MARKET IN MINUTES
Savills Research

Big Shed Briefing - topic response - issue 3

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Will recent changes to planning policy change the market for speculative development?

In 2019, the UK Government and the devolved administrations committed to the Net Zero target as recommended by the Committee on Climate Change. Reaching net-zero greenhouse gas (GHG) emissions requires extensive changes across the economy and real estate has a key role to play. Buildings currently contribute some 19% of global greenhouse gas emissions but this could double – or even treble – by 2050 if action is not taken now, according to Intergovernmental Panel on Climate Change research.

Indeed at a recent event hosted by Savills, Lord Deben, chairman of the UK government Committee on Climate Change remarked "Property is going to play a very important part in this because it cannot reach its targets, it cannot reduce its emissions by a maximum so that it can do some offsetting to make a difference between zero and net zero, it cannot reach that unless it turns the whole of the property industry into a net zero industry. So you have to find ways of sequestrating carbon. You have to plant trees. You have to make the soil more fertile so you can bring the carbon out of the atmosphere. When you look at what we have to do, the property industry becomes very central."

Whilst the UK led the way for advanced economies to legislate to deliver net zero targets by 2050 just under half of the world's annual GDP is now covered by nations, regions and cities that are legislating for a net-zero emissions target.

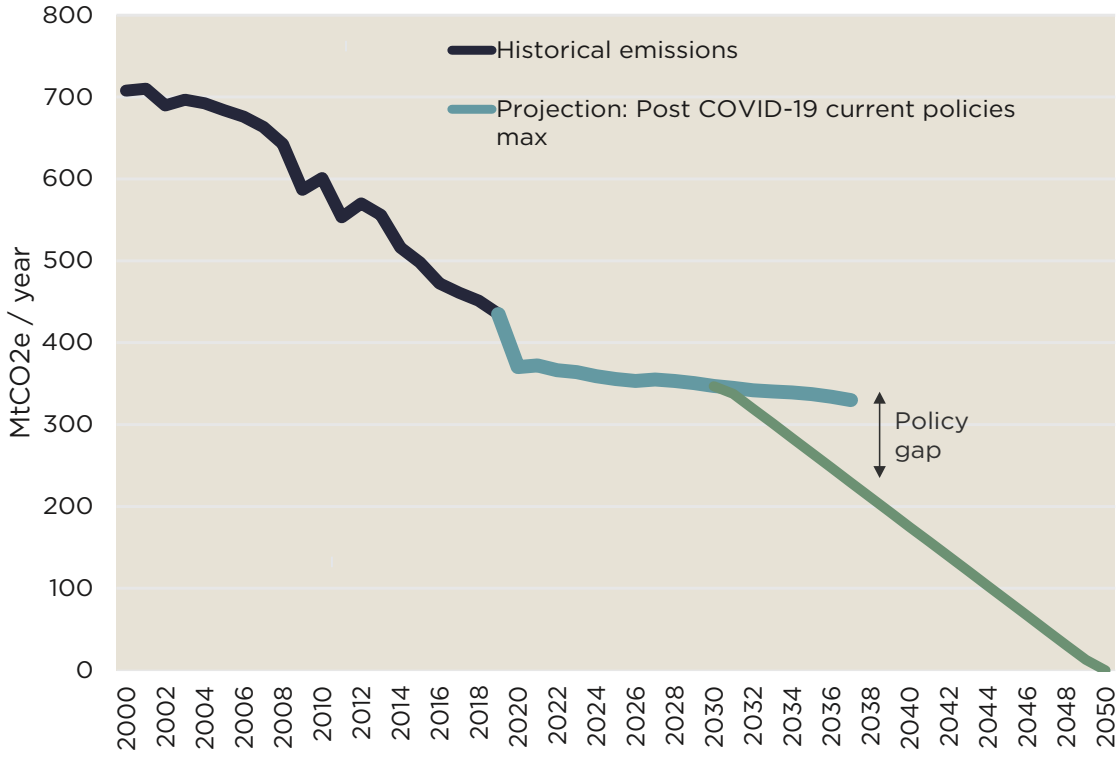
The latest analysis from the Energy and Climate Intelligence Unit (ECIU), a London-based think-tank, has found that 49% of GDP, representing more than $39trn, is now covered by regions with an actual or intended net-zero target and a total of 121 nations have put mechanisms in place to deliver net-zero emissions in time-frames that are aligned to the calls of the Intergovernmental Panel on Climate Change's (IPCC) landmark report in 2018.

