

# London Borough of Richmond upon Thames

## Affordable Housing Financial Viability Assessment – Sub Threshold Contributions

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## Executive Summary

This is a research report for the London Borough of Richmond upon Thames (LBRuT) into the viability of options for future affordable housing policy, with particular reference to sub-threshold contributions. It supports other policy requirements, particularly the need to discourage “threshold ducking”.

Section 1 summarises the policy background and the context in which we consider the central question addressed by this report: whether affordable housing provision is feasible at any site size below ten units, which is the current LBRuT affordable housing policy threshold.

Section 2 presents our methodology. Any change to planning policy must take account of market circumstances in which an adverse financial impact for developers and landowners may be counter-productive. We have utilised a standard financial appraisal in which development values less costs (including planning obligations) and profit give a residual land value, which must exceed existing use value plus a reasonable premium.

Section 3 provides commentary on these market factors, their sensitivity to planning policies and typical developer attitudes to planning requirements. We summarise recent residential market conditions in LBRuT (compared with the national picture) and the context within which LBRuT policy changes will have an impact. In essence, if planning obligations and commuted payments jeopardise financial viability then developers and landowners may simply wait for market conditions or policies to change and therefore there is a danger that less new housing will come forward, affordable or otherwise.

In Section 4 we highlight example scenarios to illustrate our conclusions and recommendations. Analysis uses traffic light indicators to compare residual land value with existing use value plus a premium. Where this analysis shows green values, LBRuT might reasonably consider applying commuted payments for affordable housing. Even in the simplest scenario, a 1 unit site with developer profit at levels currently expected by lending banks and a modest planning obligation, we find that some (but not all) developments will be viable. Other scenarios show similar constraints and dependency on value factors.

In Section 5 we consider the implications of our findings. In normal market conditions, many small sites would be able to deliver an affordable housing commuted payment. We stress, however, that viability is highly sensitive to changing profit levels, that residual use values must exceed existing use values by a significant premium and that exceptional development costs must be modest. In some cases, these assumptions will not be met. We consider other factors that might challenge our headline findings.

Section 6 provides conclusions and recommendations. In many cases, small residential sites in LBRuT will, from a purely financial perspective, be capable of delivering some level of commuted payment towards the provision of off-site affordable housing. However, standardising a formula for such payments is particularly difficult, not least because individual site circumstances, especially on small sites, often involve exceptional situations.

A standardised formulaic approach for small sites is likely to be unworkable in the majority of cases. We recommend adopting a tailored framework for all small sites in which the Council seeks the maximum reasonable amount of affordable housing on a site and/or commuted payment, taking account of viability, individual site costs and other obligations. A case by case approach will present fewer barriers to developments being brought forward; hence it is more likely to encourage new residential development in Richmond upon Thames, with affordable housing appropriate to the particular circumstances.

## 1. Introduction

### 1.1 Affordable Housing Financial Viability Assessment (FVA) – Sub Threshold Contributions

The London Borough of Richmond upon Thames (LBRuT) is preparing Affordable Housing policies which will form part of the Local Development Framework (LDF). Part of the evidential base is an *Affordable Housing Financial Viability Assessment (FVA) – Sub-Threshold Contributions* study to consider the policy as proposed in the Borough’s Development Management DPD. This work is intended to explore the financial viability implications of developing a specific policy within the Core Strategy to implement a requirement for contributions from small site developments (and thus increase the overall quantum of affordable units delivered) while discouraging affordable housing “threshold ducking”.

As part of the preparation, Christopher Marsh & Co Ltd (Sustainable Property Consultants) were commissioned in 2010 to undertake this study.

- a. to assess the different types of Borough-wide sub-threshold housing development;
- b. the possibility of these sites providing a sub-threshold affordable housing contribution; and
- c. to advise the council on an appropriate methodology and formula to be included in the Borough’s DPD

### 1.2 Approach

In terms of methodology, we have adopted standard residual valuation approaches to make appropriate comparisons and evaluations. It should, however, be stressed at the outset that due to the extent and range of financial variables involved in such calculations, they can only ever serve as a guide. Individual site characteristics (which are unique), mean that blanket requirements and conclusions must always be tempered by a level of flexibility in the application of policy requirements.

### 1.3 Background and experience

Having been involved in advising local planning authorities regarding affordable housing and other Section 106 obligations on numerous strategic and site specific financial reviews, we are very familiar with the requirements of such commissions and have recently carried out similar benchmarking exercises for many other local authorities.

### 1.4 The Policy Context

1.4.1 It is widely acknowledged (in the Council’s housing research and strategies, planning policy statements and by local market sources) that the Borough is one of the more expensive parts of London and as a result, at least in part, there is a serious problem regarding the shortage of good quality affordable housing.

1.4.2 The Council’s approach therefore has been to seek to ensure that the supply of affordable housing meets as much of the need as possible. The Core Strategy (adopted April 2009) and the

emerging Development Management DPD set out a strategic target for 50% of housing to be affordable. This is achieved by negotiating the maximum possible provision on suitable sites.

- 1.4.3 In principle, there are two main ways in which the level of affordable housing delivery can be increased:
- a. Lower the site/development size thresholds above which affordable and/or Planning Obligations are sought; and /or,
  - b. Raise the overall affordable housing (and potentially Planning Obligation) requirements.
- 1.4.4 Pursuing either or both approaches inevitably raises a dilemma, in that they will reduce the gross development value of residential schemes which may make other uses more attractive to landowners. Higher targets and additional planning obligations requirements can potentially reduce the supply of residential land, resulting in lower housing supply and, consequently, lower affordable housing delivery, and therefore require careful consideration in advance.
- 1.4.5 One product of these issues is the requirement in Para 29 of Planning Policy Statement 3 (“PPS3”) which states that:
- “In Local Development Documents, Local Planning Authorities should...set an overall (i.e. plan-wide) target for the amount of affordable housing to be provided. The target should reflect the new definition of affordable housing in this PPS. It should also reflect an assessment of the likely economic viability of land for housing within the area, taking account of risks to delivery and drawing on informed assessments of the likely levels of finance available for affordable housing, including public subsidy and the level of developer contribution that can reasonably be secured.”*
- 1.4.6 The main sections of this report therefore review the potential for policy amendments with specific reference to financial viability.

## 2. Methodology

While our methodology is consistent and uses standard development appraisal conventions (which have been entirely accepted at Core Strategy inspections at Richmond and elsewhere), it should be emphasised that local market and planning policy circumstances are always different. Consequently, not only are such viability exercises specific to each authority, they are also related to the time when they are undertaken and should of course be regularly reviewed to reflect revised policies, new market conditions and changes in the affordable housing regime. Furthermore, Circular 05/05 on Planning Obligations and the Community Infrastructure Levy Regulations (CIL) 2010 require that obligations are to be fairly and reasonably related in scale and kind to the proposed development and reasonable in all other respects. While we were not required to try and anticipate the potential of Community Infrastructure Levy, we have however, sought to ensure that the policy recommendations are reflective of longer term housing market trends, rather than focussing on the current low point in the cycle. As will become clear, we have taken account as far as is practicable, of all these variables in carrying out this study.

