WALTHAM FOREST LOCAL PLAN

DEVELOPMENT MANAGEMENT POLICIES - EXAMINATION

Matters and Issues for Examination in Public:

Affordable Housing
Policy DM3

Hearing Session – 21 May 2013
Agenda Item 1

1. Background

1.1 In accordance with CS2 B (ii), in order to deliver the maximum reasonable amount of affordable housing, applications on all sites capable of providing 10 or more homes which propose less than 50% affordable housing, will need to demonstrate a viability case, in the form of a viability assessment. Where a viability case is used to justify an affordable housing offer below policy requirements and agreed by the Council, the Council will require the shortfall to be treated as a deferred contribution.

1.2 The NPPF (paragraph 173) states, "p*ursuing sustainable development requires careful attention to viability and costs in plan-making and decision-taking. Plans should be deliverable. Therefore, the sites and the scale of development identified in the plan should not be subject to such a scale of obligations and policy burdens that their ability to be developed viably is threatened".*

2. Main Issues

- Industrial Property Investment Fund in representation dmpps136 state that deferred contributions should apply flexibly in new housing development.

- London and Quadrant in representation dmpps59 states that the DM DPD should include reference to the publication of further guidance. This guidance should be more explicit about the cut-off point for deferred contributions, the level of flexibility that can be applied and the possible approaches to agreeing where such flexibility must be applied.

- Q24 states that paragraphs 4.7 – 4.12 give detail to the policy and an explanation of the process and so perhaps are the policy. They do not appear to contain any justification for their provisions.

3. Council's overall view of and response to, representations and Inspector's questions. Presentation of proposed amendments.

3.1 Seven individual representors made comments on DM3. These representors were Aviva Life and Pensions UK Ltd, Industrial Property Investment Fund, Islington & Shoreditch Housing Association, London & Quadrant Housing Trust, National Grid Property Holdings Ltd, North East London NHS Foundation Trust and The Greater London Authority. The Council's initial response to their comments can be found in document SD17 (Part I - Summary of Representations and Council's Response Regulation 22(1)(e). The Inspector then provided a number of additional questions. The answers to these questions are set out in document KE154 (Council Response to Inspector's Questions). The Inspector stated that he agreed with the Council's responses and that the proposed modifications deal with his concerns about the clarity and effectiveness of the plan. However, he states that there still remains the question of justification for the implementation processes of DM3, which relates to his question 24.

4. The Council's Position

4.1 Flexibility of Deferred Contributions

4.1.1 In relation to both Industrial Property Investment Fund and London and Quadrant concerns, the principle or requirement of deferred contributions has been clearly established in the Core Strategy. As policy CS2 B part ii states, *"where a viability case is used to justify an affordable housing offer below policy requirements, the Council will **require** the shortfall to be treated as a deferred contribution."* It is the Council's view that sufficient flexibility is provided in the fact that development can proceed with a level of affordable housing provision which is less than policy requirements (e.g. 50%). The policy then states, *"**require** that subsequent assessment to be undertaken when the scheme is completed and largely occupied and should viability have **improved** the Council to seek and further payment...".* Additional flexibility is provided in the fact that further contributions are only sought if it is demonstrated that viability has improved. DM3 in no way seeks to alter this requirement. It is the Council's view that development viability is therefore at the heart of this process. If anything, DM3 seeks to provide greater flexibility by only seeking deferred contributions to be applied to major development (e.g.10 units or more).

4.1.2 It is the Council's view that the use of deferred contributions is the most practical and flexible way to both maximise affordable housing provision whilst also maintaining development viability in order to ensure developments proceed.

4.2 Dynamic Viability Model

4.2.1 For clarity, it should be noted that Dynamic Viability and Deferred Contributions are separate mechanisms. As the Core Strategy paragraph 5.44 states, *"where housing supply is threatened by the economic conditions the Council will consider on a site by site basis: The amount of affordable housing provision proposed in relation to the 'Dynamic Viability Model'*." It is the Council's view that L&Q's proposed additional text to paragraph 4.5 is considered unnecessary as it is covered in the Core Strategy.

4.2.2 In relation to the inconsistency in the text, the Council propose to delete paragraph 4.7, thus L&Q's proposed amendment is now void.

4.3 Effectiveness of the Implementation of Policy DM3

4.3.1 The following seeks to provide additional justification, as asked for in Inspectors Question 24, to the Council approach to the implementation of policy DM3.

<u>Restriction on Occupation</u>

4.3.2 Where viability of a scheme is to be reviewed post grant of planning consent there must always remain a possibility that an additional payment can fall due.

This would arise where the viability of the scheme has improved to the point where the developer's target profitability has been met and the scheme is generating profit beyond this level.

4.3.3 In the circumstance where such a payment is required through the S106 Agreement, the obligation to make the payment runs with the land rather than with the developer or applicant.

