Viability – technical update

Mansfield District Council

CP Viability Ltd
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1st February 2019

CPV

Profile

- CP Viability is a niche company, providing viability advice only to Local Authorities.
- Small team of specialists.
- David Newham set up the company in 2016.
- David has a public sector background and is a MRICS qualified surveyor.
- Previously head up the viability team at the District Valuer Service

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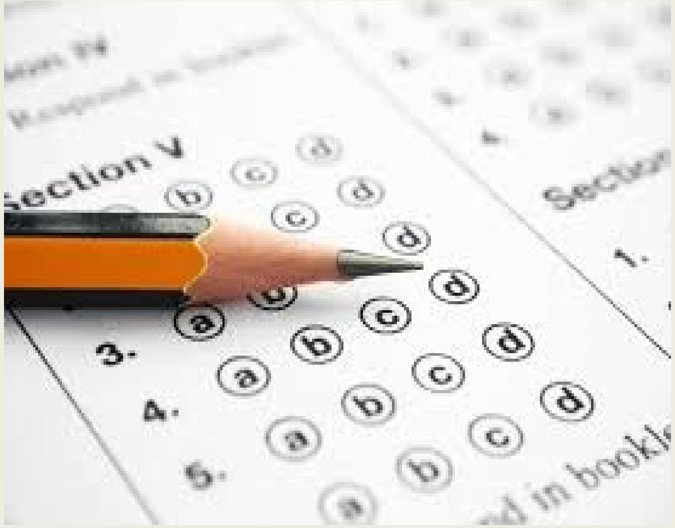
Topics

1. Viability overview
2. NPPF / PPG changes
3. Case Studies

But first, a question…



Site 1

South Fields, Morpeth
9 acres
Greenfield
Planning consent for residential
Above average value area (Northumberland)
New 3b semi £230k +
Sold to BDW in Jul 2015

Site 2

Barley Meadows, Cramlington
7.5 acres
Brownfield
Planning consent for residential
Below average value area (Northumberland)
New 3b semi circa £175k +
Sold to Miller Homes in Oct 2016

Which one sold for the highest value?

2. Viability overview

Uses the residual method or development appraisal. It is therefore a valuation exercise.

Separately the land value can be fixed (known as ‘Benchmark Land Value’).

If the residual land value in the appraisal is below the BLV the scheme is unviable, if above the scheme is viable – simple??

Basic structure of a development appraisal

Gross Development Value (i.e. Total Revenue)
Less
Development Costs (***Developer's Profit and Risk*** ***+ Construction + Fees + Finance***)
Equals
Residue for Land Acquisition

Definition of viability for planning purposes

“ ***An objective financial viability test of the ability of a development project to meet its costs including the cost of planning obligations, whilst ensuring an appropriate site value for the landowner and a market risk adjusted return to the developer in delivering that project.”***

In other words, a development appraisal is used to determine whether a scheme ‘works’ and produces a positive outcome (or not), particularly when affordable housing / Council policy ‘asks’ are applied to a scheme

Planning Guidance

National Planning Policy Framework (NPPF) Jul 2018

National Planning Policy Framework

Presented to Parliament
by the Secretary of State for Ministry of Housing, Communities and Local Government
by Command of Her Majesty

July 2018

Cm 9680

Planning Practice Guidance (PPG) Jul 18

https://www.gov.uk/guidance/viability

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Guidance

Viability

Sets out key principles in understanding viability in plan making and decision taking.

Published 6 March 2014
Last updated 24 July 2018 — see all updates
From: Ministry of Housing, Communities & Local Government
Collections: Revised National Planning Policy Framework and Planning practice guidance

Contents

This guidance has been updated in line with the new National Planning Policy Framework published in July 2018.

See previous version

Benchmark Land Value

- Controversial
- Involves fixing the land value in the appraisal
- This concept is **not** the same as Market Value
- The benchmark will not automatically be in line with the price agreed for the site in question
- If the developer paid too much for the site, the overbid is disregarded, and likewise if they negotiated a keen price, an uplift should be made

"To define land value for any viability assessment, a benchmark land value should be established on the basis of the existing use value (EUV) of the land, plus a premium for the landowner. The premium for the landowner should reflect the minimum return at which it is considered a reasonable landowner would be willing to sell their land. The premium should provide a reasonable incentive, in comparison with other options available, for the landowner to sell land for development while allowing a sufficient contribution to comply with policy requirements. This approach is often called 'existing use value plus' (EUV+)." **PPG July 2018**

3. NPPF changes July 2018

Principles

1. Greater emphasis on plan viability. Proportionate, typologies .

2. Regular detailed plan viability testing will be needed (at least every 5 years, but likely more frequently).

3. Para 57 key on viability. Greater focus on linking decision making viability to plan making & greater emphasis on change since the plan.

