

# Investment and planning obligations

## Responding to the downturn

## **INVESTMENT AND PLANNING OBLIGATIONS: RESPONDING TO THE DOWNTURN**

### **PREFACE**

The Single Conversation is the Homes and Communities Agency's (HCA's) approach to place shaping and delivery through partnership working. Delivery of the Single Conversation is dependent on a strong local vision and clear spatial planning strategy and policies through the Local Development Framework. A key element of this integrated approach is the development of an investment framework for delivering the development needed to support the quality of life outcomes envisaged in the Sustainable Community Strategies of our partner local authorities.

The Single Conversation will take a wide view of the resources needed to deliver successful places, and will seek to join up and co-ordinate investment from all sources. The HCA's investment will need to be planned alongside private investment. This will continue to include developer contributions from planning permissions and associated Section 106 (S106) obligations for the delivery of both affordable housing and the infrastructure needed to support communities. In future, S106 planning powers are expected to be complemented by a Community Infrastructure Levy.

Because sustainable housing growth requires new social, physical and green infrastructure, planning policy rightly expects planning obligations to meet both social infrastructure and affordable housing requirements. Achieving the right balance between investment for infrastructure and for affordable housing will be an important part of the Single Conversation process and will be different in different places and will change over time. This good practice note aims to inform HCA staff, as well as our stakeholders of the Agency's view on how HCA investment can best work with the planning process to assist delivery of affordable housing and help transform communities in the current downturn and into a future recovering market.

Sir Bob Kerslake

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## INTRODUCTION

1. This good practice note sets out the Homes and Communities Agency's expectations for securing affordable housing from planning permissions and associated S106 obligations alongside HCA investment. It is intended to inform HCA regional staff engagement with Local Planning Authorities (LPAs) and other stakeholders. Its focus is on policy and principles for managing delivery of growth, affordable housing and supporting infrastructure. More detailed supporting advice, drawing on case studies, is to be provided by the HCA's Advisory Team for Large Applications (ATLAS).<sup>1</sup>
2. Spatial planning's role in delivering local place-making investment strategies will be central to the future delivery of the HCA's goals which are:
  - To contribute to the delivery of housing growth;
  - To secure the delivery of new affordable housing and ensure existing social rented stock is made decent;
  - To accelerate the regeneration of under-performing areas and the renewal of deteriorating estates; and
  - To ensure high standards of design and to embed sustainability, with a legacy of skills, knowledge and capacity.
3. Our new place-focussed model of working – the Single Conversation – anticipates close alignment of HCA investment with our LPA partner's planning policy and planning's responsibilities for managing delivery of affordable housing, as well as for the infrastructure on which housing growth is dependent. The effective co-ordination of public and private investment, alongside developer contributions as a result of planning permissions will be a key focus of the Single Conversation.

## SCOPE

4. The HCA wishes to promote delivery through partnership working between Local Planning Authorities, investment partners, developers, lenders and other stakeholders to assist recovery in the housing market, through innovative and collaborative approaches which can restore stalled developments to viability.
5. Since the establishment of the HCA in December 2008, the continued downturns in the housing and commercial property markets have significantly reduced the scope for achieving viable developer contributions for affordable housing via planning permissions. Some developments with planning conditions or obligations agreed before the market downturn are no longer viable and are currently undeliverable in their consented form.
6. Planning policies and practice for securing planning obligations need to accommodate both the current realities and the future dynamic of the land and property markets. Whatever the pace of future market recovery, a changed lending environment and attitude to risk is likely to impact on residential

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<sup>1</sup> This will consider in more detail collaborative procedures, evidence needs and practical planning solutions based on current and emerging practice. Visit <http://www.atlasplanning.com/page/downturn.cfm>

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development business models, which in turn will require changed approaches to development finance and development management.

7. This note sets out good practice principles that the Agency will encourage, namely:
  - **Place shaping - sound policy principles:**  
To note the basis on which national policy expects spatial planning to deliver public and private investment for homes and for infrastructure. To highlight the requirement for a supporting evidence base for Development Plan Documents (DPDs) which justify viable and deliverable policies, supporting delivery of affordable housing and other planning obligations.
  - **Supporting delivery through planning:**  
To suggest good practice approaches to flexible working between LPAs, the HCA regions and our common stakeholders, which help unlock currently unviable, and hence undeliverable, planning permissions. Where previously achievable affordable housing obligations may not be supported in today's market, a flexible approach to developments in the housing supply pipeline will be needed.
  - **HCA's investment role:**  
To identify where HCA investment can work with local planning policies to provide additional outputs and recycle or recover the value created by early HCA investment in infrastructure, in some cases allowing contributions from developers to be deferred to later in the development period.
  - **Transparent viabilities:**  
To identify principles for a transparent approach to modelling financial viabilities that can assist collaborative working between stakeholders seeking to progress development on strategic sites where development periods are likely to fall within a future market recovery cycle. To also provide good practice to assist common stakeholder understanding of the key variables in development viability models.

## CONTEXT

### National planning guidance

8. It is a basic principle of spatial planning that development plans have regard to the resources likely to be available and the costs likely to be incurred, and be realistic about what can be implemented over the period of any plan.<sup>2</sup> Sound planning policy needs to be both deliverable and flexible.
9. National planning policy guidance for housing supply - *Planning Policy Statement 3: Housing* (PPS3), expects LPAs to set policy targets for affordable housing supply which are economically viable.<sup>3</sup> The use of planning powers to shape

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<sup>2</sup> PPS1 *Delivering Sustainable Development*, para 26 (iv).

<sup>3</sup> PPS3 paragraph 29 requires targets to "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

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mixed communities on residential and mixed use developments through a planning requirement for on site, in kind, affordable housing in planning agreements has its statutory basis explained in Circular 05/2005 *Planning Obligations*. Whilst circular 11/95 sets out the principles for the use of Planning Conditions. The companion document to PPS3, *Delivering Affordable Housing* references the five policy tests set out in this Circular, defines affordable housing for planning purposes, and sets out how planning obligations relate to public investment from the National Affordable Housing Programme (NAHP).<sup>4</sup>

