Viability in Planning Presentation

March 2023

Who We Are

- Specialist practice of property consultants advising clients on the development of the built environment
- Formed in 2017 to focus on advising complex development propositions
- Successful track record of delivering innovative development advice
- Advise on all elements of the development continuum
- Provide a holistic service encompassing concept design, the planning process through to development delivery

What We Do

- Provide viable and deliverable solutions to the most challenging of projects, maximising return and outputs whilst effectively managing project risk
- Our success is founded upon working in collaboration with our clients to deliver their business aspirations and objectives
- Seek to add value across the whole development lifecycle
- Experience in strategy, policy and delivery has provided us with an unrivalled understanding of issues throughout the development continuum

NHS Shared Business Services

ARGUS

Bloom* *Opening up procurement* Accredited Supplier

Viability in Planning

Development Management

Regeneration

Planning Consultancy

Sustainable Housing

Our Clients

We undertake the majority of our viability work on behalf of Local Authorities and this shows a selection of our key clients.

South Ribble Borough Council

Rossendale BOROUGH COUNCIL

TRAFFORD COUNCIL

Tameside Metropolitan Borough

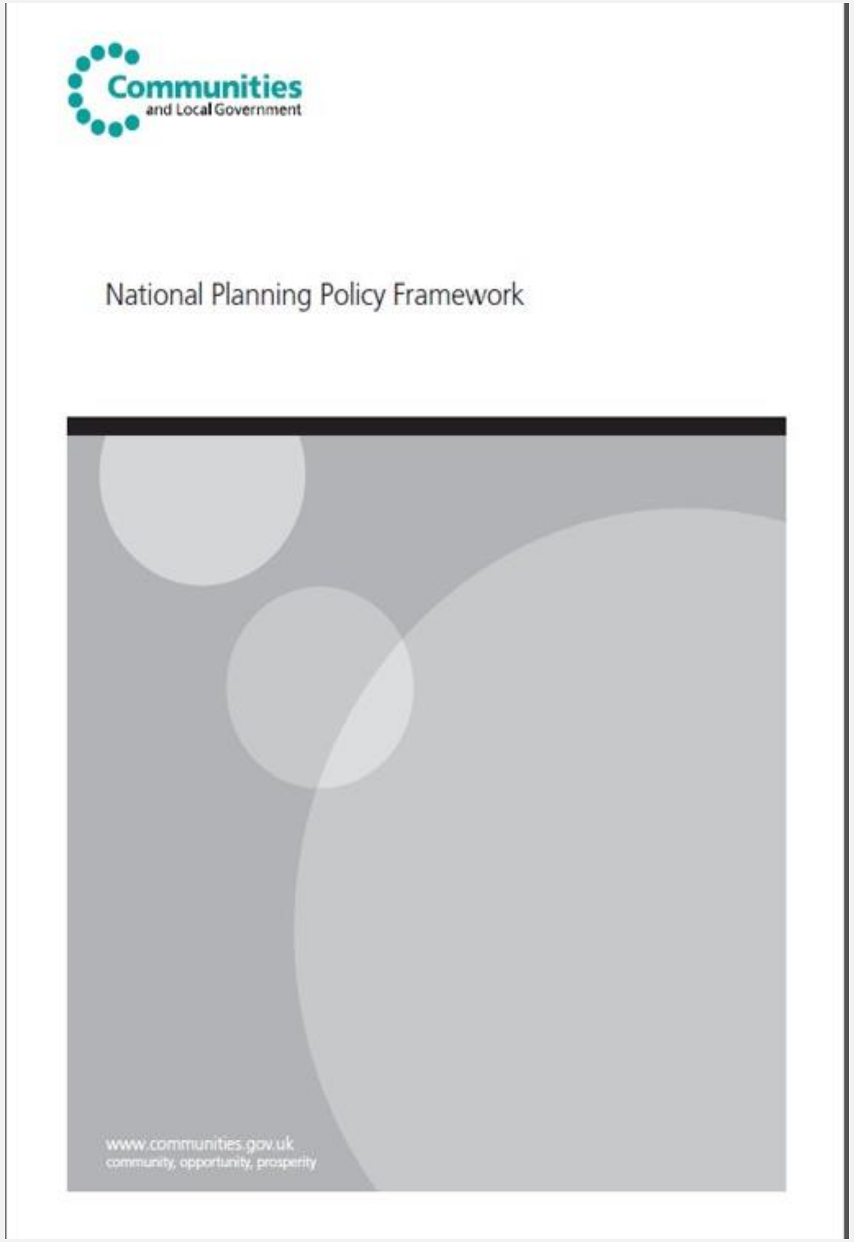
Chorley Council

WOKINGHAM BOROUGH COUNCIL

Teignbridge DISTRICT COUNCIL South Devon

Viability in Planning

- Viability has been a feature of the English planning system for some time, however, there was a significant change in approach due to the introduction of the NPPF in 2012.
- The proactive support of sustainable development as well as the key requirement of developments to be *'economically viable'* and for developers and landowners to achieve *'competitive returns'* was introduced.
- Flexibility was enhanced to permit the removal of the requirements for policy compliance in relation to affordable housing and Section 106, to allow for development to take place.
- The period between 2012-2018 can be described as one where the parameters relating to what did and did not constitute *'economically viable'* development were fluid.


Communities and Local Government

National Planning Policy Framework

www.communities.gov.uk
community, opportunity, prosperity

The Need to Set Parameters

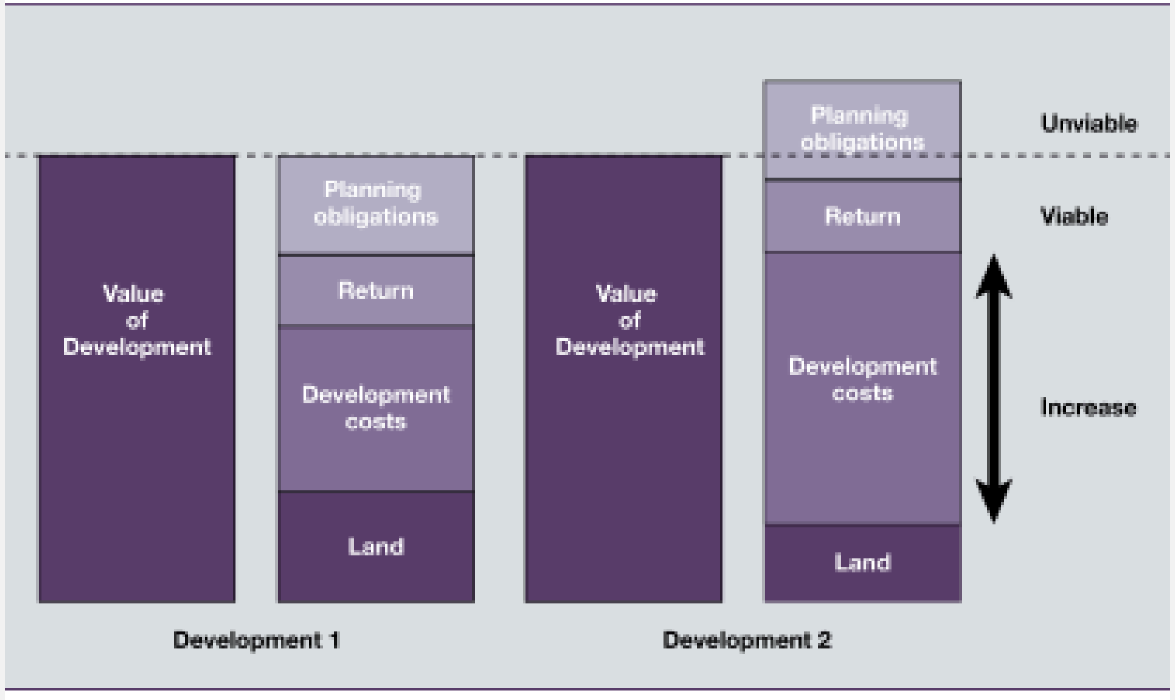
- Key High Court Parkhurst case identified the need for clearer parameters to be set in relation to viability in planning.
- Revised National Planning Policy Framework 2018-2019 and Planning Policy Guidance on Viability 2018-2019.

