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LONDON BOROUGH DEVELOPMENT VIABILITY PROTOCOL

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**February 2016
Consultation Draft**





The London Borough Viability Group was formed in 2014 in response to the increasing emphasis placed on development viability in the planning process. The Group draws together planning, housing and surveying officers from across London's Boroughs to consider best practice in the assessment of viability.

1 INTRODUCTION

- 1.1 Development viability has become an important consideration within the planning process as established in the National Planning Policy Framework (NPPF). Viability testing is undertaken when local authorities produce Local Plans. As part of the application process, the purpose of viability testing is to ensure that developments are deliverable. This influences the extent to which new developments meet Plan requirements, such as the provision of affordable housing and infrastructure and compliance with environmental policies.
- 1.2 The London Plan requires developers to provide development appraisals to demonstrate that each scheme provides the maximum reasonable amount of affordable housing output, and that Boroughs evaluate viability appraisals rigorously¹. Robust assessment is vital to ensure the implementation of adopted planning policies which form the basis of the delivery of sustainable development in each authority.
- 1.3 There is a range of different guidance relating to viability assessments which has in some cases led to a diversity in approach. The protocol sets out overarching principles for how boroughs will consider development viability as a part of the planning process, in line with the NPPF and the national Planning Practice Guidance (PPG).
- 1.4 The protocol will provide greater clarity to developers and members of the public and should be read alongside local Development Plans and associated guidance. It does not alter existing policies, but provides additional advice on the information requirements and approaches that local authorities intend to apply when assessing viability.

¹ London Plan March 2015 (FALP) policy 3.12 and paragraph 3.71

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DELIVERY OF SUSTAINABLE DEVELOPMENT

- 2.1 The National Planning Policy Framework (NPPF) establishes that the key purpose of planning is the delivery of sustainable development through a ‘plan-led’ system² as set out in statute. Planning should: help to deliver strong, responsive and competitive economies, by co-ordinating development requirements, such the provision of infrastructure; create sustainable, mixed and healthy communities; meet full, objectively assessed needs for market and affordable housing; promote sustainable transport; require good design; conserve and enhance the natural and historic environment; and, meet the challenge of climate change.
- 2.2 The NPPF also requires that the costs of planning requirements should allow for competitive returns to a willing land owner and willing developer to enable development to be deliverable³. Viability is therefore an important consideration, but the process and methodology for testing this must be accounted for within the context of the NPPF as a whole and the overarching objective of achieving sustainable development.
- 2.3 The Statutory Development Plan for each borough consists of the London Plan and borough Local Plans (typically comprising of a Core Strategy, Development Management Policies and Site Allocations).
- 2.4 Significant changes to the planning system are currently proposed through the Housing and Planning Bill. Boroughs will review progress of the Bill and consider further regulatory changes as they come into effect.

² NPPF paragraph 17

³ NPPF paragraph 173

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VIABILITY ASSESSMENT PROCESS

3.1 Development viability issues can cause delay to the determination of applications when not addressed at an early stage or when insufficient information is provided. To avoid this and to ensure that appraisals can be properly assessed and are robust:

- Section 106 Heads of Terms and development viability (where this is likely to be a consideration) should be discussed at ‘pre-application stage’.
- Proposals submitted should be designed in a form that accords with Development Plan policies and associated guidance and in a manner that is consistent with the outcome of the viability assessment process.
- Viability assessments should reflect Planning Practice Guidance on viability and borough guidance relating to methodology and inputs.
- Assessments should include all relevant information required by the council. Viability evidence must be robustly justified and appraisal assumptions benchmarked against publicly available data sources. Appraisals must be balanced, coherent as a whole and internally consistent.
- Any assessment submitted should reflect the scheme as proposed and should demonstrate that the scheme is deliverable with the proposed level of planning obligations.
- Applicants and/ or assessors should confirm that the assessment provides a fair and true reflection of viability and that this complies with professional and ethical standards within the RICS Red Book. This should include a due diligence undertaking and statement that assessors have not been instructed on the basis that their fees increase or are otherwise incentivised if they are successful in securing reductions in planning obligations.
- A working electronic version of the viability appraisal model should be provided to the relevant authority so it can be fully tested and interrogated.