10. Government guidance encourages LPAs to use planning conditions in preference to planning obligations wherever possible. Effective use of the former is dependent on the LPA having sound planning policy in place, and confidence that policy will enable consent conditions to be upheld by the Planning Inspectorate should they be appealed. Use of planning obligations can give certainty where more detail than can be incorporated into a planning condition is judged to be necessary.
11. The ability to secure, through planning conditions, or from planning obligations, contributions towards the funding of physical, social and green infrastructure, as well as in-kind contributions to affordable housing is a key policy tool for spatial planning. National policy in *Planning Policy Statement 12: Local Spatial* (2008) (PPS12) expects spatial planning practice to be based on infrastructure planning that considers costs, sources, and timing of funding for infrastructure and also provides the “*basis for the private sector facilitating of affordable housing*”.<sup>5</sup> PPS12 encourages all LPAs to advance infrastructure planning, and where tariff policies and standard charge arrangements to fund infrastructure are developed, to anticipate a future ability to make a charge on all development under future Community Infrastructure Levy regulations.
12. LPAs are expected to implement affordable housing policies requiring a proportion of homes on new developments above a threshold size to be affordable. Planning Policy Statement 3: Housing (PPS3) requires LPAs to set plan-wide targets for affordable housing which reflect housing need and an assessment of the likely economic viability of land for housing within their areas, as well as the likely levels of finance available for affordable housing, and the level of developer contributions that can reasonably be secured. This advice has been re-enforced by the 2008 Blyth Valley decision in the Court of Appeal which quashed an affordable housing target based, not on robust credible evidence of viability, but on housing need evidence alone. The Planning Inspectorate have judged some recently produced core strategies unsound where there has been lack of robust and credible economic viability testing to justify affordable housing targets.

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*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.”*

<sup>4</sup> *Delivering Affordable Housing* (CLG 2006) Paragraphs 85-88.

<sup>5</sup> PPS12 *Creating Strong And Prosperous Communities Through Local Spatial Planning*, CLG, 2008

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## PLACE SHAPING: SOUND POLICY PRINCIPLES

### Local Development Frameworks

13. The central assumption of the post 2004 planning system is that the process of sustainable place shaping requires a Local Development Framework (LDF) Core Strategy consistent with the Sustainable Community Strategy and that the investment required for delivery reflects the priorities of the Local Strategic Partnership.<sup>6</sup> The Core Strategy will set out a long term (15 - 20 years) strategy for the spatial development of the area. It should be flexible, deliverable and capable of being monitored over its life and respond to changing circumstances. The HCA's Single Conversation will assume a close alignment with the Core Strategy in the development of Local Investment Agreements.
14. Sound Core Strategies are expected to state deliverable affordable housing targets framed in a sufficiently flexible way to support decisions on individual planning applications throughout the future plan period. An evidence base, including Strategic Housing Market Assessments and Strategic Housing Land Availability Assessments, will support the deliverability of policy in the Core Strategy.
15. Where LPAs have adopted Development Plan Documents (DPDs) with policies for affordable housing based on the market conditions prior to the current recession flexibility in their operation will be required to enable delivery in the current market, and in the application of adopted planning policies will need to anticipate delivery in a future recovering housing market.
16. As a strategy document with a 15 - 20 year life, a sound Core Strategy will be evidenced by other DPDs that will have been produced and refined in consultation with stakeholders, and together have been judged sound through independent examination by the Planning Inspectorate<sup>7</sup>. Because less than 15 per cent of LPAs in England have adopted sound Core Strategies, to date, the planning decisions of the majority of LPAs in the short term will be supported by 'saved' policies from Unitary Development and Local Plans and emerging planning policy rather than adopted DPDs.
17. PPS12 states that:  
*"the Core Strategy should be supported by evidence of what physical, social and green infrastructure is needed to enable the amount of development proposed for the area, taking account of its type and distribution. This evidence should cover who will provide the infrastructure and when it will be provided."*

## AFFORDABLE HOUSING POLICY

18. Affordable housing delivery from planning permissions is viable when the cost to the developer in the form of a discounted price, to the affordable housing provider

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<sup>6</sup> *Planning Together : Updated practical guide for local strategic partnerships and planners*, CLG March 2009

<sup>7</sup> To be "sound" a DPD needs to be justified, effective and consistent with national policy. The Planning Advisory Service website provides a soundness self-assessment guide and toolkit.

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can be accommodated in the scheme economics, without undermining profitability, and is reflected in the price paid for the land.

19. A robust affordable housing policy for delivering affordable housing in line with PPS12 deliverability criteria and with PPS3 paragraph 29 financial viability criteria will:

- Ensure that good evidence is put forward to support the policy, and that in particular, financial viability based upon empirical evidence of local market conditions forms part of the case supporting affordable housing targets. It is not sufficient to rely on statements promising flexibility.
- Ensure that any viability study carried out in today's market can not only inform the economics of development today, but also for the whole plan period. The Planning Inspectorate have advised LPAs that it would not be reasonable to base a Core Strategy on a short term view of the housing market, and that a reasoned assumption on what might be a normal market is needed. Any targets would need to have been tested and justified, but that provision for flexibility will be also needed to deal with abnormal market conditions. LPAs are expected to monitor and review policies and adapt them should abnormal conditions became the norm.
- Incorporate separate targets for social rented and intermediate tenures and consider providing for flexibility, by using a target ranges for affordable housing tenures, making the targets less open to challenge.
- Recognise in the policy itself, or in supporting text, that scheme specific financial viability will be considered when applying the policy to individual schemes.<sup>8</sup>
- Recognise in its implementation the policy test requirements of Circular 05/2005, and together with other public sector agencies including the HCA, consider the appropriate balance between private and public sector investment on individual developments.

## DELIVERY IN THE DOWNTURN

20. The HCA wishes to promote the advantages of collaborative partnership working between LPAs, investment partners, private developers, lenders and other stakeholders. In addition to partnership working, successful delivery through the current downturn will be dependent on sound planning policy supported by responsive and flexible development management.

21. The HCA wishes to support local authority priorities for delivery by investing in ways that unlock schemes which are stalled for reasons of non-viability using public investment alongside private investment, in ways that continue to make best possible use of developer contributions through planning permissions and associated planning obligations. Where a development is not able to meet policy

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<sup>8</sup> This does not avoid the requirement in PPS3 paragraph 29 for an assessment of viability in development plan documents, but makes it less likely that objectors will challenge the policy as there is scope for consideration of scheme specific viability.

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requirements from previous agreed planning obligations for reasons of viability flexibility on the nature and timing as contributions may be required. This will not mean simply replacing S106 requirements for affordable housing or infrastructure with HCA funding.

22. The emphasis placed by current NAHP guidance<sup>9</sup> on the need for additionality from public investment where aligned with planning obligations for affordable housing will remain, alongside a recognition of the need for flexibility both in HCA funding and in development management arrangements for securing developer contributions over the life of a development. HCA funding to support infrastructure will be based on arrangements to recover investment either directly through funding agreements or indirectly through tariff arrangements with the LPA, or to achieve additional provision of affordable housing.

23. Managing the contribution of developers in a falling market is a new challenge for the planning system, which is faced with decisions on options, singly or in some combination, covering:

- granting a planning consent for a longer period than the three year minimum;
- extending the life of existing planning consents;
- considering whether it is appropriate to re-negotiate affordable housing planning obligations which are no longer viable, having regard to the policy reasons why the obligation was thought necessary in the first place
- supporting delivery of affordable housing through flexible management of planning obligations on new planning applications; and
- securing HCA investment through an agreement with the developer, such investment being linked to a return when market conditions permit.