Clear Methodology Guidance and Setting of Parameters

- Benchmark Land Value (BLV) based on EUV+ methodology moving away from a subjective assessment of market value.
- Replacing *'competitive returns'* to the developer and landowner with the word *'aspiration'*.
- Defining viability as a balance between the aspirations of developers and landowners and the aims of the planning system to secure maximum benefits in the public interest (Paragraph 10).
- Introduction of overage/review mechanism.
- Viability work at the plan making stage should remove the requirement for decision taking viability.
- Profit - identification of a range at the plan making stage.
- Assessment needs to be based on a fully compliant scheme.

Defining Viability

The process of working out whether a scheme is viable is not binary. There is not a right or wrong answer. You will not get a answer to the level at which a scheme is truly viable from an Applicant until the conclusion of the development.



Source: RICS, Financial Viability in Planning (2012)

Development Viability Appraisal

The Residual Method

How Development Land is Valued

What process do you go through to get to the Residual Land Value (RLV)?

1. Selecting the most beneficial land use – planning context and potential uses
2. Scheme layout and density
3. What is the Gross Development Value (GDV) of the proposed development?
4. Estimating the build costs for the scheme
5. What contingency is needed to reflect construction risk?
6. What fees are needed to deliver and sell the proposed scheme?
7. What are the planning related costs?
8. Finance cost and development timeframe.
9. Risk adjusted return (profit margin)
10. Site purchasers' cost

- Once you have your assessment of GDV and of all the costs you need to deduct from the GDV (including profit margin), what you are left with is the residual amount that can be attributed to land value.

- **The whole process is subjective and not objective!**

Argus Developer Appraisal – Summary Page Appraisal

REVENUE					
Sales Valuation	**Units**	**ft²**	**Sales Rate ft²**	**Unit Price**	**Gross Sales**
3 Bed House (Type 950)	1	1,100	377.27	415,000	415,000
3 Bed House (Type 905)	17	16,150	384.21	365,000	6,205,000
2 Bed Flat Affordable	6	4,335	230.00	166,175	997,050
4 Bed Houses	3	4,050	388.15	524,000	1,572,000
Totals	**27**	**25,635**			**9,189,050**
NET REALISATION				**9,189,050**	
OUTLAY					
ACQUISITION COSTS					
Residualised Price (5.21 Acres 329,995.80 pAcre)			1,719,278		
				1,719,278	
Stamp Duty		5.00%	85,964		
Agent Fee		1.00%	17,193		
Legal Fee		0.75%	12,895		
Survey			25,000		
				141,051	
CONSTRUCTION COSTS					
Construction	**ft²**	**Build Rate ft²**	**Cost**		
3 Bed House (Type 950)	1,100	188.66	207,526		
3 Bed House (Type 905)	16,150	188.66	3,046,859		
2 Bed Flat Affordable	5,100	188.64	962,056		
4 Bed Houses	4,050	188.66	764,073		
Totals	**26,400**		**4,980,514**	**4,980,514**	
PROFESSIONAL FEES					
Professional Fees		5.00%	249,026		
				249,026	
DISPOSAL FEES					
Sales Agent Fee		1.00%	81,920		
Marketing		1.00%	81,920		
Sales Legal Fee	21 un	850.00 /un	17,850		
				181,690	
Additional Costs					
Dev. Management Fee		1.00%	57,075		
CIL			296,318		
				353,393	
FINANCE					
Debit Rate 6.000%, Credit Rate 0.000% (Nominal)					
Land			138,275		
Construction			47,465		
Total Finance Cost				185,740	
TOTAL COSTS				**7,810,693**	
PROFIT					
				1,378,358	
Performance Measures					
Profit on Cost%		17.65%			
Profit on GDV%		15.00%			
Profit on NDV%		15.00%			
IRR		40.05%			
Profit Erosion (finance rate 6.000)		2 yrs 9 mths			

Step 1: Gross Development Value

Output: Residual Land Value

Step 9: Site Purchaser's Cost

Step 2/3/4: Build Costs, Abnormal Cost and Contingency

Step 5: Fees

Step 6: Planning Related Cost (including affordable housing)

Step 7: Finance Cost

Step 8: Risk Adjusted Return

Step 1: Gross Development Value

- Once you have your total number of units and Gross Internal Area of the development you are able to calculate the Gross Development Value (GDV).
- This is done by applying estimated sale values by looking at comparable evidence of sold units in the area and of current asking prices.
- This should be based on new build comparables where possible.
- Land value, profit margin and development costs are all a proportion of the GDV.