In the UK new development will be forced to take on more of a share of already ambitious targets and the UK planning system will be key to enforcing such targets. Indeed in the June 2020 progress report to Parliament the Committee on Climate Change noted that buildings has slightly decreased their share of emissions but more work was needed, particularly in the commercial sector.

Local authorities will be central to the functioning of the new duties being imposed by Government through the forthcoming Environment Act expected later this year.

Many authorities already apply the DEFRA Biodiversity net gain (BNG) and local nature recovery strategies Impact Assessment (October 2019), where it is assumed that a significant proportion of costs imposed on developers by the requirements of BNG, in the medium to long term, will be 'passed through' to developable land prices, thereby affecting landowners. These costs cover both promotion and impact assessment, but are not always being factored into development appraisals.

UK Carbon Emissions Falling - but current policies will not meet net zero obligations



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Key Stats

Amount that carbon emission need to fall each year by 2050

19%
Buildings current contribute to global greenhouse emissions

£89,820
per ha estimated biodiversity damage cost

22%
of the market is currently speculative development

Planning policies that will increase costs to developers

Since local authorities will be central to the functioning of the new duty, the availability of ecological expertise is a particular concern. Only about 20 per cent of authorities have ecologists to advise developers and assess whether gain plans are acceptable.

The cost to undertake the necessary biodiversity assessments using the 2012 Defra metric is approximately £7,500 but can be as high as c. £15,000 for a significant scheme. Developers will be expected to pick up the costs both of their own consultants and any external advice commissioned by local planning authorities.

Based on background assessment work taken from a joint RSPB, National Trust and Wildlife Trusts study, the costs of habitat creation (including survey and net present value of 30 years' creation and maintenance costs) are estimated as £20,598 per ha (2017 prices). However, this figure is an average and masks significant cost variations.

The DEFRA methodology for calculating biodiversity units is complex. It depends on the biodiversity present on the site, how rare existing habitats are, current use of the area and the condition it is in.

The value of habitat differs significantly between regions (£4,832 - £89,248 per ha). The damage cost of biodiversity loss will consequently differ significantly region to region. Likewise, biodiversity loss per hectare differs depending on the richness of existing habitats. So, for example, London has the lowest average biodiversity loss per hectare of development (the highest estimate of net gain delivery costs to non-residential developments is £4.79 per m2 - £47,855 per ha).

Where on-site creation is not possible and a developer is required to offset through the market for biodiversity units, the indicative price for a biodiversity unit is assumed to be £11,000 (but with a deviation of between £6,000 and £25,000 per unit). The assessment identifies the weighted average biodiversity units lost from a representative ha of (all) non-residential development as 7.48 for greenfield development (as against 7.53 for residential) and 1. 8 for brownfield development (as against 2.07 for residential), giving a cost per ha of off-site habitat creation of £82,280 (greenfield) and £19,800 (brownfield) at 2017 prices.

Research undertaken by David Hill of the Environment Bank suggests it costs less to deliver biodiversity net gain (BNG) off-site than on-site, often with better ecological consequence that provide more contiguous habitat.

Biodiversity net gain is just the start

Government has stated it wants to expand the net gain approach to include wider natural capital and green infrastructure benefits, such as flood protection, recreation and water and air quality. Paragraphs 170b and 171 of the National Planning Policy Framework requires that both plan-making and decision-taking by Local Planning Authorities must recognise and enhance natural capital. Local planning and combined authorities will target the enhancements that are needed most in their areas.