### 2.2 The Approach to Financial Viability

2.2.1 Development Appraisal models are, in essence, simple and can be summarised via the following equation:

|                             |
|-----------------------------|
| Completed Development Value |
| MINUS                       |
| Total construction costs    |
| MINUS                       |
| Developer's profit          |
| EQUALS                      |
| Residual land value         |

2.2.2 Residual Land Value – the sum that the developer will pay to the landowner to secure a site for development – will normally be the critical variable. If a proposal generates sufficient positive land value, it will be implemented. If not, the proposal will not go ahead, unless there are alternative funding sources to bridge the ‘gap’ (and these will normally be particular to regeneration areas via public bodies such as the LDA (for the moment), or the Homes and Communities Agency).

2.2.3 The problems with Development Appraisals stem from the requirement to identify the key variables – sales values, costs etc – with some degree of accuracy in advance of implementation. Even on the basis of the standard convention, namely that current values and costs are adopted (not values and costs on completion), this can be very difficult. Problems with key appraisal variables can be summarised as follows:

- a. Values attached to Completed Development Value are largely dependent on comparable evidence which requires sufficient new development in the locality, of a similar size and type, to provide a realistic value base. This is a particularly relevant issue at the current point in the market.

- b. Development costs are subject to extensive national and local monitoring and can be reasonably accurately assessed in 'normal' circumstances. In Boroughs like Richmond, most sites have been previously developed (i.e. Brownfield) and 'exceptional' costs such as decontamination will arise on occasions. Such costs can be very difficult to anticipate before detailed site surveys.
  - c. Development value and costs will also be significantly affected by assumptions about the nature and type of affordable housing provision, and other Planning Obligations.
  - d. While Developer's Profit has to be assumed in any appraisal, its level is closely correlated with risk. The greater the risk, the greater the profit level, in part as a contingency against the unexpected. While profit levels were typically around 13% - 15% of completed development value at the peak of the market in 2007, banks currently require schemes to show a profit of at least 20%.
- 2.2.4 Ultimately, the landowner holds the key and will make a decision regarding implementing the project or not on the basis of return and the potential for market change and thus alternative developments. The landowner's 'bottom line' will be achieving a residual land value that sufficiently exceeds 'existing use value' to make development worthwhile.
- 2.2.5 What in essence, therefore, is a simple equation - the development appraisal calculation – is in reality fraught with problems. The following diagram summarises the outcome.

|  |
|--|
| Completed Development Value<br>including affordable housing        |
| MINUS  |
| Total construction costs   |
| MINUS  |
| Planning obligations<br>(and any affordable housing cross subsidy) |
| MINUS  |
| Developer's profit   |
| EQUALS   |
| Residual land value (Must exceed EUV)                              |

- 2.2.6 The standard appraisal calculation shown above is reasonably clear cut, subject to the problems noted earlier. However, the delivery of Planning Obligations, and in particular the provision of affordable housing, complicates the calculation by reducing Completed Development Value. The extent to which Completed Development Value is reduced depends on the percentage, tenure and funding of the affordable housing. On the assumption that other development costs remain unchanged, a reduced Completed Development Value resulting from the requirement to provide affordable housing and obligations, results in a lower Residual Land Value and that is the essence of much of the debate.
- 2.2.7 The outcome of the development appraisal process is predictable in several respects:
- a. When negotiating with the landowner, the prudent developer will either reflect planning requirements in the offer for the land, or negotiate an option to purchase, which put crudely, will enable any additional costs arising (Planning obligations and affordable

housing for example) to be passed on to the landowner. Ultimately, the landowner pays, providing the basic condition for Residual Land Value to exceed existing use value is met; and/or,

- b. The developer will build in sufficient contingency into the development appraisal to offset risks including for example, the availability of grant support for affordable housing. In some authorities, this variable is to a degree removed by a no grant policy regime (although this may reduce the level of affordable housing delivered). In other cases, this is dealt with through a cascade mechanism in the Section 106 agreement. In Richmond as elsewhere, because the HCA are making cost efficiency savings on grant rates, the maximum grant levels that the Borough could support are bound to be adversely affected unless alternative funding mechanisms or cost savings can be achieved.

2.2.8 Clearly, however, landowners have expectations of the value of their development land which exceed the value of the existing use. The planning system affects the value of residential land through planning obligations which mitigate impacts and/or respond to policy, but ultimately, landowners cannot be forced to accept reduced values. Some will simply hold on to their sites, in the hope that policy may change.

## 2.3 The Development Industry's Approach

2.3.1 In some areas, local developers have, not entirely unreasonably, complained about lack of 'certainty', despite the obvious hedges against risk noted above, when trying to carry out development appraisal calculations. This is hardly uncommon and this was one reason why Government explored the notion of a development 'tariff' rather than Planning Obligations which are negotiated on a site by site basis.

2.3.2 In some instances, developers have suggested a 'solution' founded on the notion of a hypothetical 'Gross Land Value', from which various deductions for affordable housing and Planning Obligations are made, to then leave a 'Net Land Value' which is adequate to meet landowners expectations. This is convenient and to a degree understandable, in that it would attempt to 'price-fix' and thus be certain, but is counter-productive. Fixing the land value and then arguing the proposal cannot be viable and that Planning Obligations and affordable housing must be scaled down is effectively attempting to carry out the Residual Valuation in reverse.

2.3.3 Some developers suggest another step, namely to agree a 'formula' in advance of any particular scheme. The main requirements would be that it was equitable (not least to the local planning authority), robust in planning terms (meeting policy), and be workable. Several points are noteworthy;

2.3.4 Despite guidance to the contrary in Circular 1/97, Planning Obligations (at least at the mathematical end of the spectrum – e.g. education, health, libraries etc), have become increasingly formulaic. Government has recognised this in Circular 05/05 and in the Community Infrastructure Levy Regulations (CIL) 2010, which now strongly advocates the use of formulae.

2.3.5 Even where formulae can be determined, a host of practical difficulties will remain; how are formulae to be fixed; how would they vary in different development situations; how would they apply to different land uses and on what basis would they be reviewed? Any certainty provided

by formulae could be quickly undermined and for those reasons (amongst many) the so called 'Tariff' was abandoned by Government.