Policy for affordable housing targets alongside other relevant policies will need to support decisions by LPAs on each of the above balancing benefits and taking into account viability as a material consideration.

### **Granting a planning consent for more than three years**

24. Current national planning policy is that planning permissions should last for three years. However, where the applicant can demonstrate that land assembly arrangements or other necessary pre-conditions to the commencement of a planning consent require a consent which is longer than the standard three year period, an LPA has powers to grant a planning consent with a longer life.

### **Extending the life of existing consents**

25. The recession is resulting in a growing number of lapsed planning consents whose three year life has expired due to the scheme's current non-viability and/or the non availability of development finance. If the applicant wishes to implement a lapsed consent in its current form as the economy recovers a new application will be necessary. The government is currently consulting on a proposed new category of application whereby for a nominal fee the LPA could consider a request to extend the life of an existing planning consent.

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<sup>9</sup> NAHP Prospectus 2008-11, page 45 – 46  
<http://www.housingcorp.gov.uk/server/show/ConWebDoc.11921>



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26. Where the applicant is content to retain conditions or planning obligations associated with the original consent, the ability of LPAs to extend the life of a consent can assist more rapid delivery when the market recovers. This approach may not assist in unlocking developments where there is an underlying viability issue, and will not assist current provision of much needed affordable homes.

### **Considering whether unviable planning permissions and affordable housing provision should be re-negotiated.**

27. Where a consented development can no longer comply with planning policy for reasons of non-viability, it is likely that the LPAs are entitled to take a view on whether there are benefits to the scheme that justify flexibility. The LPA will consider whether the development is of sufficiently high priority to warrant re-negotiation of planning obligations to restore viability and allow delivery, and whether any re-negotiated development will continue to match the LPAs local vision and place-making objectives. Circular 5/05 is clear that the purpose of planning obligations is to ensure that unacceptable development can be made acceptable, and that planning permission can therefore be granted, provided that an obligation is created. So it may be that there is some flexibility to alter the terms of a planning obligation provided that the integrity of the permission is not thereby called into question in the light of local policies. The HCA can offer support and advice to this process and may be willing to provide investment support. It is important to understand the principle that a planning obligation is generally necessary to make a proposed development acceptable in planning terms, and that its non-viability is not a sufficient reason in itself for considering flexibility in its application.
28. Where changed market conditions require re-consideration of housing mix and density (for example fewer small flats and more family homes) the costs of a new planning application may be avoided if changes required can be managed in a way that allows them to be accommodated by amendment. It may be appropriate to consider adjustment of the affordable housing tenure mix. In some instances increasing the proportion of affordable housing linked to HCA investment can improve cash-flow and restore a stalled scheme to viability.
29. Because the speed of change in the current market downturn is unprecedented and the rate and direction of future change uncertain, obligations for affordable housing, entered into in current market conditions, may only support a substantially lower level of viable developer contributions than will be viable in a future recovering market. A flexible approach to managing planning obligations for affordable housing might relax or defer policy requirements linked to a developer commitment on the timing of delivery, so that a 'flexed' consent is not simply 'banked' by the applicant for implementation when the market has recovered.
30. It is legally possible to exercise a planning permission and thus preserve it without making a substantial start on site, but by making only a nominal 'material start' (which could be a little as digging a trench). Thus, a planning consent re-negotiated or granted on the basis of a 2009 viability today could be 'banked' and only substantially commenced well after its three year life.<sup>10</sup> The HCA will encourage LPAs to ensure that any short term flexibilities they may consider

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<sup>10</sup> The Government accepted the Callcutt Review's recommendation to close this loophole but have yet to amend the relevant legislation.

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appropriate to assist delivery now are not abused and only given in return for obligations that secure actual delivery within reasonable timescales. HCA regional teams will need to reassure themselves on this issue before deciding whether to invest in such schemes.

31. Where LPAs lack capacity or expertise in financial viability, the HCA, through its regional teams, supported through ATLAS and its National Consultancy Unit, can assist with the assessment of both existing and new planning applications. Further expertise is available through the HCA's panel of specialist consultants which LPAs should be encouraged to draw on<sup>11</sup>.

### Flexible responses Deferred planning obligations on phased developments

32. Considerations of the timing of the cost of obligations to assist cash flow and hence improve viability need to be considered on the basis of a transparent approach by all parties to consideration of the development's viability. Full disclosure of financial information should be expected alongside arrangements to validate assumptions used, if necessary by an independent expert. It is common practice for developers to fund the cost of independent validation.
33. Where a development can be built out in phases, policy requirements for planning obligations for affordable housing from the development could be deferred in early phases and the viability of achieving them in subsequent phases in a recovering market considered before the commencement of each phase. LPAs which adopt this approach will have considered that the benefits of achieving delivery now are outweighed by the potential uncertainty of achieving the deferred obligations in a changing market. A hypothetical example is given below:

#### Multi-Phase Development: a hypothetical example

It is agreed that a residential scheme will be developed over three phases. The LPA's ordinary affordable housing requirement is 35 per cent but for the first phase of development the LPA has accepted on viability grounds that this can be reduced to 20 per cent (although it has also said that 20 per cent is the limit below which it is not prepared to go). How then can the LPA protect its position for subsequent phases?

- planning permission is granted but it is also linked to a S106 Agreement. This requires two things:
  - (a) that the affordable housing requirement for Phase 1 is a minimum of 20 per cent; but
  - (b) before the developer can commence either of Phases 2 or 3 it agrees to submit to the LPA for its approval an updated viability appraisal to assess whether there is still a justification for reducing the affordable component of those phases below the usual 35 per cent but to a minimum of 20 per cent. The parameters for granting or withholding approval should be prescribed by the S106 Agreement. If approval is withheld for any phase then that phase cannot commence. If desired the Agreement can build in a mechanism for independent validation of viability assumptions.

<sup>11</sup>Information on the HCA consultant panel can be found at:  
[http://www.homesandcommunities.co.uk/public/documents/NCU\\_Handbook\\_1.pdf](http://www.homesandcommunities.co.uk/public/documents/NCU_Handbook_1.pdf)

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34. HCA teams will need to assess whether, in order to unlock such stalled developments, an affordable housing investment might be appropriate. While this may not achieve additional provision in the short term it would be appropriate to see if a development agreement could ensure that such investment can either be recovered or produce additional units during the scheme's development period in a recovering market.

