

Royal Borough of Kensington & Chelsea - Article 4 direction viability

1. Introduction

- 1.1. A key issue for landowners and developers is the relative capital value of existing office and retail floorspace in comparison to the potential residual value of that space if redeveloped for, or converted to residential. If a landowner perceives that an existing office or retail unit does not optimise the potential return generated by the site, they may – if no planning controls restricting such changes are in place - consider redeveloping or converting the space for other uses.
- 1.2. We have undertaken a series of high level appraisals to consider the relative values of existing office and retail floorspace in comparison to the residual land value generated by conversions or development for residential use.
- 1.3. A residual land value of a conversion or redevelopment is calculated as follows:
- The value completed development is determined (typically referred to as the Gross Development Value or GDV)
 - The costs of completing the conversion or redevelopment are deducted. These costs will include the construction costs; professional fees; marketing costs; stamp duty; finance costs; and developer's profit.
- 1.4. It is therefore important to note that a residual land value will be significantly lower than the value of the completed residential unit(s). In contrast, existing office space or retail units will have been constructed some time ago and the construction costs are effectively a 'sunk' cost that the landowner will not need to consider. For this reason, it cannot be automatically assumed that residential redevelopment or conversion will be more attractive to landowners than retention of existing offices or retail floorspace.
- 1.5. We have adopted a 'typology' approach, in line with the requirements set out by the Planning Practice Guidance. Given that permitted development rights only apply to Class E floorspace of less than 1,500 square metres, all the typologies are relatively small so that the floorspace remains within this overall amount. Table 1.5 summarises the typologies.

Table 1.5: Residential development typologies

No	Description	Density (units per ha)	Site area HA	Units	Residential floorspace (sq metres)
1	Small flatted scheme	250	0.020	5	363
2	Small flatted scheme	250	0.040	10	800
3	Small flatted scheme	250	0.060	15	1,198
4	Small flatted scheme	250	0.080	20	1,495
5	Small housing scheme	83	0.06	5	520
6	Small housing scheme	83	0.12	10	1,075
7	Small housing scheme	81	0.16	13	1,450