- 2.3.6 Formulaic approaches have also been attempted with regard to affordable housing, most notably by the Greater London Authority, but again the original 'requirement' for 50% provision in inner boroughs and 35% in outer boroughs had to be downgraded to a borough-wide strategic target. Indeed, more recently, the GLA have made clear that financial considerations, where proven via Independent Assessment, may arise which prevents the full policy expectation being delivered.
- 2.3.7 The implications of these limitations for an 'area-based' policy in any local authority area where base values do vary significantly are all too obvious. Overall, while formulae can provide useful guidance, that is all they are and ultimately every case must continue to be assessed on its merits, albeit within a strong policy framework. Specifically, if a development project cannot meet its consequential infrastructure costs – and it is important to differentiate between those costs which are literally development necessities such as access works and those impact mitigation costs, many of which will also be necessities but may be negotiable to a degree - then it is the wrong proposal.
- 2.3.8 Three possibilities result;
- a. A robust financial explanation is accepted (or not) by the authority and exceptionally - and in the interest of broader planning and community interests - policy requirements are compromised; or,
  - b. Contributions and/or affordable housing are deferred in order to improve cash flow and discount the real costs of provision; or
  - c. Gap funding is necessary to cover the financial shortfall. It is clearly prudent for the authority in developing its policy stance – not least at the area level - to 'test' as a general benchmark and as far as is possible given the unpredictability of some financial variables, how practical the policy position actually is across its area /sub areas where values will obviously vary.

This report provides that general benchmarking to the Council with particular reference to the capacity of small sites to deliver affordable housing.

### 3. The Appraisal Exercise

#### 3.1 Key appraisal variables

- 3.1.1 Key Modelling Variables are as follows and are worthy of explanation in principle.
- 3.1.2 **Sales Values by area:** Sales values – residential and commercial – will vary in all local authority areas (and within local authority areas) and of course are in a constant state of flux. Developers will obviously try to complete schemes in a rising market but ultimately this is a development ‘risk’ which the developer must accept. When house prices fall, local authorities may need to apply their policy requirements flexibly or developers may cease bringing sites forward.
- 3.1.3 **Density:** is an increasingly important determinant of development value, albeit with commensurate effects on development costs, planning obligations and thus residual land value. It should not automatically be assumed that high density development creates high residual land values.
- 3.1.4 **Gross to net floor space:** Clearly, the greater the density, the higher the gross to net floor space ratio – thus, for example, in high rise flatted schemes, more floor space is taken up by common areas and services and thus less space is available for renting/sale - and this will adversely affect the appraisal calculation.
- 3.1.5 **Base construction costs:** While base construction costs will be affected by density and other variables such as Code for Sustainable Homes requirements, flood risk, ground conditions etc., they are nevertheless well documented and can be reasonably accurately determined in advance by the developer (and thus ourselves). Nevertheless, if build costs are taken at face value, it is not difficult for the developer to inflate costs and potentially ‘hide’ ‘super-profits’. The significance of cost consultants’ estimates and their accuracy is clear.
- 3.1.6 **Exceptional costs:** In Boroughs like Richmond, clean, serviced Greenfield sites are a rarity and consequently there will occasionally be some ‘exceptional costs’ on Brownfield sites. With the majority of sites now being redevelopments, exceptional costs have become more common and need to be monitored carefully. However, for the purposes of this exercise, it is impossible to provide a reliable estimate of what exceptional costs would be, as they will differ from site to site. Our analysis therefore excludes exceptional costs, as to apply a blanket allowance would be misleading.
- 3.1.7 **Developer Profit:** Following the standard conventions, developer profits are based on an assumed percentage on gross development value. While developer profit ranged from 13% to 17% of gross development value in 2007, banks now require a scheme to show a profit of at least 20% of value. Higher profit figures reflect levels of risk; the higher the potential risk, the higher the profit margin in order to offset those risks. At the current time, development risk is high and we have run our appraisals with profits that vary between 17% and 20% of value. This is reflective of current bank requirements (around 20%), but also accommodates a return to lower profit levels. (At this stage, our terms of reference did not include a higher profit margin, arising if for example attempts to free up the credit markets fail to yield results).

## 3.2 Existing Use Value / Alternative Use Value

- 3.2.1 Existing Use Value / Alternate Use Value requires particular attention. Clearly, there is a point where the Residual Land Value that results from the development appraisal – what the landowner receives – may be less than the land’s existing use value. Existing use values can vary significantly, from very little – agricultural at say £7,200 per hectare (£3,000 per acre) to existing office sites at up to £50 million per hectare or more. Similarly, subject to planning permission, the potential development site may be capable of being used in different ways – business rather than residential for example or at least a different mix of uses (the latter being a key factor). EUV / AUV is effectively a ‘bottom line’ in the financial sense and a major driver in this modelling.
- 3.2.2 In this exercise, we have sought to provide a guide that compares all the above variables with a range of Existing/ Alternate Use Values. For modelling purposes, we have compared residual land value outcomes to four levels of EUV; that is high-end residential, offices, low-end residential and community use sites.
- 3.2.3 Ultimately however the product of the benchmarking exercise must be a guide, but no more as to how much affordable housing and other S106 obligations can be delivered before the value generated by residential development falls below EUV/AUV. EUV has of course been a contentious subject because one of the chief criticisms of the original Three Dragons work for the Greater London Authority was that they underestimated EUV in their Toolkit. In this exercise, we have indicated in our tabular results (which reflect no affordable housing as the intent is to deliver a commuted payment), a range of EUVs in order to test the viability of different development scenarios. Four levels of EUV are calculated. In each case, our calculations assume that the landowner has made a judgement that the current use does not yield an optimum use of the site, for example, it has many fewer stories than neighbouring buildings; or there is a general lack of demand for the space, which results in low rentals, high yields and high vacancies. We would not expect a building which makes optimum use of a site and that is attracting a high rent to come forward for residential development, as residential value is unlikely to exceed existing use value in these circumstances.
- 3.2.4 Yields reflect the confidence of a potential purchaser of a building in the income stream that is the rent that the occupant will pay. They also reflect the quality of the building and its location, as well as general demand for property of that time. Over the past year, yields for commercial property have moved down signalling lower confidence in future demand for commercial space. This has the effect of depressing the capital value of commercial space, resulting in a reduction in EUVs. However, as the economy recovers, we would expect yields to improve, which will result in increased capital values - indeed, very recent evidence suggests signs of improvement. Consequently, EUVs will increase, increasing the cost of potential residential sites, which will have implications for the delivery of affordable housing and other planning obligations. However, in a recovering economy, we would expect residential sales values to increase also, counteracting the impact of increasing EUVs to some degree.

In this study, we have used four levels of EUVs to demonstrate their impact:

- a. High Resi EUV – such as previously developed residential land or backland with an average residual land value of £19,500,000 per hectare

- b. Medium/High EUV – such as previously developed offices land with an average residual land value of £13,000,000 per hectare
- c. Low Resi EUV – such as previously low end residential with an average residual land value of £10,400,000 per hectare, and
- d. Low EUV such as previous community uses with an average residual land value of £3,900,000 per hectare.

3.2.5 EUVs are clearly as sensitive to location as residential values. The four EUV typologies above provide an indication only of likely values of sites across the Borough. Actual EUVs in areas of the borough will vary considerably. Furthermore, in addition to the existing site uses used in our analysis, there will be other existing uses, such as car parking and other relatively low values uses, where the economic context for the delivery of affordable housing may vary from our EUV typologies above. However, it should not be automatically assumed that low value existing use values make the delivery of target levels of affordable housing possible – some low value sites may require decontamination, for example, the cost of which may offset any savings on land purchase costs. We have also had experience of community centre sites coming forward for mixed use development where the re-provision costs of the community facility have affected the extent to which affordable housing can be provided. This has arisen where policies require replacement community facilities to be provided unless they can be proven to be surplus to requirements.