### Equitable approaches – providing certainty

35. Government guidance in Circular 05/2005 states that planning obligations should not be used purely as securing a share in the profits of a development, but need to serve a material planning purpose. The provision of affordable housing in line with adopted development plan policies is such a purpose. However, planning agreements which provide for 'claw-back' arrangements based on a share in the improved sales values in the form of obligations which are over and above those assumed at commencement of the development, could be seen to be in conflict with this guidance.
36. An equitable approach to managing planning obligations for affordable housing in current market conditions would:
- Acknowledge the significant effect on scheme design and project funding of affordable housing and supporting infrastructure contributions, and provide a developer certainty on the extent of planning obligation requirements at the commencement of a single phase development or of each phase of a multi-phase development.
  - Where flexibility or deferment of obligations are being considered against the benefits of kickstarting delivery, the viability assumptions for planning obligations purposes of a single development or one phase of a large scheme could be linked to an agreement to substantially implement the consent within an agreed period after which a re-test of viability could be required.
  - Recognise that for larger phased developments viability will change between the first and subsequent phases. Viability could therefore be re-tested prior to the commencement of each phase, and arrangements for the potential deferment of planning obligations to the latter phases of a large development considered.
  - In appropriate circumstances the HCA will consider making an affordable housing investment providing a suitable development agreement with a developer can provide for additionality over the whole development period of a phased development.
37. The HCA's preferred approach at this time is thus the use of mechanisms to defer policy based planning obligations on early phases of a phased development to subsequent phases, subject to viability testing prior to the commencement of each phase. Thereby ensuring that obligations reflect the current economic reality for delivery of a phase of a development, but recognising that the underlying Development Plan policy requirement over the development period of a large project, can provide for deferment.<sup>12</sup> Examples A1 – A3 at **Annex 1** show how a

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<sup>12</sup> This could involve an agreement with the HCA to provide investment in early phases to be recovered later as market conditions improve.

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hypothetical phased development, appraised on a phased basis can, through a combination of HCA investment and the deferment of planning obligations, maximise the level of affordable housing achieved in a recovering market.

## HCA'S ROLE AS INVESTOR

### Issues in assessing viability in the current market

38. A transparent assessment of viability will be an essential starting point for HCA involvement. There are many appraisal models available and HCA teams will need to avail themselves of appropriate skills or support via the NCU or panel consultants.
39. Viability, in the current market, is impacted by both house prices and land values. Data on the former is widely available, but for land it is very hard to establish values in the current market as the number of transactions is so low and many sales are forced (i.e. there is not a willing buyer and seller). Developers will frequently choose to hold land rather than develop at current land values, in the expectation of rising prices. However, as developers reach their financial year ends, increasing numbers of write downs are being seen. At the same time developer behaviour will seek to mitigate land value loss through negotiation or re-negotiation of viability assumptions.
40. Savills noted in their recent report on residential land values:<sup>13</sup>  
*"A combined view of realistic pricing of stock ..... high finance and holding costs together with a shift to lower density housing types to meet current consumer appetite is more appropriate. With lower house prices, and a lack of mortgage and developer finance, few development schemes are currently viable. Schemes where the developer requires a residual return equal to 2007 land values will not achieve viability for a very long period."*
41. It will be very important that HCA investment and the viability of S106 obligations are considered together and that a collaborative approach to consideration of financial viability brings together developer, LPA, affordable housing provider and (potentially) bank funder. A common approach to modelling financial viability could allow all stakeholders to consider how re-negotiation of planning obligations alongside HCA investment can together kickstart developments in a way that meets their individual objectives, and secures for the public sector the potential to benefit over the lifetime of the development from any upturn. This could be recovery of investment or the provision of additional affordable homes, better mix or quality.
42. The Housing Kickstart delivery package gives the HCA further scope to invest in stalled sites – bringing together infrastructure, affordable housing and Homebuy Direct investment. It also enables the HCA to put in place mechanisms to recover its investment as and when markets recover on these sites, through equity loan investment towards development costs.

### Land value and affordable housing price

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<sup>13</sup> UK Residential Land Briefing Note, Savills, January 2009

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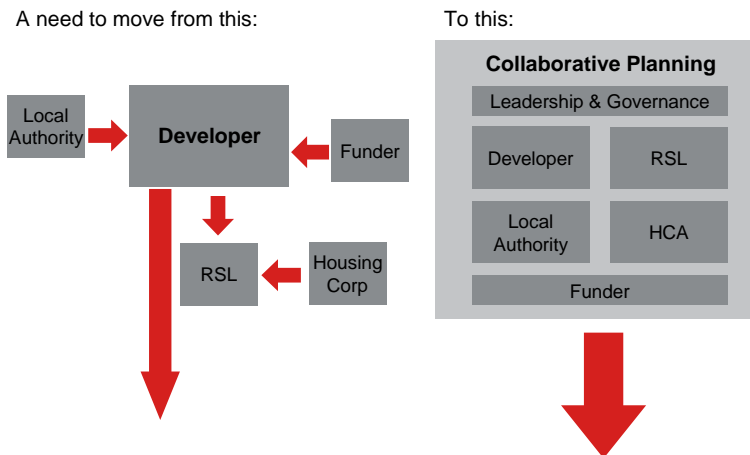
43. Investment from NAHP investment aligned with planning obligations will continue to be based on the principles outlined in the 2008-11 NAHP Prospectus<sup>14</sup>. These are that, where grant is aligned with affordable housing planning obligations, this is on the basis of demonstrable additionality – additional units, an improved mix, higher quality or a combination of these. The value of developer planning obligations being based on the discounted price of the affordable housing. These principles remain valid in the current exceptional market, although the HCA recognise that there will be circumstances in which affordable housing obligations in some value geographies are no longer viable in the current market.
44. The importance of the key variables of land value and affordable housing price to the assessment of the current potential for affordable housing planning obligations is illustrated in the hypothetical worked examples given at **Annex 1 B1 – B4** which show a development that can no longer support affordable housing planning obligations at its historic 2007 land value, but which can on the basis of a current land value viably support a reduce level of affordable housing planning obligations. It indicates how HCA investment can add value by increasing the viable proportion of affordable housing deliverable, without either supporting historic land values or inflating the affordable housing price.

## TRANSPARENT VIABILITIES

### A collaborative approach to development management

45. A collaborative approach to development management can unlock stalled developments, and maximise the value that each party can bring to the development. The optimum scenario is that the parties come together recognising what each can contribute for the benefit of the scheme as a whole and work in partnership on a commonly understood financial basis. The following diagram illustrates the difference in this approach to traditional arrangements.

