include abnormal costs, plus a further £3,075 per plot for fire sprinklers.

25. These are not easy issues to untangle and, in my view, there are likely to be a

wide spectrum of external works costs which may range from comfortably below the Council's assumption (for serviced sites) to levels more akin to those cited by the house builders. However, I must also give weight to the Council's reasonable stance that the brownfield strategy is not new, and that the transactional evidence and market intelligence that has underpinned the modelling will have reflected the 'norm' of brownfield development costs.

26. With regard to the fire sprinkler requirement, this will not be an actual and incurred construction cost until January 2016, but I am mindful that house builders must consider those costs in their appraisals and land buying activities now, along with any CIL charges that may be adopted. These extra costs cannot, therefore, be ignored.

27. Having considered the evidence carefully I do not consider it necessary to define a 'right' percentage to be added to base build costs for externals, abnormals and fire sprinklers, because I do not think that is possible given the variability of schemes. However, the examination of this evidence does underline the importance of setting CIL rates at levels that includes sufficient headroom to allow for the spectrum of different development schemes.

<u>Affordable Housing</u>

28. Affordable housing was assumed in the modelling in full compliance with the LDP policy. The proportion used in the modelling varied from 0% up to 10%.

<u>S.106 Allowances</u>

29. The EVS modelling made no specific allowance for residual S.106 obligations relating to site specific infrastructure. The house builders argued for the inclusion of a notional £1000 per plot, in line with a number of CIL studies elsewhere. There are merits to both arguments, the first that it is inordinately difficult to estimate such costs and the second that there will be such costs and applying a notional amount per unit recognises that. However, in my view, there is no fundamental flaw in not including such costs subject to ensuring sufficient headroom in the CIL rate setting to accommodate this variable element of development costs.

Conclusions on background evidence

30. The LDP was adopted in 2011. The LDP adopts a sound and intelligent growth strategy, spreading development between a hierarchy of three identified growth areas. One of its themes is to encourage most of the development in to the PGO focused around Merthyr Tydfil. The LDP was supported by detailed evidence on infrastructure needs and this was refreshed and updated in an Infrastructure Report to support the CIL proposals. This has been used to define a draft Regulation 123 List that identifies a range of physical, social and green infrastructure that the Council has identified as necessary to support planned growth. There is a very significant assessed funding gap for the identified infrastructure. Anticipated CIL receipts would make a small, but nonetheless important, contribution towards the funding this projects. The LDP

and infrastructure evidence provide a solid foundation for the introduction of a CIL charging regime.

Are the Residential CIL charging zones and charging rates informed by and consistent with the evidence?

Charging Zones

31. The evidence does provide a convincing basis for geographically differentiated charging zones. Put simply, sales values and development viability are much stronger in the north of the borough (around Merthyr Tydfil itself) and the south of the borough (around Treharris and Trelewis) than in the mid valleys area. The middle part of the borough experiences lower land and sales values and development viability is more challenging. The approach of defining the three zones, and the definition of their boundaries, was supported by the evidence and by the development industry. I conclude that the charging zones are, in principle, sensible and robust. I now turn to the CIL charging proposals for each zone.

Mid Valleys Charging Zone - £0 psm

32. Although the EVS only tested two sites in this zone, a 50 unit scheme and a 10 unit scheme, both generated negative residualised values for CIL (of -£4 and -£16 psm respectively). Given that these were both greenfield sites with either no affordable housing (the small scheme) or low affordable housing (5% content on the larger scheme) the evidence is clear. Housing development in this zone cannot currently support CIL charges and the zero rate is appropriate. However, it is worth noting that the EVS sensitivity testing did suggest that relatively modest increases in sales values (other things remaining equal) would create much stronger results that could support CIL charges. This is clearly a matter for future review and consideration.

Merthyr Tydfil Charging Zone - £25 psm

33. The EVS tested three sites – a 10 unit brownfield development, a 30 unit brownfield scheme and a larger, 110 unit greenfield development – each with a 10% affordable housing content. All three schemes generated positive results but the residualised value for CIL did vary. The two larger schemes showed strong results with theoretical maximum CIL rates of £62 psm (30 unit scheme) and £82 psm (the 110 unit scheme). By contrast the smaller 10 unit scheme only generated a £24 psm theoretical CIL. I am persuaded that the larger schemes are more representative of the development economics and that on smaller developments there is likely to be some scheme specific negotiation around affordable housing content. On this basis, the proposed CIL rate of £25 psm is comfortably below the viability level indicated by the evidence i.e. a good amount of headroom would remain. The charge would amount to between 1.6 – 1.7% of GDV on the tested schemes. However, the Council would be well advised to monitor closely the impact on smaller schemes, in respect of whether they continue to come forward and / or the Council is subject to pressures to reduce affordable housing targets. This is of

some importance given the LDP's reliance on this area to deliver most of its planned housing.