4. 10% of homes for affordable home ownership. Should improve viability but gives Councils less control.

5. New affordable housing definition. Includes social and affordable rent. Also includes Starter Homes and Discounted market sale.

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3. Planning Practice Guidance ('PPG') changes July 2018

Technical

BLV – price paid is not justification for a scheme being unviable.

BLV – EUV + premium approached now firmly advocated.

BLV – Abnormal / infrastructure costs, professional fees and planning policies should all be reflected in the BLV.

Profit – range of 15% to 20% of revenue. Potentially lower for the Build to Rent sector.

3. PPG changes (cont…)

Principles

Proof – Wording now firmer that the onus is on the applicant to prove a scheme is unviable.

Plan Reference – applicant must refer back to Local Plan viability testing and confirm what has changed since then. Can include (i) unallocated site (ii) further info needed on costs (iii) proposals significantly vary from the plan testing (iv) significant economic change

Accountability – viability appraisals should be made publicly available. Most viability assessments shouldn't apply to specific parties, reducing the need for sensitive information.

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3. Summary

1. Greater emphasis on plan viability. More regular, in depth studies likely to be needed.

2. Wider definition of affordable housing.

3. Central government looking to increase pressure on land agents / landowners to recalibrate expectations on land value.

4. Clearer guidance on viability inputs, particularly BLV. However, still areas of debate – this is not the end of the viability arguments!!

5. Viability assessments should be publicly disclosed.

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Case Study 1

- Brownfield – business in situ.
- High value area.
- Proposal for c.50 flats.
- Applicant had purchased site for £1.9million.
- Argued the scheme was unviable even before any planning policies (inc CIL) were factored in.
- Build costs purportedly in excess of BCIS upper quartile.
- Sales values circa £3,200psm

Key Questions for the assessment

1. Was it appropriate to use the purchase price as the benchmark land value?
2. Were the build costs appropriate given the nature of the proposal?
3. Were the sales values appropriate given the nature of the proposal?

Case Study 1 (cont…)

<u>Benchmark Land Value</u>

- The PPG (July 18) is clear that a purchase price should under no circumstances be justification for departing from planning policy.
- To establish BLV the assessor needs to adopt "EUV + premium" approach.
- Here, the EUV was based on the existing business.
- This suggested (inc a premium) a BLV of £1.4million. This also tied in with other BLV's agreed across the Authority.
- Applicant argued the price paid was reasonable following a marketing programme, in which offers ranged from £1.45mil to £2mil (all subject to planning).
- The offers, though, were all subject to planning. Planning had not been granted and would not be granted unless the appropriate planning policies were met. This suggested the bids had not appropriately factored in the policies.
- The PPG also is clear that the EUV + premium approach should be applied, not reference to a marketing process.
- Concluded that the BLV should be adjusted to £1.4mill in the viability assessment.

Case Study 1 (cont…)