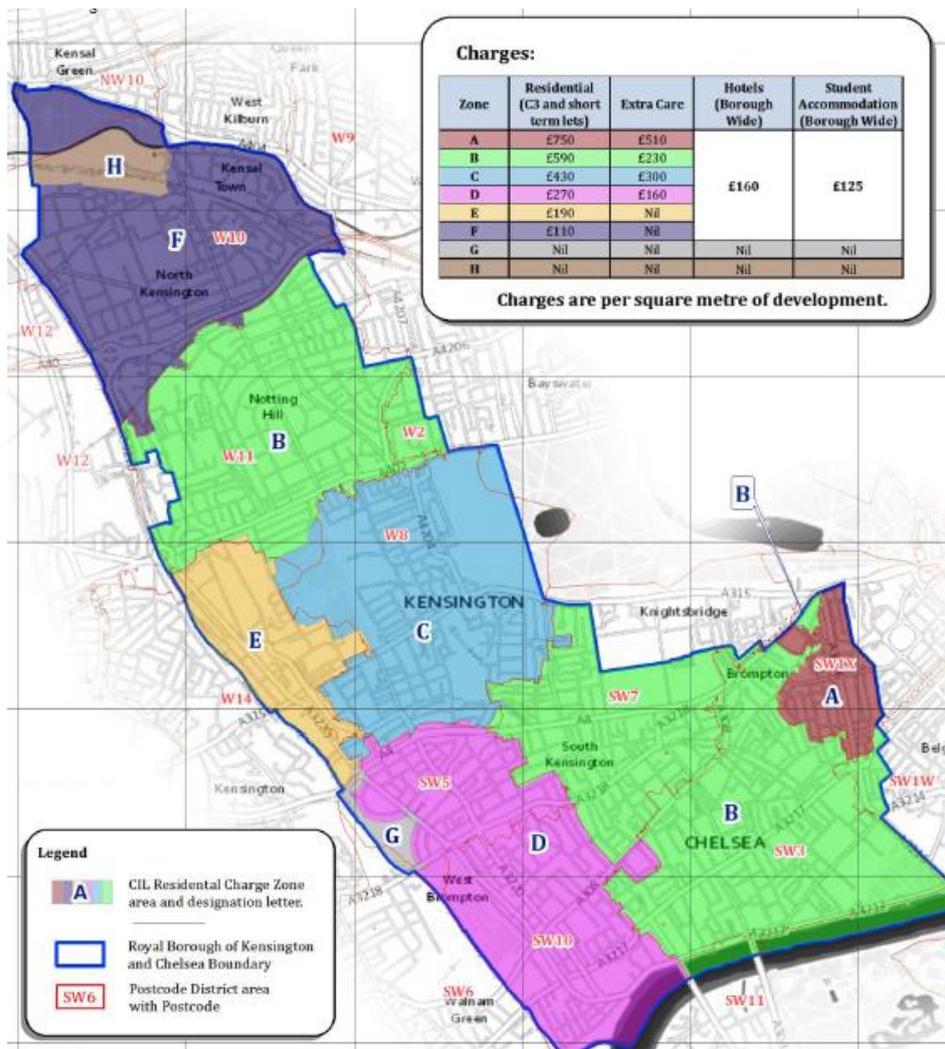
Residential sales values

- 1.6. We have analysed transactions of residential units within the zones identified by the Council's CIL Charging Schedule between 1 January 2020 and April 2021 (the most recently available data) and the average achieved values are summarised in Table 1.6.1. A map of the zones from the Charging Schedule is provided at Figure 1.6.2.

Table 1.6: Residential sales values

Zone	Value (per square metre)
A	£27,471
B	£17,727 (Notting Hill) to £24,539 (Chelsea)
C	£21,668
D	£14,527
E	£14,360
F	£10,989
G (Earl's Court)	£14,527
H (Kensal Strategic Site)	£10,989

Figure 1.6.2: CIL/value zones



- 1.7. Where relevant (i.e. redevelopment of existing space and construction of new residential), our appraisals incorporate affordable housing at 35%. We have also considered the residual land values generated when 20% affordable housing is provided, recognising that some redevelopment schemes provide reduced levels under the 'viability tested' route in the London Plan. The capital value assumed for the affordable housing is £2,025 per square metre, reflecting a blended rate between social rented housing and London Living Rent (with rents set based on GLA rent benchmarks for Notting Dale Ward).
- 1.8. Clearly when offices and retail floorspace are converted under permitted development rights, no affordable housing is currently required, although the government has indicated that this may change in the future. We have therefore run an additional set of appraisals, assuming zero affordable housing to reflect the current situation for conversions under permitted development rights.

Development costs

- 1.9. We have sourced construction costs for the residential schemes from the RICS 'Building Cost Information Service' ('BCIS') which is a database of tenders for live developments. We have adopted the 9th decile costs, as follows:

- Flats: £3,009 per square metre
- Houses: £2,416 per square metre.

BCIS costs exclude external works, for which our appraisals add 10% of base construction costs for flats and 15% for houses. In addition, we have applied a contingency of 5% of construction costs.

- 1.10. In addition, our appraisals account for the following costs:
- Professional fees (10% of construction costs);
 - CIL at prevailing rates;
 - MCIL at prevailing rates;
 - Section 106 obligations amounting to £1,000 per unit;
 - Allowances for zero carbon/carbon offsetting amounting to 6% of construction costs;
 - Electric vehicle charging points: £1,500 per space;
 - Green roofs at £150 per square metre of roof space;
 - Accessibility requirements M4(2) applied to all dwellings and M4(3) applied to 10% of dwellings at a cost of £521 per house/£924 per flat for M4(2) and £22,694 per house/£7,908 per flat for M4(3);
 - Developer's profit – 18% of private housing GDV and 6% of affordable housing GDV;
 - Marketing costs (including sales agents fees) – 2.5% of private housing GDV;
 - Sales legal fees – 0.25% of private housing GDV;
 - Finance rate – 6%.

Residual land values

- 1.11. Our appraisals generate a range of residual land values, as summarised in Table 1.10.1 and Table 1.10.2 (overleaf), the latter converting the residual land values into a value per square metre of floorspace. In addition, we have run the appraisals at 20% affordable housing, recognising that some applicants opt for the 'viability tested' route in the London Plan (tables 1.10.3 and 1.10.4). In these circumstances, the existing use value of the office on site can be used to reduce the affordable housing below 35%. Finally, we have also run a further set of appraisals in which 100% of housing is provided as private to reflect the current arrangements for conversions under permitted development rights (tables 1.10.5 and 1.10.6).

Office values

- 1.12. In order to determine whether landowners are likely to take up permitted development rights if office and retail floorspace are left unprotected by an Article 4 direction, it is necessary to compare the outputs of our appraisals to the value that offices and retail units have traded for recently.
- 1.13. We have identified sales of offices over the past two years, as summarised in Table 1.12.1 and plotted on a map at Figure 1.12.2.

