

.....

LONDON BOROUGH DEVELOPMENT VIABILITY PROTOCOL

.....

November 2016





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

1 INTRODUCTION

- 1.1 Viability testing is undertaken when local authorities produce Local Plans and can be used as part of the application process to ensure that developments are deliverable. This can influence the extent to which new proposals meet Plan requirements, such as the provision of affordable housing and infrastructure and compliance with environmental policies.
- 1.2 The protocol sets out overarching principles for how boroughs will approach development viability where this is a consideration as part of the planning process, in line with the National Planning Policy Framework (NPPF) and the national Planning Practice Guidance (PPG).
- 1.3 The protocol will provide greater clarity to developers and members of the public and should be read alongside local Development Plans and associated guidance produced by the Mayor of London and boroughs. The protocol does not alter existing policies, but provides additional advice on the information requirements and approaches that local authorities intend to apply when assessing viability.
- 1.4 A draft version of the protocol was subject to public consultation in February/ March 2016.

2

DELIVERY OF SUSTAINABLE DEVELOPMENT

- 2.1 The National Planning Policy Framework (NPPF) establishes that the key purpose of planning is the delivery of sustainable development through a ‘plan-led’ system as set out in statute¹. Planning should: help to deliver strong, responsive and competitive economies, by co-ordinating development requirements, such as the provision of infrastructure; create sustainable, mixed and healthy communities; meet full, objectively assessed needs for market and affordable housing; promote sustainable transport; require good design; conserve and enhance the natural and historic environment; and, meet the challenge of climate change.
- 2.2 The NPPF also requires that the costs of planning requirements should allow for competitive returns to a willing land owner and willing developer to enable development to be deliverable². The process and methodology for testing this must be accounted for within the context of the NPPF as a whole and the overarching objective of achieving sustainable development.
- 2.3 The Statutory Development Plan for each authority consists of the London Plan and borough Local Plans (typically comprising of a Core Strategy, Development Management Policies and Site Allocations). Where a scheme meets Development Plan policies, including affordable housing targets, a viability assessment may not be required.
- 2.4 The London Plan requires that where viability testing is undertaken, boroughs evaluate viability appraisals rigorously³. This is important to ensure the implementation of planning policies which form the basis of the delivery of sustainable development in each authority.
- 2.5 Changes to the planning system are set out in the Housing and Planning Act 2016 and proposed revisions to the NPPF. The guidance set out in the protocol is applicable when assessing the viability of proposals under the new arrangements introduced by the Act and the NPPF. Boroughs will consider further regulatory changes as they come into effect.

¹ NPPF paragraph 17

² NPPF paragraph 173

³ London Plan 2016 policy 3.12 and paragraph 3.71

3 VIABILITY ASSESSMENT PROCESS

- 3.1 Planning Practice Guidance requires that viability assessments should be evidence based. Development viability issues can cause delay to the determination of applications when not addressed at an early stage or when insufficient information is provided. To enable authorities to properly evaluate appraisals:
- Section 106 Heads of Terms and development viability (where this is likely to be a consideration) should be discussed at ‘pre-application stage’.
 - Proposals submitted should be designed in a form that accords with Development Plan policies and associated guidance.
 - Viability assessments should reflect Planning Practice Guidance on viability and Mayoral and borough guidance relating to methodology and inputs.
 - Assessments should include all relevant information required by the council. Viability evidence must be robustly justified and appraisal assumptions benchmarked against publicly available data sources. Appraisals must be balanced, coherent as a whole and internally consistent.
 - Applicants should demonstrate that the scheme is deliverable with the proposed level of planning obligations.
 - Applicants and/ or assessors should confirm that the assessment provides a fair and true reflection of viability and that this complies with professional and ethical standards.
 - A working electronic version of the viability appraisal model should be provided to the relevant authority.
- 3.2 Councils will consider whether the approach adopted and the inputs applied are appropriate and adequately justified by evidence⁴. In doing so boroughs will typically take advice from external consultants. The reasonable costs of this process will be paid for by applicants.
- 3.3 Applicants may be required to brief members of the planning committee and the public on the details of their viability assessment.
- 3.4 An appraisal should be updated where necessary to ensure that the assessment reflects current market conditions at the point of determination in line with PPG⁵.
- 3.5 Following assessment of an applicant’s viability appraisal, the relevant council will indicate whether the scheme complies with Development Plan policies and whether or not additional planning obligations are required to ensure compliance.