### Collaborative Planning Approach Transparent Financial Modelling



<sup>14</sup> NAHP Prospectus 2008 -11, paragraphs 178-184

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46. Where stakeholders to the planning process choose to take this approach it will be essential that their business planning tools are adequate. The approach to development appraisal which can support a shared approach to viability needs to be able to provide:
- **Transparency** – If the parties are to take a truly collaborative approach it is clear that a transparent tool, the accuracy and results of which all sides accept, will be fundamental. It goes without saying that there should only be one shared viability model.
  - **Clarity on drivers** – To develop the parameters of a deliverable solution there will need to be clarity on the drivers for each party and acknowledgement as to what each party needs from the scheme.
  - **Clarity on returns** – Linked to the above point there should be visibility for all parties on what each party takes away from the deal (which will include financial & non-financial outputs).
  - **Risk & reward share** – The tool will need to incorporate the agreed risk and reward share and provide an equitable deal in this respect. Return sharing will follow risk sharing.
47. A transparent approach to assessing viability will be strongly encouraged by the HCA and will on strategic schemes be a pre-condition of HCA investment. Further guidance on understanding the key variables of viability modelling to deliver a collaborative approach to kickstarting stalled developments is given at **Annex 2**.
48. Financial models such as the Greater London Authority's Affordable Housing Development Control Toolkit or the HCA's Economic Assessment Tool<sup>15</sup> (inherited from the Housing Corporation) remain appropriate tools to test the viability of single phase developments where overall levels of planning obligations are fixed. The modelling of larger, phased developments to inform consideration of an approach to the deferment of planning obligations, will require models which can reflect the future dynamics of housing market recovery, changing values and build costs, demonstrate their sensitivities and their consequent potential impacts on the out-turn scheme position.

## CONCLUSION

49. HCA investment has a common purpose with the planning system – the delivery of high quality and sustainable neighbourhoods. HCA investment can assist the delivery of the additional homes and infrastructure needed for sustainable neighbourhoods, and is capable of kickstarting stalled developments with flexible approaches. Alongside this, the priority of delivering sufficient family housing, in particular affordable family housing, in a context of well-designed, mixed communities, will remain.
50. The Single Conversation will be a new way of planning future public investment. The resulting Local Investment Agreements will be reliant on effective spatial

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<sup>15</sup> The HCA Economic Assessment Tool can be downloaded from the HCA website. The GLA's Affordable Housing Development Control Toolkit can be ordered from the GLA website.

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planning to provide local vision, to enable delivery in partnership with the private sector, and to provide a means of co-ordinating the contribution that planning obligations will continue to make in a recovering market towards investment in infrastructure and affordable housing.

51. Future collaborative working alongside the planning process – both plan making and development management – will assist the HCA to maximise the contribution that its investment makes to the delivery of local vision, strategies, and outcomes.
52. This good practice note sets out a clear framework for HCA teams to engage with LPAs to support the delivery of new housing, particularly affordable housing, based on clear evidence of local need and economic deliverability. Whilst primarily intended for HCA staff, it is also hoped that LPAs, investment partners and other stakeholders will find it helpful.

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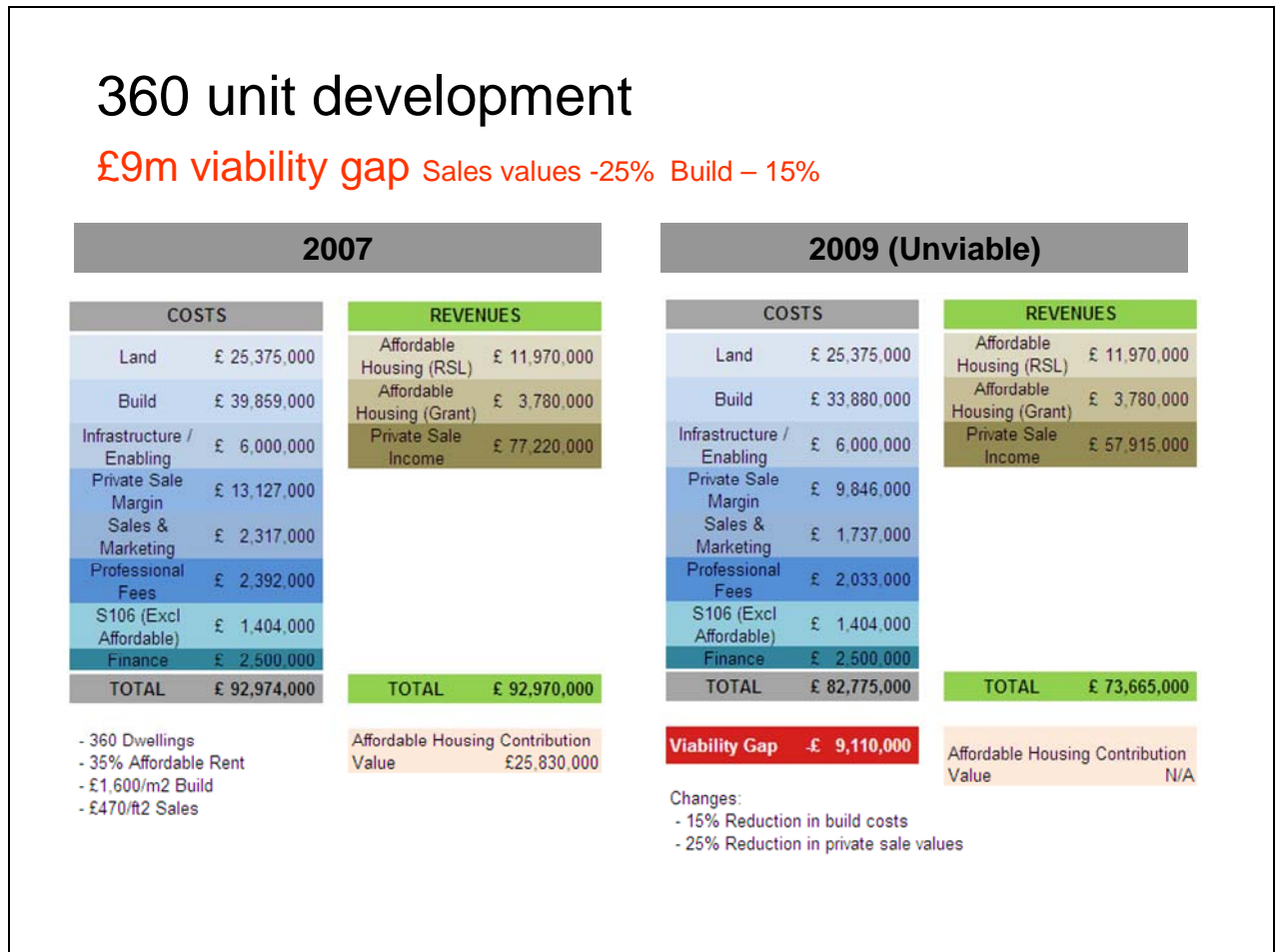
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**ANNEX 1**

**Phased development**

The following three diagrams illustrate a hypothetical 360 unit development which is no longer viable based on 2007 assumptions.