Table 1.12.1: Office sales from June 2019 onwards

Map ref	Address	Floor area sqm	Property type	Sold price	Sold price per square metre
1	22 Astwood Mews	53	Office/residential	£620,000	£11,708
2	171-175 Brompton Road	1,202	Office	£32,000,000	£26,623
3	41 Cheval Place	72	Office	£2,300,000	£31,904
4	14 Codrington Mews	401	Office/medical	£4,200,000	£10,477
5	181-185 Earls Court Road	512	Office	£1,982,369	£3,872
6	60 Golborne Road	73	Office/residential	£650,000	£8,845
7	3-3B Hans Crescent	1,035	Office/residential	£1,575,000	£1,522
8	140 Holland Park Ave	306	Office	£2,950,000	£9,640
9	28 Jameson St	87	Office/live work	£1,000,000	£11,475
10	27 Kelso Place	621	Office	£5,500,000	£8,857
11	344 Kensington High St	1,085	Office	£8,500,000	£7,835
13	92 Lots Road	34	Office	£135,000	£3,938
16	16 Portland Road	297	Office	£3,000,000	£10,091
17	49 Portland Road	178	Office/residential	£1,725,000	£9,671
18	30 Queens Gate	695	Office/residential	£8,100,777	£11,648
19	17 Radley Mews	171	Office	£2,200,000	£12,877
20	133-137 Westbourne Gdns	556	Office/residential	£12,600,000	£22,661
21	282 Westbourne Park Road	65	Office	£595,000	£9,215