3.2 Councils will consider whether the approach adopted and the inputs applied are appropriate and adequately justified by evidence⁴. In doing so councils will typically take advice from external consultants. The reasonable costs of this process will be paid for by applicants.

3.3 An appraisal should be updated where necessary to ensure that the assessment reflects current market conditions at the point of determination, in line with PPG⁵.

3.4 Following assessment of an applicant’s viability appraisal, the relevant council will indicate whether the scheme complies with Development Plan policies and whether or not additional planning obligations are required to ensure compliance.

⁴ PPG Viability Paragraph 16 states that an applicant should be “able to demonstrate to the satisfaction of the local planning authority that the planning obligation would cause the development to be unviable” before an authority agrees to vary requirements

⁵ PPG Viability Paragraph 17

Openness

3.5 Information relevant to the plan-making and planning application process is publicly available. This is consistent with the NPPF which places a requirement on councils to facilitate community involvement in planning decisions⁶. Planning Practice Guidance states that transparency of viability evidence is encouraged wherever possible⁷. The Environmental Information Regulations (2004) recognise the benefits of public participation and include a presumption in favour of disclosure. To ensure transparency and public participation:

- Authorities will expect information to be provided on an ‘open book’ basis and that this information can be made available to the public alongside other application documents. In submitting information, applicants do so in the knowledge that this may be made publically available. It will be for individual authorities to decide how to treat information provided to them.
- Regardless of the approach taken by an authority in respect of making an appraisal publically available, boroughs may make information available to planning committee members or any other member who has a legitimate interest in seeing it.
- Authorities may also be required to make information available to a third party where another body has a role in determining an application or providing public subsidy and when fulfilling their duties under the Environmental Information Regulations and freedom of information legislation.

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DEVELOPMENT VALUES

4.1 Assumptions relating to development values should be justified with reference to up to date transactions and market evidence relating to comparable new build properties within a reasonable distance from the site and, where relevant, should reflect arrangements with future occupiers. In particular:

- Information relevant to comparable properties should be: directly comparable to the site in question or should be adjusted to ensure it is comparable; and be fully analysed to demonstrate how this has been interpreted and applied to the application scheme.
- For any units with characteristics which justify higher values (e.g. upper floors, south facing units, river frontage etc) further details should be provided, with reference to units of similar characteristics in nearby schemes where possible.
- In line with the London Plan⁸, applicants should engage with Registered Providers (RPs) at an early stage. Affordable housing values should reflect discussions with and offers made by RPs. Affordable housing provision should be maximised making the most effective use of affordable housing resources. Values should be evidenced through calculations of rental and capital receipts (including staircasing receipts for shared ownership units) and available external/ internal subsidies.

⁶ NPPF paragraphs 66 & 69

⁷ PPG Viability Paragraph 4

⁸ Policy 3.12 and paragraph 3.71, 3.72

5 DEVELOPMENT COSTS

- 5.1 Build costs should be provided in an elemental form based on a detailed specification of the proposed development and supported by evidence of contractor costs.
- Cost details should generally be provided based on Gross Internal Area (GIA), clearly apportioning costs to different elements of the development (i.e. commercial, market residential, affordable housing etc).
 - Costs should be provided in a detailed elemental form that enables this to be benchmarked against publically available sources such as BCIS. Boroughs may seek advice from a Quantity Surveyor to be paid for by the applicant.
 - Boroughs will expect a clear correlation between a development's specification, assumed build costs and development values, and for there to be consistency with comparable sites.
 - In line with PPG, appraisals should normally be based on current day costs. In particular, these should not include build cost inflation where current day values are assumed. For medium and longer term schemes future changes in costs should only be reflected where projected changes in values based on relevant market data have also been incorporated.
 - Any site-specific abnormal costs should be disaggregated and supported by robust evidence (including contractor costs). The presence of abnormal costs would normally be expected to influence land value.
 - A relationship between professional and marketing fees and development values should also be evident.
 - A standardised approach will generally be adopted to finance costs which should be justified according to the specific proposal, reflecting varying interest costs throughout the development period.