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

⁵ PPG Viability Paragraph 17

Openness

- 3.6 Information relevant to the plan-making and planning application process is publicly available. This is consistent with the NPPF which places a requirement on councils to facilitate community involvement in planning decisions⁶. PPG states that transparency of viability evidence is encouraged wherever possible⁷.
- 3.7 The Environmental Information Regulations (2004) recognise the benefits of public participation and include a presumption in favour of disclosure. To ensure transparency and public participation:
- Authorities will expect that information provided can be made available to the public alongside other application documents. In submitting information, applicants do so in the knowledge that it may be made publicly available. Authorities will consider this having regard to the circumstances that apply.
 - Regardless of the approach taken by an authority in respect of making an appraisal publicly available, boroughs may make information available to planning committee members or any other member who has a legitimate interest in seeing it.
 - Authorities may also be required to make information available to a third party where another body has a role in determining an application or providing public subsidy and when fulfilling their duties under the Environmental Information Regulations and Freedom of Information legislation.

4

DEVELOPMENT VALUES

- 4.1 Assumptions relating to development values should be justified with reference to up to date transactions and market evidence from comparable new build properties within a reasonable distance from the site and, where relevant, should reflect arrangements with future occupiers. In particular:
- Information relevant to comparable properties should be: directly comparable to the site in question or should be adjusted to ensure it is comparable; and be fully analysed to demonstrate how this has been interpreted and applied to the application scheme.
 - For any units with characteristics which justify higher values (e.g. upper floors, south facing units, river frontage etc.) further details should be provided, with reference to units of similar characteristics in nearby schemes where possible.
 - In line with the London Plan, applicants should engage with Registered Providers (RPs) at an early stage⁸. Affordable housing values should reflect discussions with and offers made by RPs. Affordable housing provision should be maximised making the most effective use of affordable housing resources. Values should be evidenced through calculations of rental and capital receipts (including staircasing receipts for shared ownership units) and available external/ internal subsidies.

⁶ NPPF paragraphs 66 & 69

⁷ PPG Viability Paragraph 4

⁸ Policy 3.12 and paragraph 3.71, 3.72

5 DEVELOPMENT COSTS

- 5.1 Build costs should be provided in an elemental form based on a detailed specification of the proposed development and supported by evidence from cost consultants.
- Cost details should generally be provided based on Gross Internal Area (GIA), clearly apportioning costs to different elements of the development (i.e. commercial, market residential, affordable housing etc).
 - Costs should be provided in a detailed elemental form that enables them to be benchmarked against publicly available sources such as BCIS. Authorities may seek advice from a Quantity Surveyor to be paid for by the applicant.
 - Authorities will expect a clear correlation between a development's specification, assumed build costs and development values, and for there to be consistency with comparable sites.
 - Any site-specific abnormal costs should be disaggregated and supported by robust evidence (including contractor costs). The presence of abnormal costs would normally be expected to influence land value.
 - A relationship between professional and marketing fees and development values should also be evident.
 - A standardised approach will generally be adopted to finance costs which should be justified according to the specific proposal, reflecting varying interest costs (if applicable) throughout the development period.
- 5.2 In line with PPG, appraisals should normally be based on current day costs. In particular, these should not include build cost inflation where current day values are assumed. For medium and longer term schemes future changes in costs should only be reflected where projected changes in values based on relevant market data have also been incorporated.
- If a viability assessment assumes changes in development values and build costs, this should be accompanied by a full justification including evidence of long-term trends in new build values, current market conditions and market expectations. Profit levels should be fully justified and should not be set at a level that offsets the benefits of assuming growth.
 - If an applicant chooses to rely on growth forecasts, a viability review is likely to be necessary to assess actual changes in value and costs (see below).