Figure 1.12.2: Location of office sales

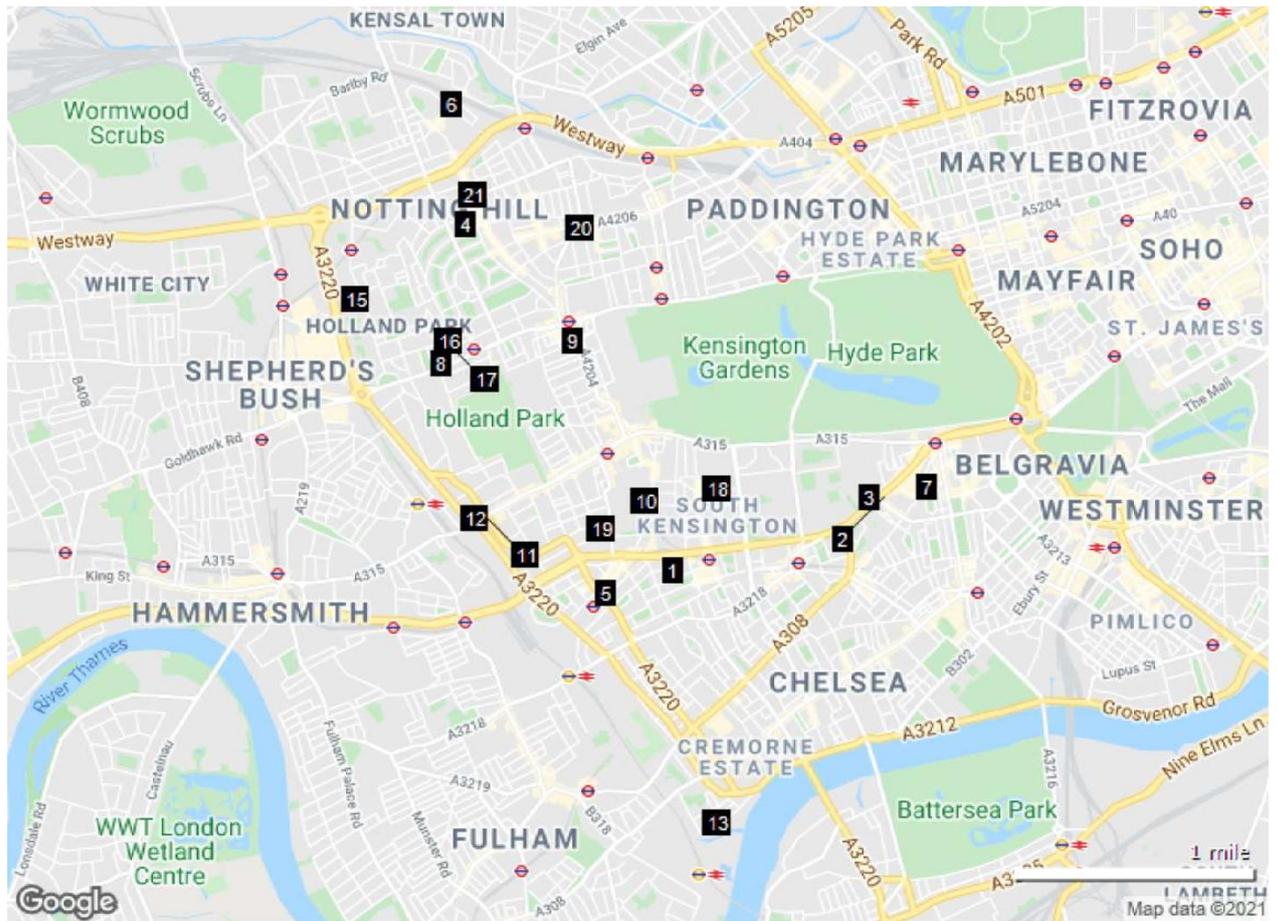


Table 1.10.1: Appraisal results - 35% affordable housing

No	Site	No of units	Residual land value (£ millions)						
			Zone A (Belgravia)	Zone B (Chelsea)	Zone B (Notting Hill)	Zone C (Kensington)	Zone D (West Brompton including Earls Court)	Zone E (West Kensington)	Zone F (including Kensal)
1	Small flatted	5	£2.35	£2.00	£1.08	£1.65	£0.73	£0.73	£0.30
2	Small flatted	10	£5.20	£4.43	£2.39	£3.66	£1.63	£1.63	£0.67
3	Small flatted	15	£7.49	£6.36	£3.41	£5.26	£2.31	£2.31	£0.92
4	Small flatted	20	£8.24	£6.95	£3.52	£5.68	£2.27	£2.27	£0.66
5	Small housing	5	£4.67	£4.06	£2.51	£3.47	£1.90	£1.89	£1.16
6	Small housing	10	£9.65	£8.40	£5.18	£7.17	£3.93	£3.92	£2.39
7	Small housing	13	£12.51	£10.89	£6.71	£9.30	£5.10	£5.08	£3.10

Table 1.10.2: Appraisal results – 35% affordable housing (per square metre)

No	Site	No of units	Residual land value (per square metre GIA)						
			Zone A (Belgravia)	Zone B (Chelsea)	Zone B (Notting Hill)	Zone C (Kensington)	Zone D (West Brompton including Earls Court)	Zone E (West Kensington)	Zone F (including Kensal)
1	Small flatted	5	£6,490	£5,516	£2,974	£4,565	£2,021	£2,019	£821
2	Small flatted	10	£6,505	£5,532	£2,989	£4,581	£2,036	£2,034	£836
3	Small flatted	15	£6,254	£5,312	£2,844	£4,392	£1,926	£1,926	£765
4	Small flatted	20	£5,513	£4,646	£2,352	£3,799	£1,516	£1,520	£445
5	Small housing	5	£8,978	£7,811	£4,820	£6,671	£3,656	£3,643	£2,223
6	Small housing	10	£8,979	£7,812	£4,821	£6,672	£3,657	£3,644	£2,225
7	Small housing	13	£8,630	£7,510	£4,627	£6,416	£3,514	£3,504	£2,138

Table 1.10.3: Appraisal results - 20% affordable housing

No	Site	No of units	Residual land value (£ millions)						
			Zone A (Belgravia)	Zone B (Chelsea)	Zone B (Notting Hill)	Zone C (Kensington)	Zone D (West Brompton including Earls Court)	Zone E (West Kensington)	Zone F (including Kensal)
1	Small flatted	5	£3.08	£2.64	£1.51	£2.22	£1.09	£1.08	£0.55
2	Small flatted	10	£6.81	£5.85	£3.35	£4.91	£2.41	£2.41	£1.23
3	Small flatted	15	£9.81	£8.42	£4.79	£7.07	£3.43	£3.43	£1.72
4	Small flatted	20	£10.92	£9.33	£5.11	£7.77	£3.57	£3.57	£1.60
5	Small housing	5	£5.91	£5.16	£3.25	£4.43	£2.50	£2.49	£1.59
6	Small housing	10	£12.22	£10.67	£6.71	£9.16	£5.17	£5.16	£3.28
7	Small housing	13	£15.84	£13.84	£8.69	£11.89	£6.71	£6.69	£4.25

Table 1.10.4: Appraisal results – 20% affordable housing (per square metre)