Step 2: Estimating Standard Build Costs

Standard build costs is made up of:

- base build;
- external works;
- Prelims; and
- Overhead and Profit (not applicable to housebuilders).

For base build costs, there has been a reliance to date on non-specific cost assessments using BCIS National and Regional price data during the decision making stage.

There has been a lack of differential between plan making and decision making stage cost assessments, however the updated RICS Guidance has given much needed clarity in this area.

Step 3 & 4: Construction Risk – Abnormal Cost Allowances and Contingency

Step 3: Abnormal Costs

- Abnormal costs are those that the developer perceives to be in addition to 'normal' costs that would be expected to be incurred in the delivery of development. The Abnormal element will be a treatment over and above standard, primarily to deal with difficult ground conditions.
- Abnormal costs should be reflected in the Benchmark Land Value.

Step 4: Contingency

- It is recommended to incorporate a contingency in order to capture any cost changes that are unforeseen.
- This is usually done by applying a percentage to the total construction cost including abnormal costs.
- The industry standard percentage applied is usually between 2.5% to 5%, depending on construction risk.
- The contingency helps captures some of the construction risk in the scheme.

Step 5: Fees

- There are two types of fees that should be incorporated into the appraisal.
- The first are fees related to the delivery – Professional Fees and Planning Application Fees:
  - Professional Fees are usually referenced as a percentage of build cost.
- The second are fees related to the sale of the scheme – marketing costs, agent fees and legal fees:
  - These are either referenced as a percentage of the GDV or cost per unit.

Step 6: Planning Related Costs

There should be allowances in the appraisal for planning relation costs such as CIL and other S106 costs.

Affordable Housing

Affordable housing has the impact of (when delivered on site) of reducing the GDV.

Normally, on site affordable houses are owned and managed by Registered Provider who will purchase the homes on a development at a discount to the market value.

- For Example shared ownership units can be purchased at a circa. 30% discount to market value and social/affordable rent at a circa. 50% to 55% discount (the prices paid are market driven).

The cost of delivery of an affordable unit reflects that of a market unit, apart from any costs associated with selling the units.

Affordable housing reduces the actual profit amount and land value amount:

- The profit margin is a percentage of the GDV, so as the GDV reduces the actual profit amount received reduces.
- The land value (residual) is a proportion of the GDV, so as the GDV reduces the land value also reduces.

Step 7: Finance Cost and Development Timeframe

The cost to finance the project is linked to the length of time it takes to deliver the project, from the first incurring of cost, right to the sale of the final unit.

A cash flow function is normally used to estimate finance cost based on an annual interest rate which is referenced as a percentage.