Balance between sales value and build costs

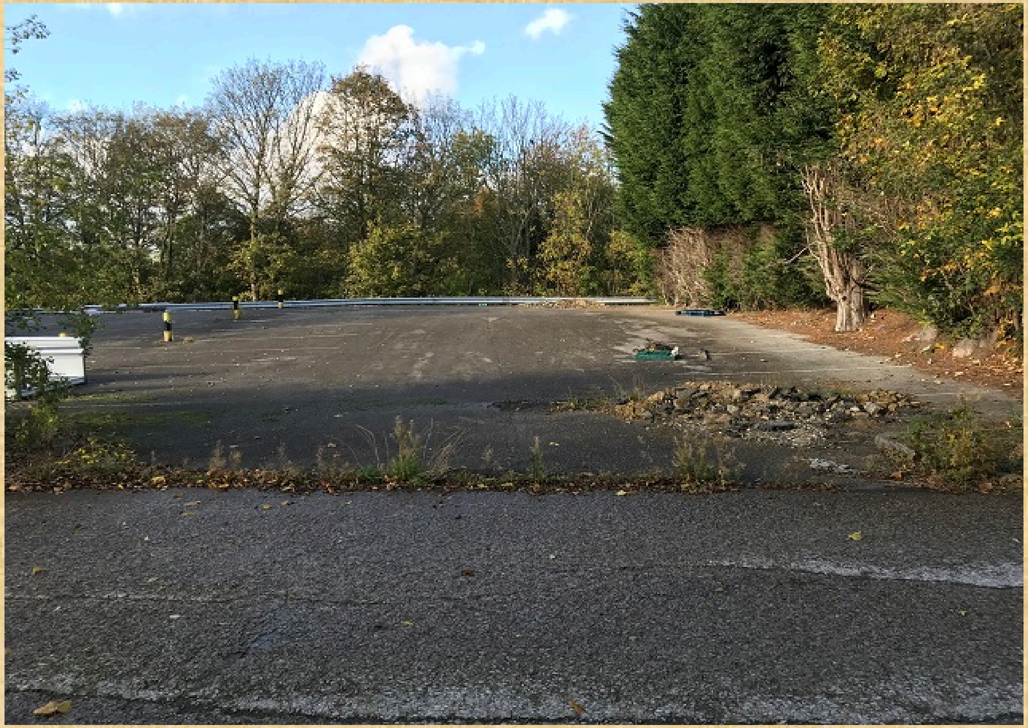
- There must be an appropriate balance between value & costs. There is no point delivering a higher specification if the market will not be able to pay for it. But equally, if a high spec is deliverable, the builder would expect an appropriate uplift in the values.
- Here the build costs were high, but sales values were mid-range when compared to other schemes (i.e. the balance wasn't appropriate). Suggestion to either reduce build costs to mid-spec or uplift sales values. Agreed (eventually) on the latter.
- However, there remained a disagreement on what the sales values should be.
- Applicant referred to key evidence and suggested the analysis undertaken by ourselves was incorrect (in that the rate per sq m was overstated). Evidence was produced to show the apartment areas were understated (increasing the £psm).
- However, on closer inspection it was found the applicant's evidence overstated the areas of the flats (as they included for balconies, which had been excluded from the subject site). The original allowance was again deemed reasonable.

Case Study 1 (cont…)

<u>Outcome</u>

- After 12 months of debate, including 3 rounds of reports, the applicant accepted the policy requirements.

Case Study 2



- Brownfield – empty buildings
- Medium value area.
- Proposal for c.30 houses.
- Requirement for 25% affordable housing and c.£200k S106.
- Applicant argued the scheme was unable to viable support any planning contributions.
- Build costs lower quartile plus externals.
- Sales values circa £2,200psm.
- BLV c. £1million.
- Profit 20%.

<u>Key Questions for the assessment</u>

1. Local evidence suggested build costs were high?
2. Was the adopted profit allowance too high?
3. Was the BLV appropriate?

Case Study 2 (cont…)

<u>Build costs</u>

- Use of BCIS is common place, however it does have its limitations.
- We had appraised another scheme in the locality where the applicant submitted build costs below the BCIS LQ.

<u>Developer profit</u>

- PPG refers to a range of 15% to 20%, suggesting this can vary from scheme to scheme.
- Not therefore the case that a profit margin of 20% should always be applied.
- Also, there is a reduced risk attached to affordable units. This is because these are typically ‘pre-sold’ to a Registered Provider and then transferred in bulk upon completion. This reduces the risk profile, which would suggest a reduction in profit for these elements.
- Scheme was brownfield and had various abnormal costs. For this reason a 20% profit was deemed appropriate for the market value units, however a reduction to 6% on the affordable dwellings was applied.

Case Study 2 (cont…)

<u>Benchmark Land Value</u>

- The applicant had adopted the BLV plus premium approach, as set out in the PPG. Their general method was therefore appropriate.
- However, to establish the EUV the applicant adopted an industrial value of £275,000 per gross acre.
- The site, though, was on split levels and not therefore considered particularly attractive for industrial development. Furthermore, there was already an existing building on site which could be considered as part of the EUV calculation.
- Applied a Market Rent of £73,000 (in line with the Business Rates) and applied a 12% yield to get to £600,000. A premium uplift of just under 10% was applied to get to a BLV of £650,000.

Case Study 2 (cont…)

<u>Outcome</u>

- Applicant challenged the findings of our report on the following grounds:
  - (i) BCIS LQ is reasonable. However, a compromise figure should be applied.
  - (ii) BLV method is acceptable, but the yield applied (12%) is too high.
- Notwithstanding the above, the applicant put forward a revised offer c. 7% affordable housing and c. £200k S106.
- Reviewed the comments raised by the applicant and revisited our findings. Noted that the BCIS LQ had been agreed elsewhere. Also accepted that the key build cost evidence we had identified was only from 1 scheme, therefore a risk this was anomalous.
- The applicant's compromise still fell below the BCIS LQ so was deemed acceptable.
- As for the BLV, reviewed the market and accepted that there was some fluctuation in yields. Adjusted to a compromise yield.
- Counter offer of 14% affordable and £200k S106. Accepted by the applicant.