3.2.6 Redevelopment proposals that generate residual land values below EUV will fail to be delivered. While any such thresholds are only a guide in ‘normal’ development circumstances, it does not imply that individual landowners, in particular financial circumstances, will not bring sites forward at a lower return or indeed require a higher return. It is simply indicative. If proven existing use value (via a formal Red Book valuation which is essential) justifies a higher or lower EUV than those assumed, then appropriate adjustments may be necessary. As such, EUVs should be regarded as benchmarks rather than definitive fixtures. At a practical level, it is also necessary to stress that in the Borough area, some residential development sites are redevelopments of existing residential uses, thus emphasising the significance of value uplift. The four levels of EUV identified in this study therefore give a broad indication of likely land values across the Borough and should only be seen as examples. It is important to recognise that other site uses and values exist on the ground.

### 3.3 Specific Modelling Variables

3.3.1 This section summarises the particular assumptions used in the benchmarking exercise.

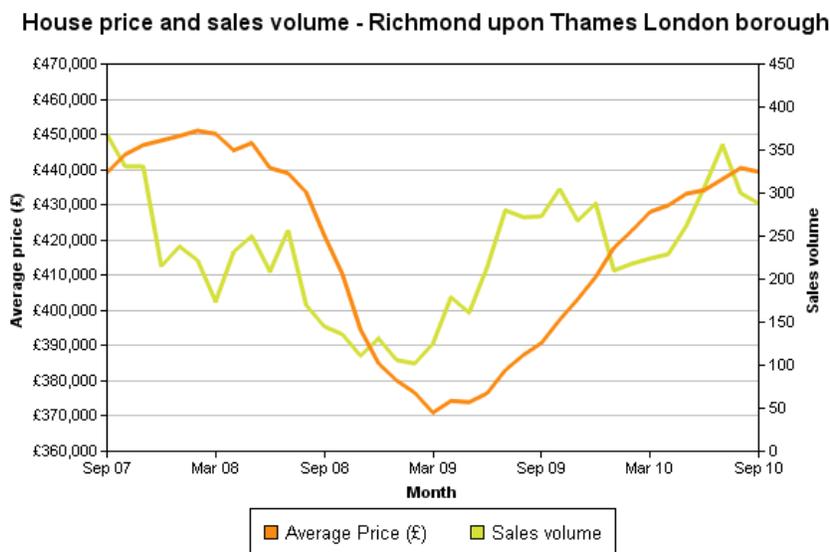
#### 3.3.2 Sales Values

3.3.2.1 Residential values in the Borough have reflected national trends in recent years but do of course vary across the Borough.

3.3.2.2 Our model uses a wider range of values - £4000psm to £13,000psm - than those currently being achieved in the Borough, to anticipate a return to peak 2007 values at some point in the next cycle or any further falls in values and/or a longer term return to house price inflation which

historically has been the case. By doing so, the outputs of our modelling provide an indication of the levels of affordable housing that might be possible if sales values increase or decrease, providing other variables do not move adversely. However, we would emphasise that the overall current level of transactional evidence (See Sales volume in the graph below) is dominated by second hand stock. Comparable new build sales evidence is very limited in the current climate.

3.3.2.3 In the first instance however, the following Chart and Table 1 summarise trends in the Borough regarding general transactional values based on Land Registry data as at September 2007 to September 2010, the peak being in March 2008. (See also Appendix 1).



**Table 1: Richmond -v- All England & Wales**

| Month          | Richmond upon Thames London borough |                   | All England & Wales |                   |
|----------------|-------------------------------------|-------------------|---------------------|-------------------|
|                | Index                               | Average Price (£) | Index               | Average Price (£) |
| September 2007 | 378.6                               | 439,101           | 292.4               | 182,388           |
| March 2008     | 388.7                               | 450,822           | 290.6               | 181,253           |
| September 2008 | 363.7                               | 421,834           | 267.6               | 166,872           |
| March 2009     | 319.7                               | 370,800           | 244.6               | 152,570           |
| September 2009 | 336.9                               | 390,795           | 254                 | 158,438           |
| March 2010     | 368.9                               | 427,845           | 264.6               | 165,031           |
| September 2010 | 379.1                               | 439,717           | 267.4               | 166,785           |

Source: Land Registry

3.3.2.4 It is immediately clear that while the turndown in values was slightly later in Richmond than the national average, the recovery in value over the last twelve months in the Borough has been greater than the national average. In other words, the local market held up reasonably well until late 2008 but then suffered sharp decreases, albeit from a relatively high base value. However,

during 2010, there have been clear signs of a recovery both in sales volume and values albeit still fluctuating. While this has clearly impacted on outputs regarding affordable housing and planning obligations, base values remain comparatively high and as such, achieving affordable housing requirements and planning obligations may be less of an issue than in other lower value London boroughs.

### 3.3.3 Density

3.3.3.1 Densities vary across the Borough, with high densities in the town centre fringe sites and close to stations, where values are highest, and lower densities in the outlying areas, where sales values do not justify the cost of higher built forms. Further to instructions from LBRuT officers, densities are assumed to range from 35 units per hectare – a modest outer urban density – to 260 units per hectare – a high central urban density.

3.3.3.2 Again, in line with our Terms of Reference, we have adopted the housing mix range specified in the modelling exercise.

### 3.3.4 Gross to Net Floor space

3.3.4.1 The higher the density, the greater the loss of net lettable/ saleable space. In this model, we have adopted a range from 100% gross to net for lower density schemes to 70% gross to net in high density situations where cores and common areas amount to 30%. This is reflected in the build cost when measured on the total saleable area (i.e. the area that excludes common areas).

## 3.5 Base Construction Costs

3.3.5.1 The modelling exercise plots a range of base construction costs reflecting density considerations ranging from £1,489 per square metre to £2,159 per square metre, incorporating the costs of meeting Lifetime Homes requirements. Our costs take the Royal Institution of Chartered Surveyors (RICS) Building Cost Information Service (BCIS) costs as their base. These costs are averages but could increase further should 'exceptional costs' arise (for example contamination and remediation). As a result, costs need to be treated with caution and where exceeded, will inevitably diminish the capacity of schemes to carry obligations and affordable housing.