	001:Mar 2017	002:Apr 2017	003:May 2017	004:Jun 2017	005:Jul 2017	006:Aug 2017	007:Sep 2017	008:Oct 2017
Monthly B/F	0	(537,802)	(1,178,405)	(2,146,122)	(3,380,377)	(4,848,481)	(6,564,650)	(8,374,503)
Revenue								
Sale - Apartment Sale Value	0	0	0	0	0	0	0	0
Sale - Ground Rent Investment	0	0	0	0	0	0	0	0
Disposal Costs								
Sales Agent Fee	0	0	0	0	0	0	0	0
Sales Legal Fee	0	0	0	0	0	0	0	0
Unit Information								
Apartment Sale Value								
Ground Rent Investment								
Acquisition Costs								
Fixed Price	(250,000)	0	0	0	0	0	0	0
Stamp Duty	(2,000)	0	0	0	0	0	0	0
Agent Fee	(2,500)	0	0	0	0	0	0	0
Legal Fee	(2,500)	0	0	0	0	0	0	0
Construction Costs								
Con. - Apartment Sale Value	(250,716)	(571,967)	(855,733)	(1,102,013)	(1,310,808)	(1,482,117)	(1,615,940)	(1,712,278)
Contingency	(12,536)	(28,598)	(42,787)	(55,101)	(65,540)	(74,106)	(80,797)	(85,614)
Professional Fees								
Professional Fees	(17,550)	(40,038)	(59,901)	(77,141)	(91,757)	(103,748)	(113,116)	(119,859)
Net Cash Flow Before Finance	**(537,802)**	**(640,603)**	**(958,421)**	**(1,234,255)**	**(1,468,105)**	**(1,659,971)**	**(1,809,853)**	**(1,917,751)**
Debit Rate 6.500%	6.500%	6.500%	6.500%	6.500%	6.500%	6.500%	6.500%	6.500%
Credit Rate 0.000%	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%
Finance Costs (All Sets)	0	(2,913)	(6,383)	(11,625)	(18,310)	(26,263)	(35,559)	(45,362)
Net Cash Flow After Finance	**(537,802)**	**(643,516)**	**(964,804)**	**(1,245,879)**	**(1,486,415)**	**(1,686,233)**	**(1,845,412)**	**(1,963,113)**
Cumulative Net Cash Flow Monthly	(537,802)	(1,181,318)	(2,146,122)	(3,392,002)	(4,878,417)	(6,564,650)	(8,410,061)	(10,373,175)

Step 8: Risk Adjusted Return (Profit Margin)

- There are two elements of risk: construction and sale.
- Construction risk – which is dealt through the allocation of money in the appraisal, plus a contingency to cover unforeseen cost increases.
- Sale Risk – which has two distinct elements.

  1. The risk of not being able to sell the home in the timeframe you have estimated (takes longer to sell)
  2. The risk that you are unable to sell the home at the price you predicted

- Sale risk is reflected through the risk adjusted return (profit margin).
- A risk register should be created for a development project. In your risk register you need to identify all the risks to the project and allocate them to construction or sale risk. As well as identify what risks are being covered through the financial cost assumptions and what is covered by the risk adjusted return.

Step 8: Risk Adjusted Return (Profit Margin) Continued…

The risk adjusted return should reflect the nature of the project being delivered.

If the development is in a well-located affluent area, where all the comparables tell you that houses are selling quickly at a good value and increasing on an annual basis, then there is inherently less risk with a project of this nature. Therefore the risk adjusted return applied should reflect this.

Conversely, if a development site is in a less affluent area with constraints such as a noise generator (Motorway/A road) in close proximity, this could be a deterrent to potential purchasers, so needs to be reflected in a greater level of return to reflect the risk to sale.

The level at which you adjust the return is something that is subjective and the developer will need to determine.

There should never be a benchmark risk adjusted return, because each site has different challenges.

The risk adjusted return is typically a proportion of the GDV – referenced as a percentage on GDV.

Step 9: Residual Land Value

- Once you have your assessment of GDV and of all the costs you need to deduct from the GDV (including profit margin), what you are left with is the residual amount that can be attributed to land value once site purchasers' cost are deducted.
- The site purchasers' cost included Stamp Duty, Agent Fees and Legal Fees.
- In addition, there is the finance cost related to the land value (which is a function of the appraisal) which is deducted from the site value in the appraisal.
- The output of this is the Residual Land Value (RLV).

Benchmark Land Value

The PPG (2019) states that the Benchmark Land Value (BLV) should be estimated using the EUV plus method. The PPG set out clearly how the EUV+ method should be applied, these are:

- *"be based upon existing use value*
- *allow for a premium to landowners (including equity resulting from those building their own homes)*
- *reflect the implications of abnormal costs; site-specific infrastructure costs; and professional site fees and*
- *… This evidence should be based on developments which are fully compliant with emerging or up to date plan policies, including affordable housing requirements at the relevant levels set out in the plan." (para. 14).*

Case Study: Warburton Lane Appeal

- 400 unit scheme in Trafford being promoted on a greenfield site by a major housebuilder.
- Their viability case was to offer no affordable houses due to viability.
- The key issues that were considered at the planning inquiry related to:
  - Benchmark land value (BLV);
  - Sales values;
  - Standard build costs; and
  - Abnormal costs.
- The inspector found that the Appellant had assumed costs to high and values too low, this was seen to effectively reduce the developers risk at the expense of the public purse. The overall conclusion was the scheme provided sufficient residual value to fund 45% affordable housing and full S106 contributions.