6 PLANNING CONTRIBUTIONS

- 6.1 Likely S106 planning obligations should be included as a development cost and be determined in accordance with borough policies and guidance. Community Infrastructure Levy (CIL) charges should also be included as a development cost and should be calculated in accordance with borough/ Mayoral Charging Schedules and the CIL Regulations. Borough and Mayoral CIL instalment policies, and phased payments under the CIL Regulations, which aid developer cashflow should also be reflected in the assumed timing of payments.

7 DEVELOPER PROFIT

- 7.1 Evidence should be provided from applicants and lenders to justify proposed rates of profit taking account of the individual characteristics of the scheme, a development's risk profile and comparable schemes. Profit levels should be appropriate to current market conditions and in particular would be expected to be lower than levels that were typical following the downturn. Profit levels are likely to fall within a range of 15-20% as a proportion of development costs for market housing and commercial floorspace depending on the circumstances of the proposal. Profit requirements for affordable housing are lower at typically 6% on costs reflecting lower levels of risk.
- 7.2 It should be made clear how the profit level has been risk adjusted taking into account other assumed inputs within an appraisal. For example, the adoption of cautious assumptions such as the inclusion of contingencies and other costs at the upper end of typical parameters would warrant a lower target profit.
- 7.3 Boroughs will normally consider profit as a factor of gross development value (GDV) and/ or gross development cost (GDC). Where a development programme and the timing of costs and income are uncertain or likely to change, an 'internal rate of return' (IRR) approach of measuring profit which is sensitive to these factors is likely to be less reliable. If IRR is relied on a full justification must be provided for the assumed development programme, the timing of cost and value inputs and the target IRR. Where IRR is used as a measure of profit, boroughs may also consider profit as a factor of GDC/GDV.

8 LAND VALUE

- 8.1 Within planning viability assessments there are two assessments of land value that are undertaken to determine whether a proposal is viable: The assessment of *residual land value* and *benchmark land value*. The *residual land value* is determined through deducting development costs from development value (see guidance on costs and values above) to ascertain the remaining value that is available to pay for land⁹. This is then compared with the *benchmark land value* which is the value below which the current / existing use will be retained onsite and the land will not be released for development.

⁹ This is the residual method of land valuation

Benchmark land value

- 8.2 The process for establishing an appropriate benchmark land value for a viability assessment is key, because this indicates the threshold for determining whether a scheme is viable or not. A development is typically deemed to be viable if the 'residual land value' is equal to or higher than the benchmark land value, as this is the level at which it is considered that the landowner has received a 'competitive return' and will release the land for development. In line with Planning Practice Guidance:
- In all cases land or site value should reflect Development Plan Policies, planning obligations and CIL¹⁰. This is the case when calculating the residual land value as planning policies determine the form of development that is acceptable (land use, density, height, design, tenure etc.), and policy requirements (e.g. planning obligations and CIL) are included as development costs¹¹.
- 8.3 This is also relevant when determining the benchmark land value. If it is assumed that land value will increase due to the grant of permission but this does not adequately reflect policy requirements, the adopted site value is likely to be excessively inflated.
- 8.4 If a site value that does not reflect policy requirements is included as a benchmark or a fixed cost in an assessment, this will artificially reduce viability and undermine the delivery of sustainable development and those policies it failed to reflect. It is therefore crucial to the delivery of the plan-led system that land value mirrors or replicates all relevant policy requirements, including borough affordable housing targets and CIL charges.
- 8.5 The benchmark land value must also be consistent with the approach taken within the assessment as a whole, for example if value and cost inputs have been determined on a current day basis, this should also be reflected in the benchmark.
- 8.6 For these reasons the benchmark land value is distinct from the sale price of land which may not be consistent with the principles above. These issues are considered further below.