3.3.5.2 Our base construction costs assume that housing is provided to Code for Sustainable Homes level 4 (which will be mandatory by 2012) and includes an allowance of £8,064 per unit for the additional costs of achieving this. This is based on the costs of a range of schemes that have achieved Code Level 4. The cost of moving to level 5 or 6 is currently prohibitive and technological solutions are required to bring costs down. Clearly, seeking code level 5 or 6 using current technologies would have a significant impact on scheme economics, and consequently, there would be implications for affordable housing delivery and other Planning Obligations. However, there is no doubt that with emerging build systems, additional costs associated with achieving Code 4 are falling. Nevertheless, we have retained a relatively high figure to take account of, for example, demolition costs and (to some degree) other exceptional costs. Overall however, our cost assumptions are reasonably generous but it should be noted that tender price deflation, a feature for the last 18 months has according to BCIS bottomed out (Oct.2010, No 187) and inflation will gradually reappear in 2011/12.

### 3.3.6 Developer's profit

3.3.6.1 As noted earlier, developer's profit is closely related to the perceived risk of residential development. The greater the risk, the greater the profit level, which helps to mitigate against the risk, but also to ensure that the potential rewards are sufficiently attractive for a bank to fund a scheme. In 2007, profit levels were around 17% of Gross Development Value. This was the 'benchmark' profit adopted by the GLA in its revised Development Control Toolkit Model (previously 15%). However, following the impact of the credit crunch and the collapse in interbank lending and the various government bailouts of the banking sector, profit margins have increased. It is important to emphasise that the level of minimum profit is not necessarily determined by developers (although they will have their own view and the boards of the major house builders will set targets for minimum profit). The views of the banks which fund development are more important; if the banks do not fund a development, it is very unlikely to happen, as developers do not generally carry sufficient cash to fund it themselves. Consequently, future movements in profit levels will largely be determined by the attitudes of the banks towards residential development. The near collapse of the global banking system resulted in a much tighter regulatory system which will continue for some time, with UK banks having to take a much more cautious approach to all lending. In this context, the banks may not allow profit levels to decrease much lower than their current level, if at all. The minimum generally acceptable profit level is now around 20%, while the banks will require some riskier schemes to show a higher profit level, of perhaps up to 25%. However our appraisals have been run therefore with two different profit levels, as follows:

- 17%
- 20%

By running the appraisals with a range of profit margins, we are pre-empting a very wide range of outcomes.

### 3.3.7 Planning Obligations

3.3.7.1 Further to our Terms of Reference, we have modelled Planning Obligations as provided by the Borough's Planning Officers. Planning obligations are assumed to apply to all units, irrespective of tenure. Levels of Planning Obligations will vary according to needs arising from individual developments. We have therefore run our appraisals with a range of planning obligations, as follows:

- £5,000
- £10,000 and
- £15,000 per residential unit.

3.3.7.2 It should be noted that for the purposes of this study these are average amounts per unit. In practice different amounts would be required from each size of unit (including number of bedrooms) in a scheme to meet Planning Obligation requirements so that the occupancy levels for different unit sizes are taken into account.

### 3.3.8 Other Influential Factors

- 3.3.8.1 Variability of landowner attitudes. There is no question that land markets do need time to adapt to changing policy circumstances and landowners may have the choice to hold sites back and hope that policies change. Recently, a more common circumstance in areas of sharp price inflation has been developers 'taking a punt' – i.e. buying sites without consent on the expectation that rising capital values would offset risk and then seeking, in a market that turns, to persuade the authority that the scheme cannot afford its consequential infrastructure and affordable housing. However, up to 2007, landowners' expectations of value were also high and developers faced tough competition to purchase sites from investment funds that could take a longer term view on values.
- 3.3.8.2 Having said that, there is no question that site specific circumstances will arise where the authority may make compromises between contradictory policy requirements.

## 4. Appraisal Outputs

4.1 Before examining the illustrated outcomes, it is important to stress again and summarise those variables which may change the outputs – positively and negatively - and which must be treated with caution. They are as follows:

**Table 2 Positive and negative impacts on appraisal outcomes**

| Positive impacts                         | Negative impacts                          |
|--|---|
| Low and/or deferred Planning Obligations | High and/or up/front Planning Obligations |
| Historic land cost (minimal)             | High Existing/Alternative Use Value       |
| Availability of gap funding              | Contamination/remediation costs           |

With these caveats in mind the tabular presentation summarises the key outputs.

### 4.2 Presentation of data

4.2.1 The tables, illustrated below from the full set contained in Appendix 2, are constructed to provide the maximum amount of data in the same place to provide easy comparison. Each table shows a range of sales values (on the left hand side) and a range of densities (along the top row). For each density, we show the build costs adjusted to reflect gross to net floorspace. The box (top right on each sheet) summarises other key variables. The appraisal outputs are compared with four different EUVs, as described in Section 3. Red symbols show where, for any given sales values and density of development, a scheme would yield a residual land value that is more than 15% lower than the site's EUV. Yellow symbols show where viability is marginal (i.e. up to 15% below EUV). Green symbols show where the residual land value exceeds EUV by at least 15% and can be considered viable. The figures reflected by these symbols are shown in Appendix 2.

4.2.2 The full set of data tables show the following variables:

- Each of the above with planning obligations of £5,000, £10,000, and £15,000 per unit;
- Each of the above showing 1, 3, 6 and 9 units;
- Each of the above with profit levels of 17% and 20% profit.

### 4.3. Illustrative Scenarios - 1 Unit

4.3.1. In the first set of tables, we show the outputs of the appraisal model for developments with 20% developer profit with £5,000 planning obligations for a site which could provide 1 unit. The significance of existing use value and sales value is immediately clear on viable development scenarios where lower EUV and reasonably high sales value maintains most scenarios as viable. In contrast, high EUV will only be viable as a redevelopment with higher densities and higher values.

**Table 3**

MODEL 1 - 20.0% developer profit, £5,000 planning obligation, 1 unit

Cost and profit calculations - 1 unit

| Density             | Units/ha | 35     | 70     | 130    | 200    | 260    |
|---------------------|----------|--------|--------|--------|--------|--------|
| Build costs - £ psm |          | £1,400 | £1,550 | £1,750 | £1,894 | £2,013 |

| Unit size/m            | 90         | 70         | 65          | 60          | 55          |
|------------------------|------------|------------|-------------|-------------|-------------|
| Build cost per ha      | £4,410,000 | £7,595,000 | £14,787,500 | £22,728,000 | £28,785,900 |
| Build cost PU          | £126,000   | £108,500   | £113,750    | £113,640    | £110,715    |
| Build cost PU plus CSH | £134,064   | £116,564   | £121,814    | £121,704    | £118,779    |
| Build cost PU plus PO  | £139,064   | £121,564   | £126,814    | £126,704    | £123,779    |
| Build cost PU plus DP  | £166,877   | £145,877   | £152,177    | £152,045    | £148,535    |
| Total cost per unit    | £166,877   | £145,877   | £152,177    | £152,045    | £148,535    |
| Total build cost pm    | £1,854     | £2,084     | £2,341      | £2,534      | £2,701      |

|       |                 |
|-------|-----------------|
| PO    | £5,000 per unit |
| CSH   | £8,064 per unit |
| Grant | No              |
| DP    | 20.0%           |
| Units | 1               |