This will require wider natural capital assessments which, in turn, will require developers to look at incorporating measures for carbon sequestration (the removal of climate change gases from the atmosphere through the provision of a range of habitats eg woodland), air pollution removal, noise mitigation, and urban cooling (provision of green and blue space to cool urban environments on hot days).

The Environment Bill proposes a legally binding target to improve air quality and increase local authority powers to address sources of air pollution. New planning guidance on air quality advises local planning authorities when considering planning applications to consider "what would happen to air quality in the absence of the development".

The implications of this are already being felt in some local authority pilot areas, where Defra's Impact Pathways Approach metric is being used to assess air quality damage costs. This metric is used to monetise the effects of 5 pollutants: nitrogen oxides, particulate matter, sulphur dioxide, volatile organic compounds and ammonia as a means to secure financial contributions to mitigate damage. Applying the metric to a scheme for a 23,000 m2 light industrial/distribution scheme in one of the pilot areas produced a damage cost range of £27,653 - £616,954.

Damage costs vary widely as they can be reduced by the inclusion of measures such as:

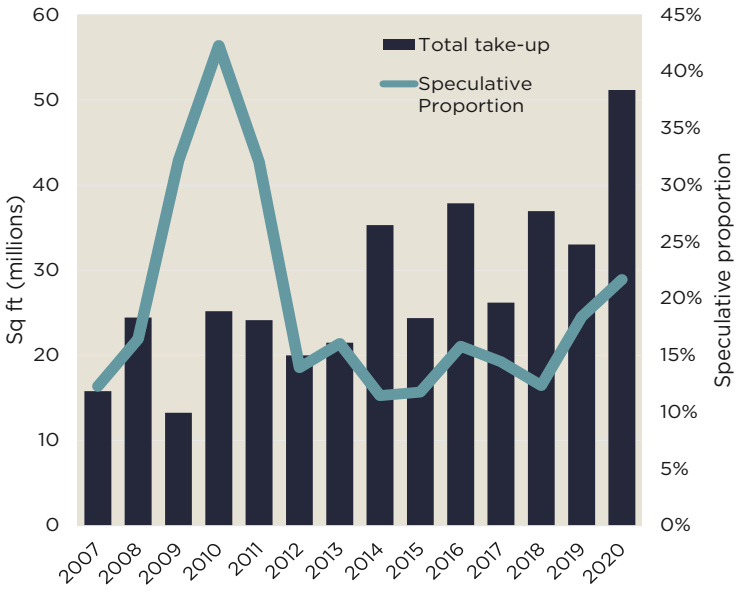
- On- and off-site tree/woodland planting and use of green wall/roofs
- Investing in sustainable travel – eg pedestrian footway links, public transport, cycle parking and facilities, car share spaces, electric vehicle charging points and use of electric loading vehicles
- Incentives for visiting HGVs with Euro 6 or better engines
- Incorporating environmental and recreational measures to provide physical and mental health benefits
- Enhanced SUDS measures

What are the implications of this for developers?

Speculative development accounts for 22% of all of the warehouse space taken in the UK, and in 2020 reached 11.1m sq ft. Occupiers need the flexibility to take speculative buildings when they are in rapid expansion mode as build to suits take longer to procure. Developers with a business plan to deliver speculative buildings will have little option but to accept these costs, and if possible recover them from the occupiers through rental growth. There could also be longer term implications for land values as developers appraise new sites based on assumptions that comply with the legislation.

Larger corporate occupiers are now more aware than ever of their own ESG targets and many newly constructed warehouses are achieving net zero status. The ability to move from older buildings, with low EPC's, to modern accommodation may present them with a quick ESG win that more than offsets any changes to the rental levels paid.

Speculative development accounts for 17% of the market in the last five years



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