**A1** shows a viability gap between 2007 and 2009 of £9m, despite reduced build cost assumptions partially of-setting a 25 per cent fall in sales values.





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**A2** shows the high cost in public funding that would result from a non-phased approach to viability based on 2009 values and build costs, but which does not take into account potential value increases and changes to build costs over a five year development period.

## Can grant fill the gap?

1/3 less affordable for 3 x more grant

2007			2009 ("Viable" Option 1)		
COSTS		REVENUES	COSTS		REVENUES
Land	£ 25,375,000	Affordable Housing (RSL) £ 11,970,000	Land	£ 25,375,000	Affordable Housing (RSL) £ 6,840,000
Build	£ 39,859,000	Affordable Housing (Grant) £ 3,780,000	Build	£ 32,999,000	Affordable Housing (Grant) £ 6,480,000
Infrastructure / Enabling	£ 6,000,000	Private Sale Income £ 77,220,000	Infrastructure / Enabling	£ 6,000,000	Private Sale Income £ 71,280,000
Private Sale Margin	£ 13,127,000		Private Sale Margin	£ 12,118,000	
Sales & Marketing	£ 2,317,000		Sales & Marketing	£ 2,138,000	
Professional Fees	£ 2,392,000		Professional Fees	£ 1,980,000	
S106 (Excl Affordable)	£ 1,404,000		S106 (Excl Affordable)	£ 1,728,000	
Finance	£ 2,500,000		Finance	£ 2,500,000	
<b>TOTAL</b>	<b>£ 92,974,000</b>	<b>TOTAL £ 92,970,000</b>	<b>TOTAL</b>	<b>£ 84,838,000</b>	<b>TOTAL £ 84,600,000</b>
<ul style="list-style-type: none"> <li>- 360 Dwellings</li> <li>- 35% Affordable Rent</li> <li>- £1,600/m2 Build</li> <li>- £470/ft2 Sales</li> </ul>		Affordable Housing Contribution Value £25,830,000	<b>Changes:</b> <ul style="list-style-type: none"> <li>- 15% Reduction in build costs</li> <li>- 25% Reduction in private sale values</li> <li>- Affordable housing reduced to 25%</li> <li>- HCA grant triple original value</li> </ul>		Affordable Housing Contribution Value £4,500,000

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**A3** shows how, with a phased approach to viability, adjustment of land values combined with flexibility of HCA funding in phases 1 and 2, and the deferment of planning obligations in early phases, an overall level of planning obligations can be maintained and better value for public investment achieved.

# Deferred planning obligations

## Phased viability – overall s106 maintained

### 2009 Viable Option 2 – Phased View

PHASE 1		PHASE 2		PHASE 3		TOTALS	
£ 7,275,620	£ 1,710,000	£ 7,904,151	£ 2,280,000	£ 8,458,333	£ 3,420,000		
£11,293,440	£ 3,120,000	£ 11,957,760	£ 2,340,000	£ 13,401,600	£ 1,560,000		
£ 2,000,000	£ 1,080,000	£ 2,000,000	£ 720,000	£ 2,000,000	£ -		
£ 3,281,850	£ 960,000	£ 3,938,220	£ 360,000	£ 4,443,120	£ -		
£ 579,150	£19,305,000	£ 694,980	£23,166,000	£ 784,080	£26,136,000		
£ 677,606		£ 717,466		£ 804,096			
£ 234,000		£ 468,000		£ 864,000			
£ 833,333		£ 833,333		£ 833,333			
£26,175,000	£26,175,000	£ 28,513,910	£ 28,866,000	£ 31,588,563	£ 31,116,000		

COSTS		REVENUES	
Land	£ 23,638,104	Affordable Housing (RSL)	£ 7,410,000
Build	£ 36,652,800	Intermediate Housing (RSL)	£ 7,020,000
Infrastructure / Enabling	£ 6,000,000	Affordable Housing (Grant)	£ 1,800,000
Private Sale Margin	£ 11,663,190	Intermediate Housing (Grant)	£ 1,320,000
Sales & Marketing	£ 2,058,210	Private Sale Income	£ 68,607,000
Professional Fees	£ 2,199,168		
S106 (Excl Affordable)	£ 1,566,000		
Finance	£ 2,500,000		
<b>TOTAL</b>	<b>£ 86,277,472</b>	<b>TOTAL</b>	<b>£ 86,157,000</b>

Changes:	Changes:	Changes:
- Start 2009	- Start 2011	- Start 2013
- Sales 2011	- Sales 2013	- Sales 2015
- Build costs -15%	- Build costs -10%	- Build costs 0%
- Values -25%	- Values -10%	- Values +10%
- 65% Private	- 65% Private	- 60% Private
- 20% Intermediate	- 15% Intermediate	- 10% Intermediate
- 15% Rented	- 20% Rented	- 30% Rented
- Grant doubled	- Grant as original	- No grant
- S106 halved	- S106 as original	- S106 Doubled
- Land value writedown £1.2m	- Land value writedown £0.5m	- No land value writedown

**Overall Position:**

- Simple inflation applied to build / sales in line with programme
- Similar overall grant input
- Similar overall S106 payments
- Similar overall affordable housing (37% affordable of which 15% intermediate / 22% rented)

Affordable Housing Contribution Value	£22,169,842
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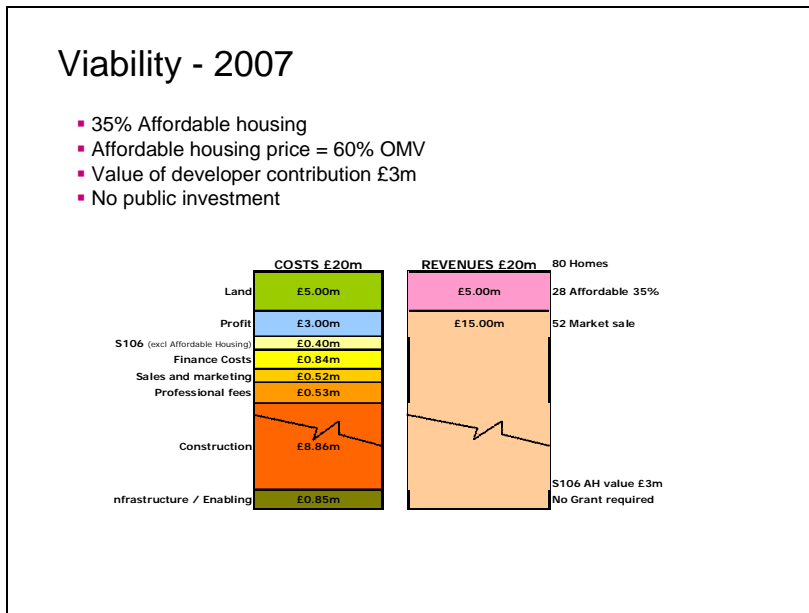
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**The Impact of land value on viability (single phase development)**