6 PLANNING CONTRIBUTIONS

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

7 DEVELOPER PROFIT

- 7.1 Evidence should be provided from applicants and lenders to justify proposed rates of profit taking account of the individual characteristics of the scheme, a development's risk profile and comparable schemes. Target profit levels should be appropriate to current market conditions and would be expected to be lower than levels that were typical following the financial downturn of 2008/9. Profit requirements for affordable housing should reflect lower levels of risk when compared to private residential units. Similarly lower levels of return would normally be expected for commercial and private rented accommodation.
- 7.2 It should be made clear how the profit level has been risk adjusted taking into account other assumed inputs within an appraisal. For example, the adoption of higher contingencies and costs at the upper end of typical parameters may warrant a lower target profit.
- 7.3 Authorities will normally consider profit as a factor of gross development value (GDV) and / or gross development cost (GDC). An 'internal rate of return' (IRR) approach of measuring profit, which is associated with a long term development programme and assumed growth in values and build costs, is sensitive to the timing of costs and income. If IRR is relied on a full justification must be provided for the assumed development programme, the timing of cost and value inputs and the target IRR. Where IRR is used as a measure of profit, authorities may also consider profit as a factor of GDC/GDV.

8 LAND VALUE

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

⁹ This is the residual method of land valuation

Benchmark land value

8.2 The process for establishing an appropriate benchmark land value for a viability assessment is key, because this indicates the threshold for determining whether a scheme is viable or not. A development is typically deemed to be viable if the residual land value is equal to or higher than the benchmark land value, as this is the level at which it is considered that the landowner has received a 'competitive return' and will release the land for development.

Existing Use Value Plus Premium

8.3 The 'Existing Use Value plus' (EUV+) approach to determining the land value benchmark is based on the current use value of a site plus a premium. The principle of this approach is that a landowner should receive at least the value of the land in its 'pre-permission' use, which would normally be lost when bringing forward land for development. A premium is added to provide the landowner with an additional incentive to release the site, having regard to site circumstances.

8.4 The benefit of this approach is that it clearly identifies the uplift in value arising from the grant of planning permission because it enables comparison with the value of the site without planning permission.

8.5 PPG confirms that comparing the current use value of a site with the residual land value generated by the proposed development (which must be equal to or higher than the benchmark) is an appropriate way to determine whether or not a 'competitive return' is achieved for the land owner¹⁰.

8.6 In line with the Mayor's Housing Supplementary Planning Guidance (SPG) and the GLA Affordable Housing Toolkit Guidance Notes, the boroughs consider that the 'existing use value plus a premium' approach is most conducive to achieving the goals of the planning system and should be used to determine the benchmark land value in most circumstances¹¹.

8.7 When determining an appropriate land value benchmark:

- An existing use value should be fully justified with reference to comparable evidence, which excludes any hope value associated with development on the site or alternative uses. This evidence should relate to sites and buildings of a similar condition and quality or otherwise be appropriately adjusted. Where an existing use and its value to a landowner is due to be retained in a development (and not lost as is usually the case), a lower benchmark would be expected.
- Premiums above Existing Use Value should be justified, reflecting the circumstances of the site and landowner¹². The actual percentage will be determined on a site by site basis depending on the use of the site. For a site which does not meet the requirements of the landowner or creates ongoing liabilities / costs, a lower premium would be expected compared with a site occupied by profit-making businesses that require relocation.

¹⁰ PPG Viability Paragraph 24

¹¹ This approach is also applied within the Homes and Communities Agency Guidance 'Responding to the Downturn', and Local Housing Delivery Group 'Viability Testing Local Plans: Advice for Planning Practitioners'

¹² This is considered further in: the GLA Development Appraisal Toolkit Guidance Notes (2015)

- As set out in PPG, in all cases land or site value should reflect Development Plan Policies, planning obligations and CIL¹³. When determining a level of premium that would be sufficient to incentivise release of a site for development and ensure that a landowner receives a ‘competitive return’, this should take into account the overarching aim of delivering sustainable, policy compliant development and that an uplift in land value is dependent on the grant of planning consent.