Lower Valley Charging Zone - £25 psm

34. The EVS tested three schemes in this area which is centred around the settlements of Treharris and Trelewis. The schemes were 30, 80 and 90 unit developments and included the LDP affordable housing content of 5% (for the SGA). The residualised values for CIL were, respectively, £33 psm, £18 psm and £5 psm. The Council's proposed CIL rate in this area is £25 psm but clearly, based on the evidence, this cannot be achieved by two of the schemes, whilst the third (the smallest scheme) can only achieve it with limited headroom. Overall, the evidence is telling me that in this zone, 170 of the 200 dwellings tested (85%), would not be viable. My concern is compounded by the fact that all three schemes involved greenfield sites, against a policy backcloth which is heavily skewed toward brownfield land development. It is reasonable to speculate that brownfield scheme appraisal results would reduce margins available to fund CIL further.

35. Whilst it would be overstating matters to claim that the CIL charges here could threaten the delivery of the LDP as a whole, I am nonetheless concerned that, based on the evidence, there could be negative impacts on development viability and the LDP objectives. The SGA, which approximates to the Lower Valley Charging Area, is expected to deliver 15% of the LDP's new homes and the evidence before me indicates that the £25 psm CIL would render the development of most of those houses unviable. I must also factor in the views of the house builders on costs and returns, which suggest that the absence of a comfortable buffer could impact on the otherwise more attractive schemes in this area, such as the one scheme that did exceed the proposed charge.

36. Overall, the Council's evidence does not support the proposed £25 psm CIL charge in this zone. I have weighed the evidence and carefully considered whether a reduced rate would be appropriate in this zone. However, the nature and inconsistency of the evidence does not provide a basis for doing so, given that even reducing it to £10 psm would still leave the largest scheme unable to sustain the charge. In the circumstances, I have no alternative but to recommend that the charge be reduced to £0 psm in this zone.

Are the Commercial CIL charging rates informed by and consistent with the evidence?

37. The EVS provided clear evidence that certain development types were not currently viable and could not sustain CIL charges. These included all employment type developments (Use Classes B1, B2 and B8) along with developments of care and nursing homes, hotels and cinemas. For all of these uses the £0 psm charge listed in the DCS is justified. I turn now to the three development types where positive CIL charges are proposed.

Class A1 Retail - £100 psm

38. The EVS tested two sites, each involving relatively large format shops. The results showed very strong residualised CIL values of £348 psm and £507 psm. Although there was no testing of small format retail development the Council does not envisage any significant new retail development of that type. Based on the evidence available to me, it does appear that the limited retail development that may come forward should be able to comfortably afford the £100 psm CIL charge i.e. there would be significant headroom to accommodate a range of schemes.

Class A3 – Restaurants, Cafés and Drinking Establishments- £25 psm

39. The Council does not envisage any significant Class A3 development in the plan period. However, its testing of a modelled 400 square metre restaurant development generated a £76 psm theoretical residual CIL. Whilst I am mindful that other Class A3 developments may display different viability characteristics, there is a practical limit to the appraisal testing, particularly for developments which are not likely to be forthcoming in any great quantity. The setting of the CIL rate of £25 psm would be well below the theoretical maximum of the one example tested, and should leave sufficient scope for other Class A3 development types to remain viable.

Class D1 – Primary Healthcare Development - £60 psm

40. The Council's proposal to introduce a CIL charge on primary healthcare development was the source of some contention at the Hearing sessions. It was acknowledged that it was not unusual for Charging Authorities (in England) to include primary healthcare facilities in their Draft Regulation 123 lists i.e. CIL receipts would help fund such social infrastructure facilities to support new developments and growing /ageing populations.

41. The local health board made representations to the neighbouring Caerphilly CBC DCS (which was being jointly examined) and was represented at the Hearing sessions. Although there were no formal written representations specifically concerning the Merthyr Tydfil CBC's DCS, it was plain to me that the health board objections related to both Councils proposals (and to Rhondda Cynon Taff CBC whose CIL proposal are yet to be examined). I have treated the representations accordingly.