cost per ha / units per ha  
plus CSH per unit  
plus s106 per unit  
times DP

inc. PO, CSH, DP

RLVs less existing use value

|                       | 35 /ha             | 70 /ha        | 130 /ha  | 200 /ha | 260 /ha |
|-----------------------|--------------------|---------------|--|---------|---------|
| <b>1 - High EUV</b>   | <b>£19,500,000</b> | <b>per ha</b> | <b>(previously developed - high end residential)</b> |         |         |
| £4,000                | 🟡                  | 🟡             | 🟡  | 🔴       | 🔴       |
| £5,000                | 🟡                  | 🟡             | 🟢  | 🟢       | 🟢       |
| £6,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £7,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £8,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £9,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £10,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £11,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £12,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £13,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| <b>2 - Medium EUV</b> | <b>£13,000,000</b> | <b>per ha</b> | <b>(previously developed - offices)</b>              |         |         |
| £4,000                | 🟡                  | 🟡             | 🟡  | 🟡       | 🟡       |
| £5,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £6,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £7,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £8,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £9,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £10,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £11,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £12,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £13,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| <b>3 - Low EUV</b>    | <b>£10,400,000</b> | <b>per ha</b> | <b>(previously developed - low end residential)</b>  |         |         |
| £4,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £5,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £6,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £7,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £8,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £9,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £10,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £11,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £12,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £13,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| <b>4 - Lower EUV</b>  | <b>£3,900,000</b>  | <b>per ha</b> | <b>(previously developed - community uses)</b>       |         |         |
| £4,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £5,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £6,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £7,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £8,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £9,000                | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £10,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £11,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £12,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |
| £13,000               | 🟢                  | 🟢             | 🟢  | 🟢       | 🟢       |

**Table 4**

MODEL 6 - 20.0% developer profit, £10,000 planning obligation, 3 units

Cost and profit calculations - 3 units

| Density             | Units/ha | 35     | 70     | 130    | 200    | 260    |
|---------------------|----------|--------|--------|--------|--------|--------|
| Build costs - £ psm |          | £1,400 | £1,550 | £1,750 | £1,894 | £2,013 |

|       |                  |
|-------|------------------|
| PO    | £10,000 per unit |
| CSH   | £8,064 per unit  |
| Grant | No               |
| DP    | 20.0%            |
| Units | 3                |

| Unit size/m            | 90         | 70         | 65          | 60          | 55          |
|------------------------|------------|------------|-------------|-------------|-------------|
| Build cost per ha      | £4,410,000 | £7,595,000 | £14,787,500 | £22,728,000 | £28,785,900 |
| Build cost PU          | £126,000   | £108,500   | £113,750    | £113,640    | £110,715    |
| Build cost PU plus CSH | £134,064   | £116,564   | £121,814    | £121,704    | £118,779    |
| Build cost PU plus PO  | £144,064   | £126,564   | £131,814    | £131,704    | £128,779    |
| Build cost PU plus DP  | £172,877   | £151,877   | £158,177    | £158,045    | £154,535    |
| Total cost per unit    | £172,877   | £151,877   | £158,177    | £158,045    | £154,535    |
| Total build cost pm    | £1,921     | £2,170     | £2,433      | £2,634      | £2,810      |

cost per ha / units per ha  
plus CSH per unit  
plus s106 per unit  
times DP

inc. PO, CSH, DP

RLVs less existing use value

|                     | 35 /ha  | 70 /ha | 130 /ha | 200 /ha | 260 /ha |
|---------------------|---|--------|---------|---------|---------|
| <b>1 - High EUV</b> | <b>£19,500,000 per ha (previously developed - high end residential)</b> |        |         |         |         |
| £4,000              | ☹️  | ☹️     | ☹️      | ☹️      | ☹️      |
| £5,000              | ☹️  | ☹️     | ☹️      | ☹️      | ☹️      |
| £6,000              | 😊   | 😊      | 😊       | 😊       | 😊       |
| £7,000              | 😊   | 😊      | 😊       | 😊       | 😊       |
| £8,000              | 😊   | 😊      | 😊       | 😊       | 😊       |
| £9,000              | 😊   | 😊      | 😊       | 😊       | 😊       |
| £10,000             | 😊   | 😊      | 😊       | 😊       | 😊       |
| £11,000             | 😊   | 😊      | 😊       | 😊       | 😊       |
| £12,000             | 😊   | 😊      | 😊       | 😊       | 😊       |
| £13,000             | 😊   | 😊      | 😊       | 😊       | 😊       |

|                       | 35 /ha   | 70 /ha | 130 /ha | 200 /ha | 260 /ha |
|-----------------------|--|--------|---------|---------|---------|
| <b>2 - Medium EUV</b> | <b>£13,000,000 per ha (previously developed - offices)</b> |        |         |         |         |
| £4,000                | ☹️   | ☹️     | ☹️      | ☹️      | ☹️      |
| £5,000                | 😊  | 😊      | 😊       | 😊       | 😊       |
| £6,000                | 😊  | 😊      | 😊       | 😊       | 😊       |
| £7,000                | 😊  | 😊      | 😊       | 😊       | 😊       |
| £8,000                | 😊  | 😊      | 😊       | 😊       | 😊       |
| £9,000                | 😊  | 😊      | 😊       | 😊       | 😊       |
| £10,000               | 😊  | 😊      | 😊       | 😊       | 😊       |
| £11,000               | 😊  | 😊      | 😊       | 😊       | 😊       |
| £12,000               | 😊  | 😊      | 😊       | 😊       | 😊       |
| £13,000               | 😊  | 😊      | 😊       | 😊       | 😊       |

|                    | 35 /ha   | 70 /ha | 130 /ha | 200 /ha | 260 /ha |
|--------------------|--|--------|---------|---------|---------|
| <b>3 - Low EUV</b> | <b>£10,400,000 per ha (previously developed - low end residential)</b> |        |         |         |         |
| £4,000             | 😊  | 😊      | 😊       | 😊       | 😊       |
| £5,000             | 😊  | 😊      | 😊       | 😊       | 😊       |
| £6,000             | 😊  | 😊      | 😊       | 😊       | 😊       |
| £7,000             | 😊  | 😊      | 😊       | 😊       | 😊       |
| £8,000             | 😊  | 😊      | 😊       | 😊       | 😊       |
| £9,000             | 😊  | 😊      | 😊       | 😊       | 😊       |
| £10,000            | 😊  | 😊      | 😊       | 😊       | 😊       |
| £11,000            | 😊  | 😊      | 😊       | 😊       | 😊       |
| £12,000            | 😊  | 😊      | 😊       | 😊       | 😊       |
| £13,000            | 😊  | 😊      | 😊       | 😊       | 😊       |

|                      | 35 /ha   | 70 /ha | 130 /ha | 200 /ha | 260 /ha |
|----------------------|--|--------|---------|---------|---------|
| <b>4 - Lower EUV</b> | <b>£3,900,000 per ha (previously developed - community uses)</b> |        |         |         |         |
| £4,000               | 😊  | 😊      | 😊       | 😊       | 😊       |
| £5,000               | 😊  | 😊      | 😊       | 😊       | 😊       |
| £6,000               | 😊  | 😊      | 😊       | 😊       | 😊       |
| £7,000               | 😊  | 😊      | 😊       | 😊       | 😊       |
| £8,000               | 😊  | 😊      | 😊       | 😊       | 😊       |
| £9,000               | 😊  | 😊      | 😊       | 😊       | 😊       |
| £10,000              | 😊  | 😊      | 😊       | 😊       | 😊       |
| £11,000              | 😊  | 😊      | 😊       | 😊       | 😊       |
| £12,000              | 😊  | 😊      | 😊       | 😊       | 😊       |
| £13,000              | 😊  | 😊      | 😊       | 😊       | 😊       |