4.3.4 It is common practice for developments to be carried out through special purpose vehicles (SPV's). These are limited companies specifically set up for the development which are designed to limit risk to the parent holding company. When a housing scheme is completed any residual profit within the SPV is usually transferred to the main holding company leaving the SPV as a shell company with no assets or capital.

4.3.5 If an additional payment subsequently falls due and there are no funds available within the SPV to meet the payment then the Council cannot practically enforce the payment obligation on the developer. The only remaining option would be for the Council to pursue the debt directly from the residential occupiers of the scheme. This would be both a cumbersome and potentially punitive action against parties who through no fault of their own had inherited the developer's debt.

4.3.6 Restriction on occupation avoids this possibility. The aim is that the value of the units retained should marginally exceed the maximum potential payment due to the Council. In this way there remains a financial advantage to the developer to make the payment.

4.2.7 Restriction of a lower value number of units could create a situation where it is financially advantageous to the developer to leave the units vacant rather than make the payment. This would clearly be an unsatisfactory outcome.

Basis of Assessment

4.2.8 The commonly accepted basis for reviewing viability of development schemes is through use of the residual valuation method. This is summarised briefly below:

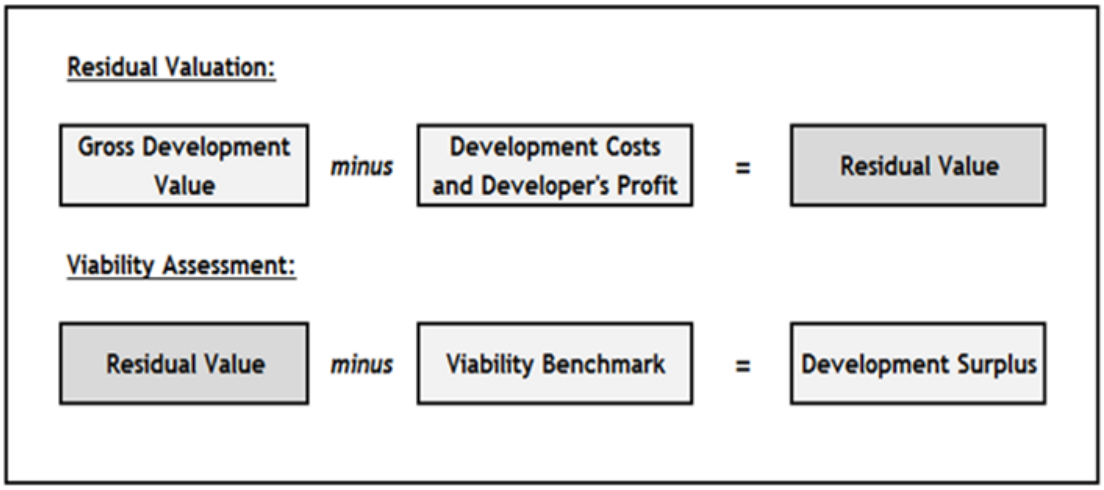
4.2.9 Viability for planning purposes is based on the principle that if the residual value generated by the proposed scheme does not equal or exceed an appropriate land value benchmark it can be viewed as none viable and consequently unlikely to be implemented. A fundamental issue in considering viability assessments is whether an otherwise viable development is made unviable by the extent of planning obligations or other requirements.

4.2.10 Financial viability for planning purposes is defined by recently published RICS Guidance1 as an *"objective financial viability test of the ability of a*

[1] RICS, Financial Viability in Planning, 1st Edition Guidance Note, August 2012

development project to meet its costs including the cost of planning obligations, while ensuring an appropriate site value for the landowner and a market risk adjusted return to the developer in delivering that project." This reflects the NPPF principle that in order to ensure viability, developments should provide competitive returns to a willing land owner and willing developer to enable them to be deliverable.

4.2.11 Development appraisals work to derive a Residual Value for a proposed scheme, which can then be compared against a viability benchmark so as to indicate whether the proposed scheme is economically viable. This approach can be represented by the simple formula set out below:



4.2.12 Development costs include elements such as planning obligations, professional fees, finance charges and contingencies as well as the necessary level of 'return' that would be required to ensure developers are capable of obtaining an appropriate market risk adjusted return for delivering the proposed development.

4.2.13 It is standard practice, endorsed by RICS Guidance, that when determining planning applications, the aim should be to reflect industry benchmarks. LPAs should therefore disregard who is the applicant, except in exceptional circumstances (such as personal planning permissions, as planning permissions run with the land). In formulating information and inputs into viability appraisals, these should accordingly disregard either benefits or disbenefits that are unique to the applicant, whether landowner, developer or both.

4.2.14 In determining viability the residual value should be compared to an appropriate land value benchmark.

4.2.15 There are currently a number of conflicting approaches to defining the appropriate benchmark. The NPPF 173 suggests that:

4.2.16 *"...development identified in the plan should not be subject to such a scale of obligations and policy burdens that their acceptability to be developed viably is threatened. To ensure viability the costs of any requirements [for affordable*

housing and other requirements] should, when taking account of the normal costs of development and mitigation, provide competitive returns to a willing land owner and willing developer to enable the development to be delivered"

4.2.17 This statement has been interpreted through from a variety of sources to suggest that in relation to the land value an additional sum should be allowed for over and above existing use value (EUV) as an incentive for the site to be released for development.