42. The health board fundamentally opposes the Council's proposed CIL charges, and has indicated that imposing them could stifle primary healthcare development, or result in a migration of limited resources to other areas (where CIL charges on primary healthcare development were not in place). In support of its case the health board argued that the whole funding process surrounding such developments had not been taken into account. However, the Council's position was that there was now a mature development market defined by investors constructing primary care facilities for the NHS, which became a rent paying tenant (with a very strong covenant). The health board countered this argument by stating that the District Valuer (whose 'services'

division produced the EVS) is directly involved in rent setting on primary healthcare schemes, and should be setting rents at levels which yield sufficient profit to make the scheme happen (but no surplus beyond to fund CIL).

43. The EVS tested just one primary healthcare development on a site in the Council's area. This was for a very large (circa 9,000 square metres) scheme on a brownfield site on the edge of Merthyr Tydfil; it generated a theoretical maximum CIL rate of £84 psm. The EVS also included a modelled appraisal in the neighbouring authorities of Rhondda Cynon Taff CBC (a commissioning partner of the EVS); that smaller scheme generated a much higher potential CIL rate of £221 psm. Furthermore, in seeking to explain the inconsistency between large and small developments the EVS states that 'each scheme is very specific to a range of factors including land cost and the scope of occupiers'.

44. The funding and viability economics of such developments have clearly become quite complicated as new public / private sector delivery models have developed and evolved. Indeed, examination of the evidence further revealed that, falling under the 'Primary Healthcare Development' heading used in the DCS, there appear to be four different funding models. 'Health fund investors' and 'Third Sector Investors' are clearly commercially driven models, whereas 'NHS Capital Projects' and 'GP DIY' are not. The Council's evidence suggested that the two non-commercial models were 'not easily identified' in the EVS and that they could not sustain the same level of CIL as the commercial variants.

45. Overall, I found the evidence to be inconsistent and confusing. In my view, the reliance on just one appraisal for a very large scheme, the spectrum of funding models with different viability characteristics (some of which may not be able to afford the charge), and the risk that health board funding might migrate to other areas, all combine to suggest that the proposed charge is not properly supported by the evidence. That is not to say that such development should necessarily be exempt from the CIL *per se,* but I am unconvinced that the Council has defined the development type with sufficient precision and with viability evidence to support it at this stage.

46. Given that little development in this category is anticipated, the effects of the CIL charge, should it prevent schemes coming forward, would not threaten the LDP as a whole. However, I am mindful of the health and deprivation profiles of parts of the borough, which the LDP seeks to improve. For all of these reasons, I conclude that CIL charge would not serve a positive purpose in terms of supporting the LDP, as set out in paragraph 30 of the 2013 CIL Guidance. I therefore recommend that the charge is reduced to £0 psm.

Overall Conclusions

47. The evidence demonstrates that, subject to my recommended modifications, the overall development of the area, as set out in the LDP, will not be put at risk if the proposed CIL charges are applied. In setting the CIL charges the

Council has used appropriate and available evidence which has informed assumptions about land and development values and likely costs. The CIL proposals will achieve a reasonable level of income to help address a well evidenced infrastructure funding gap.

LEGAL REQUIREMENTS	
National Policy/Guidance	The Charging Schedule complies with national policy/guidance.
2008 Planning Act and 2010 Regulations (as amended 2011)	The Charging Schedule complies with the Act and the Regulations, including in respect of the statutory processes and public consultation, consistency with the adopted Merthyr Tydfil Local Development Plan and is supported by an adequate financial appraisal.

48. I conclude that, subject to the modifications set out in Appendix A, the Merthyr Tydfil County Borough Council Community Infrastructure Levy Charging Schedule, as modified by its Statement of Modifications, satisfies the requirements of Section 212 of the 2008 Act and meets the criteria for viability in the 2010 Regulations (as amended). I therefore recommend that, subject to my modifications, the Charging Schedule be approved.

P.J. Staddon

Examiner

This report is accompanied by Appendix A (attached) – Modifications that the Examiner specifies so that the Charging Schedule may be approved.

Appendix A

Modifications that the Examiner specifies so that the Charging Schedule may be approved.

NOTE – these modifications should be read in conjunction with the Modified Draft Charging Schedule submitted for examination (Examination Document CE2)

Modification No.	Modification
EM1	Page 2 of Draft Charging Schedule – Table 1 – Residential (C3) Development CIL rates. Lower Valley – delete "£25" and replace with £0 psm
EM2	Appendix 1 Plan – Residential Charging Zones Delete "Treharris and Trelewis - £25 psm" and replace with "Lower Valley - £0"
EM3	Page 2 of Draft Charging Schedule – Table 1 Primary Healthcare Development (D1) - delete "£60" and replace with "£0"