¹⁰ PPG Viability Paragraph 23

¹¹ Planning applications are determined in accordance with the Development Plan unless material planning considerations indicate otherwise

Existing Use Value Plus Premium

- 8.7 The ‘Existing Use Value plus’ (EUV+) approach to determining the land value benchmark is based on the current use value of a site plus a premium. The principle of this approach is that a landowner should receive at least the value of the land in its ‘pre-permission’ use, which would normally be lost when bringing forward land for development. A premium is added to provide the landowner with an additional incentive to release the site, having regard to site circumstances.
- 8.8 The benefit of this approach is that it clearly identifies the uplift in value arising from the grant of planning permission because it enables comparison with the value of the site without planning permission.
- 8.9 Planning Practice Guidance confirms that current use value is an appropriate basis from which to determine whether a ‘competitive return’ is achieved through comparison with the land value generated by a development (which must be higher than the benchmark)¹².
- 8.10 In line with the Mayor of London’s Housing Supplementary Planning Guidance and the GLA Affordable Housing Toolkit Guidance Notes, the boroughs consider that the ‘existing use value plus a premium’ approach is most conducive to achieving the goals of the planning system and should be used to determine the benchmark land value in most circumstances¹³.
- 8.11 When determining an appropriate land value benchmark:
- An existing use value should be fully justified with reference to comparable evidence, which excludes any hope value associated with development on the site or alternative uses. This evidence should relate to sites and buildings of a similar condition and quality or otherwise be appropriately adjusted. Where an existing use and its value to a landowner is due to be retained in a development (and not lost as is usually the case), a lower benchmark would be expected.
 - Premiums above Existing Use Value should be justified, reflecting the circumstances of the site and landowner¹⁴. For a site which does not meet the requirements of the landowner and creates ongoing liabilities/ costs, a lower premium would be expected compared with a site occupied by profit-making businesses that require relocation.
 - When determining a level of premium that would be sufficient to incentivise release of a site for development and ensure that a landowner receives a ‘competitive return’, this should take into account the overarching imperative of delivering sustainable, policy compliant development and that an uplift in land value is dependent on the grant of planning consent. It is vital that land value is not overstated based on a purchase price, land transactions or land owner aspirations which do not sufficiently reflect the role and requirements of the Development Plan, which could also have the effect of pre-determining the outcome of the process.

¹² PPG Viability Paragraph 24

¹³ Also applied within the Homes and Communities Agency Guidance ‘Responding to the Downturn’, and Local Housing Delivery Group ‘Viability Testing Local Plans: Advice for Planning Practitioners’

¹⁴ This is considered further in the GLA Development Appraisal Toolkit Guidance Notes (2015)

The Market Value Approach

- 8.12 An alternative approach determines the benchmark land value using the market value of land, *having regard* to Development Plan policies and material considerations. This is based on RICS guidance which is predicated on basis that land trades at market value¹⁵. Notwithstanding this, a research paper published by the RICS identifies a misapplication of this approach in which Development Plan policies are not fully taken into account when determining land value¹⁶. As referred to above, this is inconsistent with the requirements of Planning Practice Guidance, and creates a scenario where it becomes almost inevitable that policy requirements are found to make a development unviable.
- 8.13 The GLA Viability Toolkit Guidance Notes (2015) also reference potential problems with this approach: “It is possible for the Toolkit to model an approach where the land acquisition cost is used as a driver for the viability calculation. Users will need to be aware that this approach effectively “turns the model on its head”, and determines that policy requirements are the ‘residual’ in the calculation and thus open to being ‘squeezed’ by developers who have not reflected policy in their bid for land”.
- 8.14 Similarly, reliance on land transactions for sites that are not genuinely comparable or that are based on assumptions of low affordable housing delivery, excess densities or predicted value growth, may lead to inflated site values. This undermines the implementation of Development Plan policies and the ability of planning authorities to deliver sustainable development. For these reasons:
- Where site value does not take full account of the Development Plan or CIL charges, where market land transactions are not fully evidenced and genuinely comparable, or where transactions have been inflated through growth assumptions (while PPG requires that assessments are normally based on *current day values*), this approach will not be supported.