- 4.3.2 Table 4 – Model 6 above shows the developer running at 20% profit and with a planning obligation of £10,000 on a site that could provide 3 units. While there is of course a difference in terms of residual values, the target is still achievable in many cases where EUVs are lower. It is also important to note that the areas in which high sales values can be achieved are likely also to have higher existing use values. So while the “lower EUV” table below shows a very high percentage of green cells, it is important to note that the sales values achievable may be in the lower bandings, where the residuals are less viable.
- 4.3.3 Finally, Table 5 (p.20) shows the outputs of the appraisal model with a 17 % profit level, with £5,000 per unit planning obligation on a site that could provide 6 units. Here the “low” and “lower” EUV tables show 100% green cells while the “medium” and “high” EUV tables show a low percentage of yellow or red cells.

**Table 5**

MODEL 15 - 17.0% developer profit, £5,000 planning obligation, 6 units

Cost and profit calculations - 6 units

| Density             | Units/ha | 35     | 70     | 130    | 200    | 260    |
|---------------------|----------|--------|--------|--------|--------|--------|
| Build costs - £ psm |          | £1,400 | £1,550 | £1,750 | £1,894 | £2,013 |

| Unit size/m            | 90         | 70         | 65          | 60          | 55          |
|------------------------|------------|------------|-------------|-------------|-------------|
| Build cost per ha      | £4,410,000 | £7,595,000 | £14,787,500 | £22,728,000 | £28,785,900 |
| Build cost PU          | £126,000   | £108,500   | £113,750    | £113,640    | £110,715    |
| Build cost PU plus CSH | £134,064   | £116,564   | £121,814    | £121,704    | £118,779    |
| Build cost PU plus PO  | £139,064   | £121,564   | £126,814    | £126,704    | £123,779    |
| Build cost PU plus DP  | £162,705   | £142,230   | £148,372    | £148,244    | £144,821    |
| Total cost per unit    | £162,705   | £142,230   | £148,372    | £148,244    | £144,821    |
| Total build cost pm    | £1,808     | £2,032     | £2,283      | £2,471      | £2,633      |

|       |                 |
|-------|-----------------|
| PO    | £5,000 per unit |
| CSH   | £8,064 per unit |
| Grant | No              |
| DP    | 17.0%           |
| Units | 6               |

cost per ha / units per ha  
plus CSH per unit  
plus s106 per unit  
times DP

inc. PO, CSH, DP

RLVs less existing use value

|                       | 35 /ha             | 70 /ha        | 130 /ha  | 200 /ha | 260 /ha |
|-----------------------|--------------------|---------------|--|---------|---------|
| <b>1 - High EUV</b>   | <b>£19,500,000</b> | <b>per ha</b> | <b>(previously developed - high end residential)</b> |         |         |
| £4,000                | ☹️                 | ☹️            | ☹️   | ☹️      | ☹️      |
| £5,000                | ☹️                 | 😊             | 😊  | 😊       | 😊       |
| £6,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £7,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £8,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £9,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £10,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £11,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £12,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £13,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| <b>2 - Medium EUV</b> | <b>£13,000,000</b> | <b>per ha</b> | <b>(previously developed - offices)</b>              |         |         |
| £4,000                | ☹️                 | 😊             | 😊  | 😊       | 😊       |
| £5,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £6,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £7,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £8,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £9,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £10,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £11,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £12,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £13,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| <b>3 - Low EUV</b>    | <b>£10,400,000</b> | <b>per ha</b> | <b>(previously developed - low end residential)</b>  |         |         |
| £4,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £5,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £6,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £7,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £8,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £9,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £10,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £11,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £12,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £13,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| <b>4 - Lower EUV</b>  | <b>£3,900,000</b>  | <b>per ha</b> | <b>(previously developed - community uses)</b>       |         |         |
| £4,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £5,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £6,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £7,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £8,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £9,000                | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £10,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £11,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £12,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |
| £13,000               | 😊                  | 😊             | 😊  | 😊       | 😊       |

## 5. Other Results

5.1 This section needs to be read in conjunction with the presentations in Appendix 2 (together with the illustrative examples shown in the preceding section). In the main tables, the residual land values are calculated for different sales values and densities of development, and then compared with existing use value.

### 5.2 Residential Sites

5.2.1 The Tables demonstrate that in normal market conditions, many small sites will be able to deliver a significant affordable housing commuted payment, in combination with other planning obligations of between £5000 and £15,000 per unit, especially when residential sales values are at or above £5000-6000m<sup>2</sup> (£465-558psf). Clearly, site specific circumstances may over-ride this conclusion but in a recovering market during the plan period, such values are likely to be commonplace.

5.2.2 It is important to emphasise, however, that these results are highly sensitive to changing profit levels. At the higher profit level modelled of 20%, the range of densities and value bands over which schemes are viable is considerable, even when planning obligations are increased to £15,000 per unit. However, with margins over and above a 20% return, viable proposals will gradually diminish.

It should also be noted that the existing use value of high value sites can be greater than residential land values with full affordable housing policies applied. This is to be expected, but will be less of an issue in comparison to Boroughs within or bordering Central London where office sites, for example, with very high EUVs are rarely redeveloped for residential use.

5.2.3 There are further important caveats to the results:

- (a) Residual land values need to exceed Existing Use Value by a significant premium, in order to be considered viable. While the tables in Appendix 2 demonstrate in principle the thresholds, there may be site specific circumstances where these thresholds may be higher or lower. While a higher existing use value requires a commensurate higher residential sales value, in many circumstances, this will still be viable although lower density schemes are more vulnerable to existing use value requirements.
- (b) That exceptional development costs are no more than modest sums in comparison to total build costs. Extensive decontamination, although not common in Richmond, could require significant expenditure, which would have a considerable impact on the residual land value.

### 5.3 Impact of Code for Sustainable Homes Requirements

5.3.1 Our appraisals incorporate a supplement to build costs (£8,064 per unit), albeit falling, covering the costs of Code for Sustainable Homes to level 4 for all the housing units. If schemes were not required to meet Code level 4, clearly this would result in a cost saving that could – in theory – increase the amount of affordable housing commuted payment.