"The Planning Practice Guidance gives no indication as to what the uplift should be and the reason for that is because it will vary according to site specific and policy circumstances. There is no evidence that I have seen that says the premium should be any particular value. The important point is that it should be sufficient to incentivise the landowner to sell the land and should also be the minimum incentive for such a sale to take place." (para. 114)

Unviable 100% Market Scheme

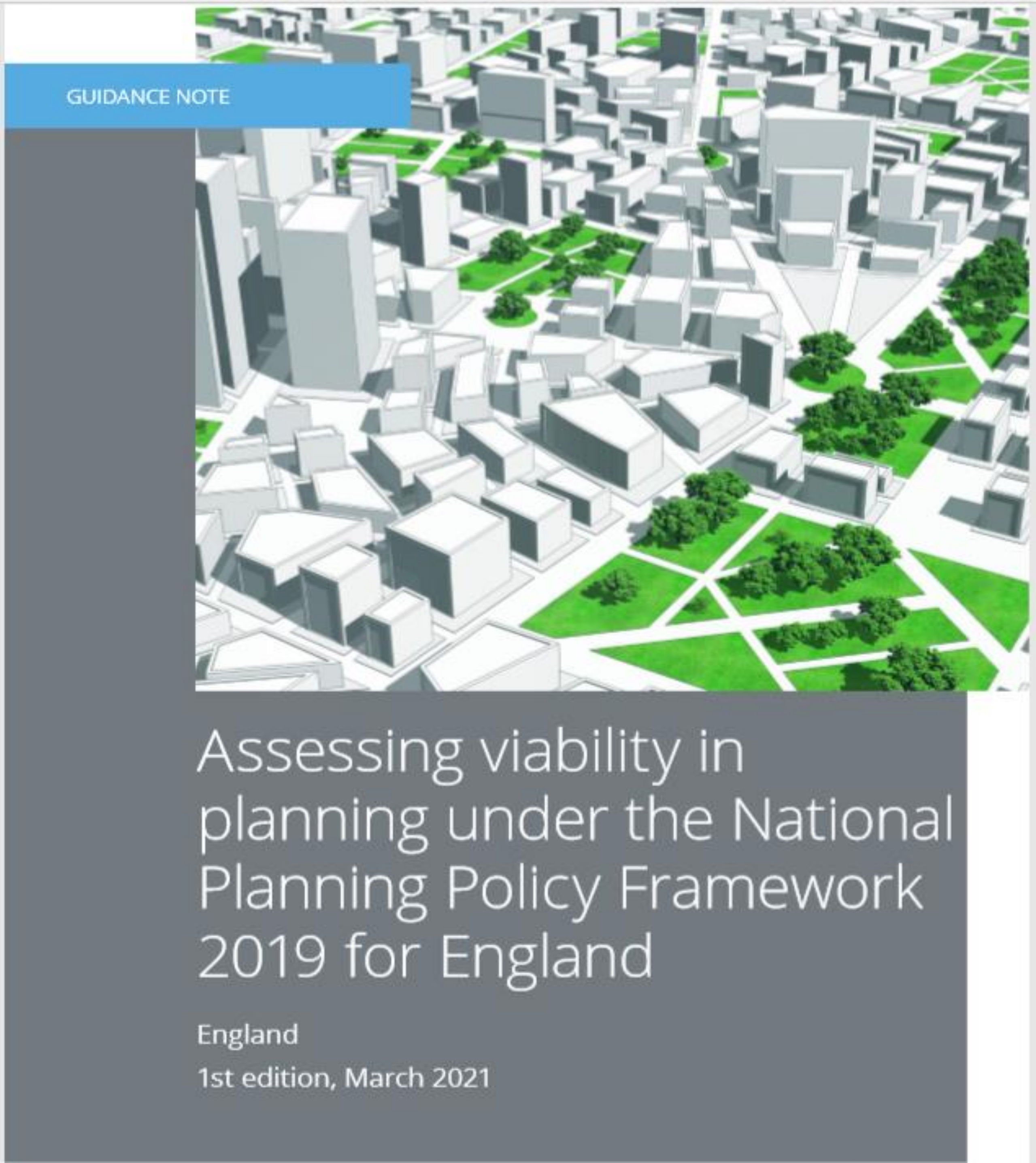
One tactic used by Applicant's recently is to make their scheme unviable even when it is making no planning gain contributions.