No	Site	No of units	Residual land value (per square metre GIA)						
			Zone A (Belgravia)	Zone B (Chelsea)	Zone B (Notting Hill)	Zone C (Kensington)	Zone D (West Brompton including Earls Court)	Zone E (West Kensington)	Zone F (including Kensal)
1	Small flatted	5	£8,495	£7,296	£4,167	£6,126	£2,994	£2,992	£1,517
2	Small flatted	10	£8,510	£7,311	£4,182	£6,141	£3,009	£3,007	£1,533
3	Small flatted	15	£8,192	£7,033	£3,996	£5,901	£2,865	£2,865	£1,436
4	Small flatted	20	£7,304	£6,238	£3,415	£5,196	£2,385	£2,390	£1,067
5	Small housing	5	£11,362	£9,926	£6,245	£8,523	£4,813	£4,797	£3,049
6	Small housing	10	£11,363	£9,927	£6,246	£8,524	£4,814	£4,798	£3,050
7	Small housing	13	£10,923	£9,544	£5,996	£8,197	£4,627	£4,614	£2,932

Table 1.10.5: Appraisal results - 100% private housing

No	Site	No of units	Residual land value (£ millions)						
			Zone A (Belgravia)	Zone B (Chelsea)	Zone B (Notting Hill)	Zone C (Kensington)	Zone D (West Brompton including Earls Court)	Zone E (West Kensington)	Zone F (including Kensal)
1	Small flatted	5	£4.05	£3.51	£2.09	£2.97	£1.56	£1.55	£0.89
2	Small flatted	10	£8.95	£7.75	£4.62	£6.58	£3.45	£3.44	£1.97
3	Small flatted	15	£12.91	£11.17	£6.62	£9.48	£4.93	£4.93	£2.79
4	Small flatted	20	£14.49	£12.50	£7.22	£10.55	£5.30	£5.31	£2.84
5	Small housing	5	£7.56	£6.63	£4.24	£5.72	£3.30	£3.29	£2.16
6	Small housing	10	£15.63	£13.70	£8.76	£11.82	£6.83	£6.81	£4.46
7	Small housing	13	£20.27	£17.77	£11.34	£15.33	£8.86	£8.84	£5.79

Table 1.10.6: Appraisal results – 100% private housing (per square metre)

No	Site	No of units	Residual land value (per square metre GIA)						
			Zone A (Belgravia)	Zone B (Chelsea)	Zone B (Notting Hill)	Zone C (Kensington)	Zone D (West Brompton including Earls Court)	Zone E (West Kensington)	Zone F (including Kensal)
1	Small flatted	5	£11,167	£9,669	£5,758	£8,206	£4,292	£4,289	£2,446
2	Small flatted	10	£11,182	£9,684	£5,773	£8,221	£4,307	£4,304	£2,461
3	Small flatted	15	£10,777	£9,328	£5,531	£7,913	£4,118	£4,118	£2,332
4	Small flatted	20	£9,693	£8,360	£4,831	£7,058	£3,544	£3,550	£1,897
5	Small housing	5	£14,541	£12,746	£8,145	£10,993	£6,354	£6,334	£4,150
6	Small housing	10	£14,542	£12,747	£8,146	£10,993	£6,355	£6,335	£4,151
7	Small housing	13	£13,980	£12,257	£7,822	£10,573	£6,110	£6,094	£3,992

Implications of the results

- 1.14. The results our appraisals indicate that the residual values generated by residential schemes frequently exceed the capital value of office floorspace, thus making it vulnerable to loss in the absence of planning controls that prevent conversion or redevelopment.
- 1.15. The risk can be identified by comparing the residual land values per square metre in tables 1.10.2, 1.10.4 and 1.10.6 to the values for offices in Table 1.12.1. The existing offices identified in Table 1.12.1 as sites 4, 5, 6, 7, 8, 10, 11, 13, 16 and 17 would be at most immediate risk of loss to residential, equating to approximately 61% of the floorspace in our sample.
- 1.16. Clearly the office space with lower rents would be at most risk of loss to other uses; this floorspace accommodates a sub-set of the wider market that would no longer be catered for if this floorspace is lost. As a result, businesses currently located in such floorspace would need to move out of the borough entirely, which would reduce diversity in the type of nature of businesses and employers.
- 1.17. With prime residential values forecast to increase by 21.6% over the next five years¹ (after a long period of stagnation), residual land values for residential development will increase significantly. Over the same period, office rents are not forecast to increase; rising residual land values for residential will increase the risk of losses of office floorspace to a greater extent than shown by our appraisals.

BNP Paribas Real Estate
9 June 2021

¹ Savills 'Prime UK Residential – Spring/Summer 2021' (May 2021)