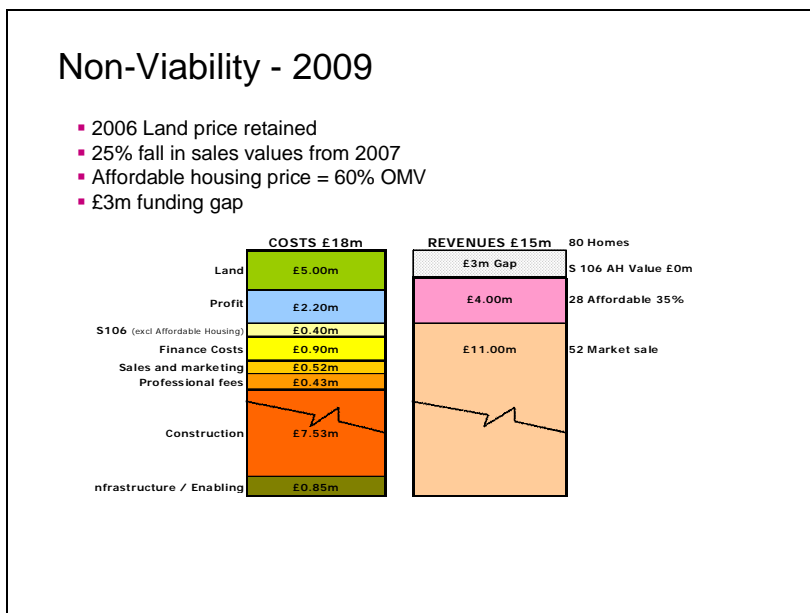
The following four diagrams illustrate for a hypothetical 80 unit residential development the impact of land value on the financial viability of affordable housing planning obligations.

Scenarios B1 and B2 illustrate the non-viability of retaining the historic 2007 land value in 2009.

**B1**



**B2**

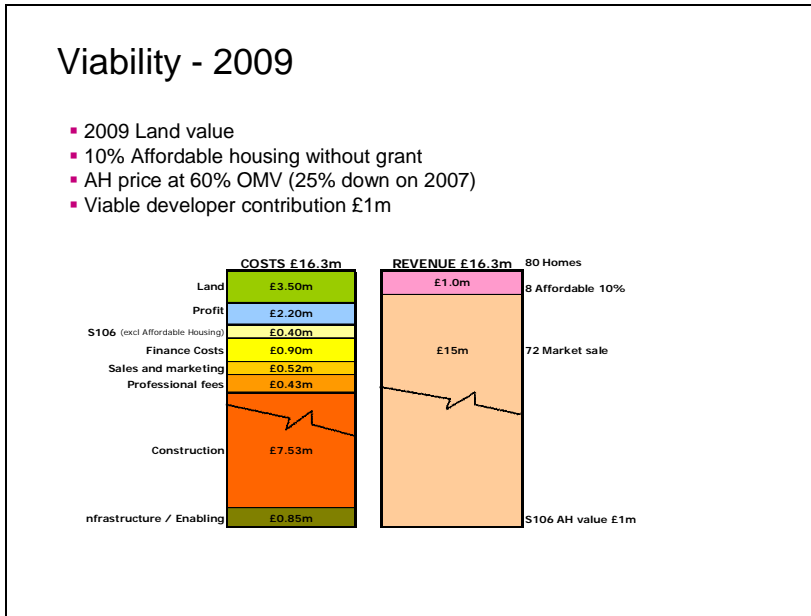


**Good Practice Note**

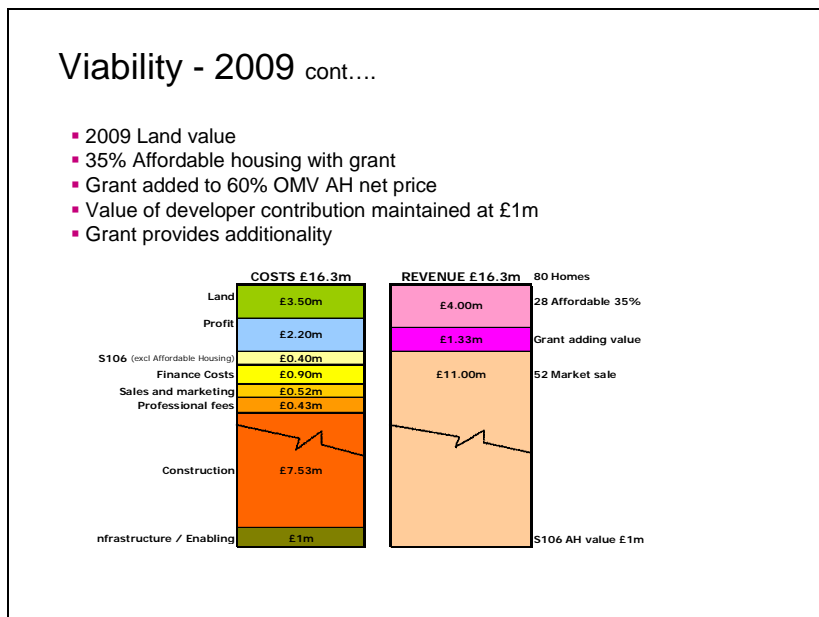
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Scenarios B3 and B4 illustrate a viable development based on 2009 land values (down by 30 per cent on 2007) with a viable but reduced level of planning obligations which, with grant investment on the basis of additionality, has the potential to restore the original 35 per cent affordable housing provision. Additionality in this instance being more affordable homes while maintaining the level of developer obligations.

**B3**



**B4**



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**ANNEX 216**

## TRANSPARENT DEVELOPMENT VIABILITY MODELS:

### Achieving common stakeholder understanding of the key variables

#### HCA approach

As stated in the note above, the HCA will strongly encourage stakeholders to employ a transparent approach to considering viability where HCA investment is being sought to unlock stalled residential and mixed-use developments. This should be on the basis of full financial disclosure by stakeholders with appropriate safeguards for commercial confidentiality.

#### Guidance on key variables

Transparent viability appraisals have the potential to remove the mistrust and suspicion that has often characterised negotiations around the viability of planning obligations sought by adopted planning policy. A commonly owned viability model can inform an approach to partnership working in which the strengths and contributions of each stakeholder is translated into a transparent and flexible business case for unlocking stalled developments.

**Components of the appraisal** – In simple terms any whole scheme viability model uses a set of costs and incomes to arrive at an output:



#### Areas requiring particular clarity

Because the following are often the source of misunderstandings, they deserve particular attention.