- Should a planning consent been given to a scheme that is unviable?
- Is this about deliverability and not viability?

Conflict of Interest

RICS Guidance Note 2019

- In April 2021, RICS published Assessing viability in planning under the National Planning Policy Framework (NPPF) 2019 for England
- The guidance note responds to the revision of the NPPF in 2019 and echoes what is set out in the Planning Practice Guidance (PPG) on viability also revised in 2019.
- The PPG (2019) is the key document with regard to financial viability in planning providing guidance on how to implement in practice the policy objectives of the NPPF (2019).
- The guidance note has provided much welcome clarity on the interpretation of the PPG (2019).



The New Stage in Viability

- The PPG (2019) puts the onus on the Applicant to demonstrate particular circumstances for viability to be assessed at the decision taking stage
- RICS guidance now supports this requirement and echoes the 4 examples:
  - Wholly different type of site;
  - High abnormal costs;
  - Particular tenure of housing (e.g. BTR, retirement) and
  - Significant economic change (recession, pandemic)
- Continuum consider that the identification of "particular circumstances" should form part of the pre-application consultation
- Our experience in other Boroughs located in the North West shows that this streamlines and expedites viability negotiations

*"It is up to the applicant to demonstrate whether **particular circumstances** justify the need for a viability assessment at the application stage"*

PPG, Paragraph 07

No Fixed Inputs in Decision Making

- Where in the past there has been a focus on "standardised" inputs to areas such as land value (BLV) and profit, there is now a clear directive that each site needs to be assessed individually due to its "unique" characteristics.
- RICS make their own differentiation between the plan making and decision-making stage.
- It is recognised that at the decision-making stage a far greater degree of information is known about the subject development, specifically in relation to costs.
- The onus is on the applicant to provide detailed information, such as a cost plan, rather than rely on standardised inputs.

Benchmark Land Value (BLV)

- BLV should be assessed following the **Existing Use Value plus (EUV+)** a premium methodology. The RICS guidance note recommends a 5 step approach.
  - **Step 1**: Establish Existing Use Value (EUV)
  - **Step 2:** Premium (mainly assed on other BLVs from Financial Viability Assessments)
  - **Step 3**: Alternative Use Value, where appropriate
  - **Step 4**: **policy-compliant site value assessed by the residual method (only to be used a cross-check)**
  - **Step 5**: policy-compliant site value assessed by the comparative method (only to be used as a cross-check).
- Step 4 is an important addition as it leads to the identification of where the planning balance can be applied.

Overage and Review Mechanism

- The RICS guidance note comments upon the use of overages (review mechanisms) with S106 agreements stating that all non-compliant schemes should now be subject to an overage to strengthen Local Authority's ability to seek compliance over the lifetime of a project.
- A review mechanism can be an effective tool for Local Authorities expediating the decision-making process whilst also achieving substantial contributions towards affordable housing.

"Where contributions are reduced below the requirements set out in policies to provide flexibility in the early stages of a development, there should be a clear agreement of how policy compliance can be achieved over time."

PPG, Paragraph 009

Striking a Balance

- The purpose of viability is to **strike a balance** between:
  - Aspirations of the land owner;
  - Aspirations of the developer; and
  - Benefits in the public interest (S106 contributions)
- This is set out in paragraph 10 of the PPG (2019) but an interesting **omission** from the new RICS guidance note (2021)
- If this balance is struck sustainable development is facilitated and the overall aim of the spatial planning framework can be achieved

Any Other Questions?

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