The Market Value Approach

- 8.8 An alternative approach determines the benchmark land value using the market value of land, *having regard* to Development Plan policies and material considerations. This is based on RICS guidance which is predicated on the basis that land trades at market value¹⁴. Notwithstanding this, as referred to in the Mayor’s Housing SPG, recent research by the RICS has identified flaws in the application of the ‘Market Value’ approach¹⁵.
- 8.9 The RICS research explains that *‘if market value is based on comparable evidence without proper adjustment to reflect policy compliant planning obligations, this introduces a circularity, which encourages developers to overpay for sites and try to recover some or all of this overpayment via reductions in planning obligations’*¹⁶. This is inconsistent with the requirements of PPG, and creates a scenario where it becomes almost inevitable that policy requirements are found to make a development unviable.
- 8.10 The GLA Viability Toolkit Guidance Notes (2015) also highlight difficulties with this approach: *“It is possible for the Toolkit to model an approach where the land acquisition cost is used as a driver for the viability calculation. Users will need to be aware that this approach effectively “turns the model on its head”, and determines that policy requirements are the ‘residual’ in the calculation and thus open to being ‘squeezed’ by developers who have not reflected policy in their bid for land”*¹⁷.
- 8.11 Land transactions reflect the specific circumstances of the developer whereas planning viability appraisals are typically undertaken on a standardised basis. Reliance on land transactions for sites that are not genuinely comparable or that are based on assumptions of low affordable housing delivery, excess densities or predicted value growth, may lead to inflated site values. This can undermine the implementation of Development Plan policies and the ability of planning authorities to deliver sustainable development.

¹³ PPG Viability Paragraph 23

¹⁴ See RICS Guidance Financial Viability in Planning (2012)

¹⁵ Mayor’s Housing SPG (2016), paragraph 4.1.5; RICS (2015) Financial Viability Appraisal in Planning Decisions: Theory and Practice, Professor Neil Crosby and Professor Peter Wyatt, University of Reading

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

¹⁷ GLA Viability Toolkit Guidance Notes (2015), page 11

- 8.12 For these reasons the sale price of land is distinct from a benchmark land value and is not usually relevant in the context of standardised viability appraisals submitted as part of the planning process which are normally based on current day values. Where site value does not take full account of the Development Plan or CIL charges, where market land transactions are not fully evidenced and genuinely comparable, or where transactions are based on growth assumptions and have not been appropriately adjusted, the Market Value approach will not be supported.
- 8.13 The same approach will apply when determining land value on sites that may be subject to planning permission in principle. Site values that do not fully reflect Development Plan Policies including affordable housing requirements will not be accepted.

Alternative Use Value

- 8.14 Where a benchmark land value is based on an alternative use, this should be realistic and comply with planning policy¹⁸. The Mayor's Housing SPG states that an *Alternative Use Value* (AUV) approach to determining a benchmark land value should only be used if the alternative use would fully comply with development plan policies and it can be demonstrated that the alternative use could be implemented on the site in question¹⁹.
- 8.15 Where an applicant intends to rely on an alternative use valuation they should provide information to enable the authority to determine whether the scheme is capable of securing consent and demonstrate that there is market demand for the alternative use. A viability assessment for the alternative use should be submitted which includes the full costs of developing the site in the alternative use.

Residual Land Value

- 8.16 The residual land valuation approach is sensitive to small changes in value and cost inputs which can significantly change the resulting land value that is generated. The *comparison method* of valuation can be used to cross-check the residual land value. This uses market evidence as a basis of assessing whether a residual land value realistically reflects market conditions as required by PPG. In some circumstances, such as where a residual land value is significantly lower than transacted land values²⁰, it may be necessary to revisit relevant inputs in an appraisal (such as profits/costs) to ascertain whether these are appropriate and realistic.

¹⁸ PPG paragraph 24

¹⁹ Mayor's Housing SPG (2016), paragraph 4.1.6

²⁰ These should be comparable, reflect Development Plan Policies and be consistent in approach or adjusted accordingly

VIABILITY REVIEW MECHANISMS

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

10

MAYORAL 'CALL-IN' APPLICATIONS

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



LONDON
BOROUGH
VIABILITY
GROUP