## 5.4 Impact of Varying Levels of Section 106 Payments

- 5.4.1 Our appraisals show the impact of Planning Obligations at various levels, ranging from £5,000 per unit to £15,000 per unit. While S106 contributions have an impact on scheme viability, the impact is relatively modest. As the Tables demonstrate, while the effects increase, it is not until the S106 contribution increases to £15,000 that there is a noticeable impact on viability and even then, it is relatively marginal. Variations in EUV, sales values and profit, are far more significant than Planning Obligations. Nevertheless, in specific cases, sensitivity analysis would be required to avoid impacting on affordable housing commuted payments.

## 5.5 Commuted Payments in Principle

- 5.5.1 We have considered commuted payments in this study and in particular, the repercussions for residual land value on smaller schemes. In principle, there is no issue. Circular 05/05 and in the Community Infrastructure Levy Regulations (CIL) 2010, recognises the notion that there is no reason why obligations should not be applied consistently to smaller schemes. Indeed, while there will always be higher costs associated with smaller schemes, in 'normal market circumstances', there will also be some level of premium attached to small sites.

- 5.5.2 While we have demonstrated at least in principle (in Appendix 2) that applying a standard approach to smaller schemes from a purely financial perspective is practicable (and it is), there will clearly be circumstances where policy application needs to be re-considered, such as where individual sites are contaminated and require remediation. While the broader principles of financial appraisal apply to smaller sites, we accept that they will be situations where small sites have to be considered on a site-by-site basis. Broader questions also then arise.

- 5.5.3 In particular, the issue then is not so much the capacity of a small scheme to generate a commuted sum, but what will that commuted sum then deliver? This is much more problematic.

Starting, say from a 'base' cost position that a good standard Code 4, 1-3 bed unit could be built for between say, £70,000 and £120,000, then clearly the 'surplus' value shown in the main tables (that is, excess residual land value after all costs over and above existing use value), divided by the cost of providing an affordable unit, will EQUAL the number of affordable units to be delivered. This is optimal but only if the land is free or heavily discounted through a S106 agreement. Thus, where the LPA own the site OR the RSL owns the site but are underfunded in terms of delivery, then the commuted sum will deliver as described.

- 5.5.4 However, if the commuted sum pooled or otherwise, requires a site acquisition in order for affordable housing to be delivered, then two possibilities arise:

- a. the acquired site is allocated for housing and therefore the policy requirements on affordable housing apply anyway and thus, the site value reflects that expectation and thus using the commuted sum is applied over and above the policy requirements (as above),or,
- b. the site is not allocated for residential; it has an existing use value (plus hope value) and it requires a consent for change of use to housing.

Either way, the commuted payment will clearly deliver a significantly lower amount of affordable housing and that is before any reductions in affordable housing grant.

So, from a policy perspective, the financial numbers in the Tables make some sense when applied to smaller sites, albeit this does of course exclude any exceptional costs on a site specific basis.

In principle therefore, and in the right financial circumstances, we may be able to justify say a commuted payment of £50,000 per unit or a graduated formulaic approach based on size of site, but any policy statement and specific calculation applied as a 'blanket' approach, would have to be heavily caveated to reflect site specific circumstances. This is of course the reason why those local authorities who have adopted 'fixed' commuted payment formulae, have had great difficulty in applying them, or, where they have been accepted, they are by implication too low, the inevitable *lowest common denominator* policy stance.

## 6. Conclusions

- 6.1 In conclusion, we have explored in this work the principle and the detail of formulating a standard approach (based on emerging policy in the Development Management DPD on delivering affordable housing) aimed at requiring all small residential schemes in LBRuT to contribute a commuted payment towards the provision of off-site affordable housing.
- 6.2 The results of this study are quite clear, namely that:
- 6.3 In many cases, small residential sites in LBRuT will, purely from a financial perspective, be capable of delivering some level of commuted payment towards the provision of off-site affordable housing. It is only where individual site circumstances combine a high existing use value, low residential values and modest densities that residual values show as a negative. In most other circumstances, residual values are positive or very positive.
- 6.4 Bearing in mind that 33% has been added to existing use values (albeit accepting that EUVs will vary hugely, some being higher and others lower than the assumed levels in the modelling exercise) in order to reflect the need for an incentive to the landowner to sell, these results are encouraging. (The explanation is of course broadly high sales values across the Borough).
- 6.5 However, 'standardising' a formulaic approach to commuted payments is far more difficult. Individual site circumstances, especially on small sites, often involve exceptional situations, which then become the norm rather than the exception and it is for this reason, that standardised policies have been very difficult to apply with any level of consistency. The inevitable inconsistency in application leads unavoidably not only to precedents being set which are then quoted in subsequent schemes but also to pooling of variable contributions. A further level of inconsistency would arise from attempts at area-based variations in policy. Such approaches have worked in areas where there is a natural geographic delineation such as urban centres surrounded by green belt containing villages which can then be treated in a different way including differential charges. In LBRuT, this would be very difficult and would then require constant reassessment and changes in delineation as the market distorts outcomes and adjusts to reflect differential charges.
- 6.5 Setting aside the practical limitations of a standard policy, a further issue then is not so much the capacity of a small scheme to generate a commuted sum, it is what will that commuted sum deliver and this is also problematic.
- 6.6 Starting from a 'base' cost position that a good standard Code 4, 1-3 bed unit can be built for between say £70,000 and £120,000, then clearly the values shown in the tables in Appendix 2 will generate x number of units: that is the surplus value shown (which is over and above EUV + 33%, cost, planning obligations, Code and developer profit) and a variable depending on local residential values DIVIDED by the cost of providing an affordable unit (as above) will EQUAL the number of affordable units delivered.
- 6.7 This works on the basis that the land is free or heavily discounted through say a S106. Thus, where the LA own the site OR the RSL owns the site but is underfunded in terms of delivery, then the commuted sum may deliver as described in para.6.6.
- 6.7 However, if the commuted sum pooled or otherwise, requires a site acquisition in order for affordable housing to be delivered, then the sub-threshold planning obligation will clearly deliver

a significantly lower amount of affordable housing and that is before any reductions in affordable housing grant. (See para.5.5.4)

- 6.8 Overall, therefore, we are obliged to recommend to the Council that an approach based on a standardised approach to determining commuted payments toward the delivery of affordable housing from small sites, is likely to be unworkable in the majority of cases, albeit for different reason. It is our view that a more sensible approach would be to adopt a more generalised approach to all small sites, in which the Council seeks the maximum reasonable amount of affordable housing on site and/or commuted payment, taking account of viability, individual site costs and other obligations. While this is clearly potentially more time consuming, this could be mitigated by issuing guidelines to developers in advance of applications on small sites which sets down the financial criteria that will need to be addressed in any such proposals.
- 6.9 A case by case approach will present fewer barriers to developments being brought forward; hence it is more likely to encourage new residential development in Richmond upon Thames, with affordable housing appropriate to the particular circumstances.