**Profit / margin** – A shared understanding of what the end 'scheme position' represents is essential. The key issue is whether profit is treated as an 'above the line' cost either by way of a profit on the building works or by a developer's margin deducted as a cost from the commercial and private sale values. In this case the 'scheme position' output is an additional margin. Alternatively, if no profit is built in 'above the line' the output becomes the profit which may be subject to sharing arrangements between stakeholders.

With a transparent approach either of the above approaches can work – the key will be to show what each party receives in total including any 'above' or 'below' the line profit.

<sup>16</sup> Annex 3 together with related sections above has been drafted with the assistance of **EC Harris**

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Different organisations may define margin differently. A transparent approach needs to show precisely how profit is measured and on what basis it is expressed as a percentage. Items such as sales and marketing costs or overheads may be included within a 'headline' margin.

**Risk and profit** – Different elements of a project will incur less risk than others – for example where affordable housing is constructed with an agreed purchase price from an RSL the risk is minimal, consequently the margin will be relatively low and akin to that of a construction activity (perhaps six or seven per cent or build costs at present including overheads). Other elements such as private residential sales have a greater risk and a figure of perhaps 16 per cent of values (rather than costs) may be targeted exclusive of sales and marketing and overheads which may each add a further 3 per cent. The differentiator between different profit margin levels is risk and it follows that different risk sharing arrangements will use different margins.

**Cashflow** – The cashflow of an appraisal, particularly for larger schemes, is fundamental. It determines both a significant input (finance costs) and a key output measure (return on capital employed – the relationship of capital invested to profit generated). Costs for a typical project are front loaded with a time gap between costs (land, infrastructure and building works) and income (say dwelling sales). The duration of this period and magnitude of the gap between costs and income which will determine the finance costs incurred.

A key point to examine is how the movement of costs or incomes can reduce finance costs – for example bringing forward part of a grant to fund early infrastructure or delaying an 'up front' land receipt or S106 obligation until the project begins to generate income. The opportunity to improve viability through this sort of approach is significant.

**Development finance** – An optimum cashflow minimises the quantity of development finance needed. The other driver finance cost is the interest rate applied, for example 7.5 per cent. Considerations which a bank funder may make in setting this rate include the **debt to equity ratio** (how much of the scheme is being funded by the bank compared to the equity partners of the development e.g. the developer), **the loan to value ratio** (how the loan value compares to the value of any security offered such as the land) and other measures which give confidence as to the robustness of the proposals. The extent of public sector funding and any guarantees of the bank's capital will have a significant effect.

## OTHER ISSUES

### Definition of viability and land values

The residual land value method of determining viability assumes that a viable development will support a residual land value at level sufficiently above the site's existing use value (EUV) or alternative use value (AUV) to support a land acquisition price acceptable to the landowner. This residual land value being the developments gross development value (or total scheme revenues) less total expenditures including the cost of planning obligations (as cash or in-kind at a discounted price) plus developer profit.

In the current market downturn, developers who have purchased land at high historic values may be unwilling or unable to use current residual land values as the basis for re-negotiating and assessing the viability of planning obligations. In the absence of

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comparable open market transactions to provide an alternative benchmark to the residual valuation method, land value assumptions in re-negotiated viabilities are likely to be contentious.

### Land purchase and overage

Landowners in the currently depressed land market will often seek to sell on the basis of overage arrangements which provides them with a share of any additional value obtained from sales. Overage arrangements can complicate the approach to deferring planning obligations across a phased development described in this note.

### Basic questions to ask in understanding viability appraisals

Variable	Questions to ask
<b>Private residential and commercial incomes</b>	<p>Are the values based on a recent, detailed review by an independent agent?</p> <p>Does the review of values compare what is currently achieved in the area to the maximum that could be achieved given the project proposals?</p> <p>Are things which drive value (for example parking spaces or overlooking a park) identified and the additional benefit of these quantified?</p> <p>Who retains the freehold for apartments and where is the capitalised sum of this future ground rent income stream included?</p> <p>Is there a future income stream from on-site energy generation and does operation of this concession generate a capitalised sum?</p> <p>What rates of sale / letting are assumed within the programme?</p> <p>Has a robust assessment of the demand for, and income from, all potential commercial uses been undertaken?</p> <p>What yield, rental income and assumptions such as sales incentives have been used for commercial uses?</p> <p>Sales incentives could include rent-free periods.</p>
<b>Affordable housing income</b>	<p>There are three potential elements of this offer – the capital value derived from the RSL's operational (rents and maintenance) model, any HCA grant and any additional contribution from the RSL's own reserves. Are all three clearly identified &amp; calculations to underpin them provided?</p> <p>Where intermediate tenure homes are included what assumptions underpin the offer price?</p> <p>What impacts would there be for cashflow and total income if homes moved between tenures due to market conditions?</p>
<b>Build costs</b>	<p>How recently have build costs been reviewed and do they accurately reflect the current market? What benchmarks have been used?</p> <p>Where costs are expressed on a £/m<sup>2</sup> basis, are net or gross areas used and are supporting benchmarks calculated on the same basis?</p>

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Variable	Questions to ask
	<p>Are items such as preliminaries, design fees, statutory fees and the like clearly identified and the method of calculation clear (e.g. are preliminaries and design percentages added to build costs in a simple or compound form?).</p> <p>Is the link between costs and values clear – how has the specification and design been optimised to generate value?</p>
<b>Inflation</b>	<p>Are figures 'current costs &amp; current values' or have cost and value inflation assumptions been included?</p> <p>Has the current downturn in costs and values been treated sensibly – is it recognised that costs will occur at an earlier point in time than income and there is therefore the potential to save more cost than the value lost?</p>
<b>Public sector income</b>	<p>Is the quantum and timing of any public sector grants clear and is best use made of this income to 'pump prime' development and reduce finance costs?</p> <p>Are the outputs (financial and non-financial) delivered in return for the public sector input clear?</p> <p>Where there is risk sharing is the sharing of return also offered?</p>
<b>Land</b>	<p>Has the land already been purchased or is this a variable cost?</p> <p>Where the land has already been purchased what is the current (residual) value of the land and, where different to the purchase value, which is it appropriate to use?</p> <p>What are the existing use value (EUV) and alternative use values (EUV) of the site as determined by an independent valuer?</p> <p>Are public sector land payments timed sensibly to maximise benefit by for example deferring receipts to later in the development?</p>
<b>Planning obligations</b>	<p>Does the land purchase value reflect an agreed viable level of planning obligations, and an appropriate residual land value?</p> <p>Is the value of affordable housing planning obligations reflected in a discounted affordable housing price?</p> <p>Are S106 payments timed sensibly to maximise the benefit achieved?</p>
<b>Financial output measures</b>	<p>Is it clear precisely what calculation is performed to generate the key measures of margin and return on capital employed and other measures for a bank funder noted above?</p> <p>Are these within reasonable parameters when the apportionment of risk is considered?</p>



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