BNP PARIBAS REAL ESTATE

WESTMINSTER CITY COUNCIL
AFFORDABLE HOUSING PAYMENTS IN LIEU

1. Introduction

This note was previously issued on 26 February 2018 setting our recommended approach to calculating payments in lieu of on-site affordable. The key principle is one of financial neutrality; the payment in lieu should be set at a level that does not incentivise an Applicant to opt for this route, but conversely – where it is agreed by the Council that a PIL is appropriate – the payment should not be set at a level that financially penalises the Applicant.

Clearly, one of the Council's concerns will be to ensure that any payments in lieu are sufficient to fund the delivery costs of units off-site. It is important to bear in mind that there will be other sources of funding to support provision of affordable housing alongside the PIL itself. These include the receipt that a Registered Provider ('RP') will pay to acquire a long lease in the affordable housing (equivalent to the sum they would have paid the Applicant had the affordable housing been provided on site). The combined payment in lieu and payment by the RP would fully fund the conversion of private units on other developments to affordable. If the payment is used to support affordable housing provision in an area where private values are lower, then the Council will be able to secure a greater number of affordable housing units than would have been possible on-site.

This note updates the underlying market values used in the 2018 version of the note to determine whether any changes to the payments in lieu are required as a result of changes over the intervening period.

The base market values were sourced from comparable transactions in June 2015 to support appraisals used to determine viable levels of Community Infrastructure Levy ('CIL') in Westminster.

2. Updating the payment in lieu

The payment in lieu is calculated by reference to the difference in value between affordable housing and private housing. It will therefore be necessary to update the payment in lieu on a regular basis to reflect changes in market values and values payable by Registered Providers for affordable housing. The latter can be sourced from Registered Providers.

Market values can be updated by applying indexation to the June 2015 values in Table 2.1. The most appropriate index is the Land Registry House Price Index, which can be sourced on line with data for the Royal Borough of Kensington & Chelsea.

For practical purposes, we would suggest that the payment in lieu is recalibrated on an annual basis at a common date (e.g. 1 April).

3. Establishing the amount of a payment in lieu

In the circumstances where it is agreed that a commuted sum payment to the Council is appropriate, it will be necessary to establish the value of the payment in lieu of 'on-site' affordable housing. The Council has indicated a preference for this to be based on a fixed rate per square metre of floorspace that would normally have been provided as affordable housing in line with Local Plan policy. The payment in lieu will be equivalent to the uplift in value resulting from the floor area that would have been provided as affordable housing being delivered as private housing. This approach will ensure a cost neutral impact on the developer.

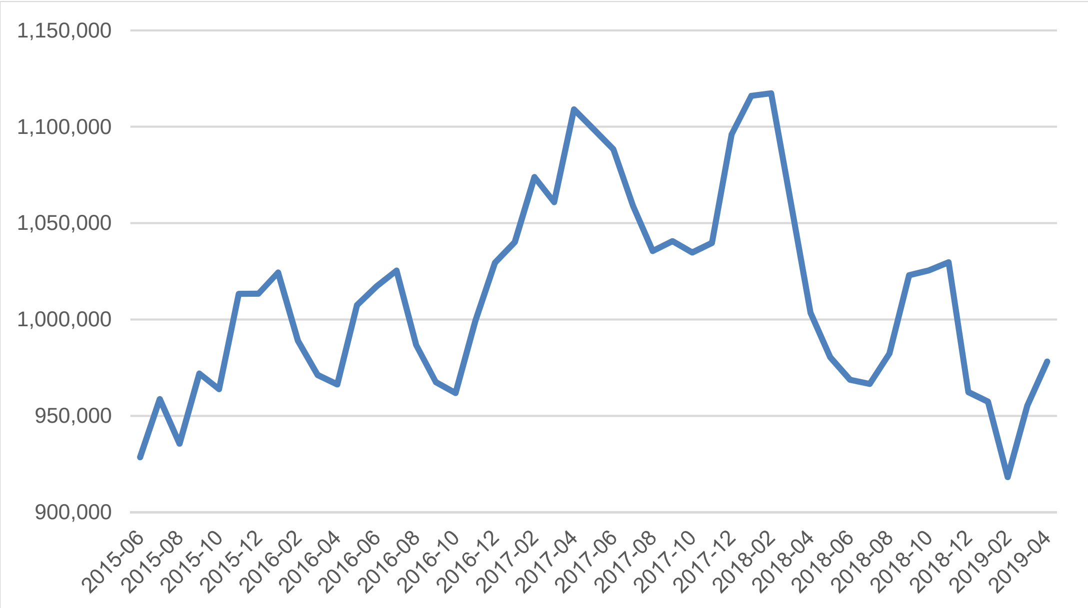
The payment in lieu per square metre is calculated using the following formula:

(a) The Market Value of a square metre of floorspace in the Development

LESS
(b) The value of Affordable Housing per square metre (reflecting the blend between affordable rent and shared ownership)
LESS
(c) Additional Developer Costs (profit and marketing)
Equals
(d) The Commuted Sum Payment

The Market Value per square metre is derived from the Council's Community Infrastructure Levy ('CIL') Viability Study (June 2015), uprated by the change in the Land Registry House Price Index over the intervening period (there has been a change of 5% between June 2015 and April 2019. The trajectory of house prices in Westminster is shown in Figure 2.1. Although values increased sharply between 2015 and early 2018, much of this increase has fallen away. Values are therefore lower than they were at the time we previously calculated payments in lieu in February 2018 (although still higher than they were in June 2015) and consequently we have adjusted the payments in lieu downwards.

Figure 2.1: Land Registry House Price Index – Westminster City – June 2015 – April 2019



Source: Land Registry

For the three residential charging zones, the market values are as follows:

Table 2.1: Market values

Area	Average values £s per sq m (June 2015)	Average values £s per sq m (indexed) April 2019
Prime (Mayfair, Knightsbridge, Belgravia, Whitehall, Covent Garden, Strand, St John's Wood)	£22,400	£23,597

Area	Average values £s per sq m (June 2015)	Average values £s per sq m (indexed) April 2019
Core (Soho, Fitzrovia, Pimlico, Westbourne Grove, Paddington, Bayswater, Marylebone, Victoria)	£15,750	£16,592
Fringe (Lisson Grove, Church Street, Queens Park, Churchill)	£11,000	£11,588

The value of the affordable housing is the value that the Affordable Units would have sold for if they were sold to an RP. The "Value of the Affordable Housing" is the capitalised value of the net rental stream for Social and Affordable Rent (gross rent less service charge, management, maintenance, voids and bad debts), and the value of the first tranche sale plus the capitalised value of the net rental stream for the shared ownership units. For the purposes of establishing these values, we have relied upon the assumptions in the CIL Viability Study. As a result of rent caps introduced by central government, these values will not have changed over the intervening period. The affordable housing values are summarised in Table 2.2.

Table 2.2: Affordable housing values

Tenure	£s per square metre
Affordable rent	£1,600
Shared ownership	£3,200
Blended rate, based on tenure split of 60% rent and 40% shared ownership	£2,240

In a development appraisal, profit is applied at different rates to different tenures, reflecting their relative sales risk. Private housing is inherently more risky than affordable housing. This is developers typically enter into a contract with an RP prior to commencing construction, so all the affordable units are effectively pre-sold. In contrast, the Developer will need to build all the private units speculatively, hoping to sell them by the time the units are constructed or shortly thereafter. When considering the impact this has on a payment in lieu, affordable units that would have attracted a profit of 6% will be converted into private units, to which a 20% profit will be applied. The additional profit is reflecting in the payment in lieu calculation.

Similarly, the Developer will incur marketing costs of private units that they would not have incurred had the units been provided as affordable. This marketing cost typically amounts to 3% of private housing value.

4. The payments in lieu calculation

Table 4.1 applies the methodology set out in the previous section to the three CIL charging zones in the City. The result of applying this methodology is the following payments in lieu per square metre, which we have rounded to the nearest hundred. The previous February 2018 figures are shown in brackets.

- Prime: £17,700 (Feb 2018: £18,491);
- Core: £11,900 (Feb 2018: £12,450);
- Fringe: £7,800 (Feb 2018: £8,134).

Table 4.1: Payments in lieu calculation – per square metre

		Prime	Core	Fringe
Private value		£23,597	£16,592	£11,588
Affordable Rented value		£1,600	£1,600	£1,600
Shared ownership value		£3,200	£3,200	£3,200
Blended rate (60%/40% split)		£2,240	£2,240	£2,240
Uplift (affordable to private)		£21,357	£14,352	£9,348
Additional developer costs				
Profit differential (20% less 6%)	*14%*	-£2,990.02	-£2,009.26	-£1,308.71
Marketing allowance	*3%*	-£641	-£431	-£280
Net uplift in value		£17,727	£11,912	£7,759

5. Worked example

Applying the payment in lieu to a scheme of 20 units would result in the following payments, assuming schemes were brought forward in the three charging zones:

Table 4.1: worked example

Total number of units	20		
Average floor area per unit	75 sqm		
Private units	65%	13	975 sqm
Affordable units	35%	7	525 sqm
Payment in lieu	Prime	£17,700 x 525 sqm	**= £9,292,500**
	Core	£11,900 x 525 sqm	**= £6,247,500**
	Fringe	£7,800 x 525 sqm	**= £4,095,000**

BNP Paribas Real Estate
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