Residual Land Value

- 8.15 The residual land valuation approach is sensitive to small changes in value and cost inputs which can significantly change the resulting land value that is generated. The *comparison method* of valuation can be used to cross-check the residual land value. This uses market evidence as a basis of assessing whether a residual land value realistically reflects market conditions as required by PPG. In some circumstances, such as where a residual land value is lower than transacted land values¹⁷, it may be necessary to revisit relevant inputs in an appraisal (such as profits/costs etc.) to ascertain whether these are appropriate and realistic.

¹⁵ See RICS Guidance Financial Viability in Planning (2012)

¹⁶ RICS (Professor Neil Crosby, Professor Peter Wyatt) Financial Viability Appraisal in Planning Decisions: Theory and Practice (2015)

¹⁷ These should be comparable and consistent in approach or adjusted accordingly

VIABILITY REVIEW MECHANISMS

- 9.1 Development values adopted within viability assessments are typically determined based on current day values at the point of the planning permission. However there is usually a time lag between the planning stage and delivery of the development with developers normally having up to three years to implement a development and the construction period further delaying the point at which values are realised. During this time significant changes can occur to the viability of a development.
- 9.2 London Plan Policy 3.12 makes provisions for ‘contingent obligations’ where viability is re-appraised at a later stage through a viability review to determine if a greater level of policy compliance can be achieved. This is intended to ensure that the maximum public benefit is secured over the period of the development.
- Where affordable housing targets and other policy requirements are not met at application stage due to viability considerations, Boroughs will require applicants to enter into review mechanisms within Section 106 agreements. These will enable a re-assessment of viability to determine whether additional affordable housing and other planning obligations can be provided at a later date. In line with the Mayor’s Housing Supplementary Planning Guidance and current practice, boroughs may seek reviews on phased and non-phased schemes.
 - Reviews may take place prior to or at an early stage of development enabling additional onsite affordable housing to be provided or at a later stage based on actual values/ costs which will generally result in a financial contribution. On phased schemes viability reviews may be required at different stages of the development process.
 - Where a ‘surplus’ profit is generated over and above the ‘target’ or ‘base’ profit level (which is necessary to ensure a viable development), this will be prioritised for a greater level of policy compliance (capped by relevant policy requirements). In some instances a council may deem it appropriate for a developer to receive a share of surplus profit to remain incentivised to maximise value. The overall purpose of review mechanisms is to ensure the greatest possible level of policy compliance in instances where surplus profit is generated.
 - The purpose of review mechanisms is to ascertain whether additional policy compliance can viably be achieved at the point of delivery. Review mechanisms should not result in a reduction in policy compliance which is likely to affect the acceptability of a development proposal¹⁸.

¹⁸ Separate provisions exist under S106B of the Town and Country Planning Act 1990 (as amended) through which the viability of affordable housing obligations can be reconsidered on the grounds of viability

9.3 In some cases, applicants apply value growth assumptions in development appraisals based on expected market performance. This approach has been used as a basis for arguing for the adoption of both higher levels of profit and that the viability of a scheme should not be reviewed. However, for some proposals adopted growth assumptions have been found to be significantly lower than long term trends and actual growth. For these reasons:

- If a viability assessment assumes changes in development values and build costs, this should be accompanied by a full and detailed justification including evidence of long-term new build trends, current market conditions and market expectations. Profit levels should be fully justified as set out above and should not be set at a level that offsets the benefits of assuming growth.
- If an applicant chooses to rely on growth forecasts, the inherent uncertainty associated with forecasting is such that a viability review will be necessary to assess actual changes in value and costs.

10 MAYORAL 'CALL-IN' APPLICATIONS

10.1 For developments that are 'called-in' by the Mayor of London, boroughs will work with the Mayor to assess viability appraisals in accordance with the Statutory Development Plan.



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