4.2.18 The logic being that if a landowner is unable to generate a value that exceeds the EUV there would be no reason to sell the land for development. This would lead to restriction on the supply of development land.

4.2.19 There is the potential to consider the incentive component of land value either as a fixed margin over EUV or related to the specific circumstances of the site.

4.2.20 EUV is described by the RICS Red Book as follows:

4.2.21 *"The estimated amount for which an asset should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion – assuming that the buyer is granted vacant possession of all parts of the asset required by the business, and disregarding potential alternative uses and any other characteristics of the asset that would cause its market value to differ from that needed to replace the remaining service potential at least cost.*[2]*"*

4.2.22 In effect EUV ignores the potential for an alternative use but otherwise represents market value.

4.2.23 Where a site has a potentially higher alternative use value (AUV) accessible only though the grant of planning consent, the potential for uplift over EUV is represented by the margin between EUV and AUV. For simplicity this is referred to as the "margin".

4.2.24 It is generally only this same margin that is also available to fund planning obligations.

4.2.25 Land is generally sold through a competitive process such as described in the RICS definition of Market Value i.e. '*an arm's length transaction after proper marketing'.* Naturally in a competitive process developers will be tempted to bid to the maximum of scheme viability to secure land, without which they will not be able to work as a developer.

4.2.26 If the land purchase price includes the EUV and the entire margin as an "uplift" there is nothing left available to fund planning obligations. Therefore

[2] RICS Valuation – Professional Standards Incorporating the International Valuation Standards March 2012Global and UK Edition

Market Value or price paid if adopted as a viability benchmark will result in schemes providing no planning obligations.

4.2.27 It is therefore important to ensure that there is a balance retained in the application of "uplift" or additional return to a landowner over EUV. RICS Guidance, Financial Viability in Planning 2st Edition 2012 states:

4.2.28 *"Site Value should equate to the market value subject to the following assumption: that the value has regard to development plan polices and all other material planning considerations and disregards that which is contrary to the development plan."*

4.2.29 This statement recognises the need for balance but does not seek to determine how an appropriate balance is offered in sharing the margin between the land owner and planning obligations.

4.2.30 The GLA has also issued guidance The Affordable Housing – Development Control Toolkit: Guidance Notes (2012) from which the following extract has been taken:

4.2.31 *"The approach has been very much bolstered in the report by Mr Keith Holland, the Examiner appointed by the Mayor of London to evaluate the London Community Infrastructure Levy. The planning Inspector stated in response to an alternative (and 'market value') approach being promoted by the Royal Institution of Chartered Surveyors"*

4.2.32 *"The market value approach is not formalised as RICS policy and I understand that there is considerable debate within the RICS about this matter. The EUV plus a margin approach was used not only by the GLA team but also by several chartered surveyors in viability evidence presented to the examination. Furthermore the SG at paragraph 22 refers to a number of valuation models and methodologies and states that there is no requirement for a charging authority to use one of these models. Accordingly I don't believe that the EUV approach can be accurately described as fundamentally flawed or that this examination should be adjourned to allow work based on the market approach to be done".*

4.2.33 This statement suggests that approaches other than market value should be considered acceptable.

4.2.34 The RICS Guidance offers the additional statement in respect of the need to have regard to the specific circumstances of the scheme under review;

4.2.35 *"3.3.2 The benchmark return, which is reflected in a developer's profit allowance, should be at a level reflective of the market at the time of the assessment being undertaken. It will include the risks attached to the specific scheme. This will include both property-specific risk, i.e. the direct development risks within the scheme being considered, and also broader market risk issues, such as the strength of the economy and occupational demand, the level of rents and capital values, the level of interest rates and*

availability of finance. The level of profit required will vary from scheme to scheme, given different risk profiles as well as the stage in the economic cycle."

4.2.36 It is clear from the above that site specific circumstances are highly relevant. In this context the application of a blanket approach to "uplift" on EUV would appear to run contrary to this advice.

4.2.37 The Council's guidance to applicants makes the following statement:

4.2.38 *"The Council will expect to use the Residual Land Value approach with viability tested against existing use value or where, a former use is capable of resurrection, alternative use. The Council will, in general, not accept a premium on existing use value unless it can be demonstrated that development will result in extinguishing an existing business or there is a complex site assembly involved in the scheme. Where this is the case appropriate evidence will be required."*

4.2.39 This guidance seeks to establish a number of important principles:

4.2.40 1) Where reliance on alternative use value is made it should relate to a real possibility of resurrection an alternative use for which either a consent has been issued or where the use was previously established. This avoids detailed discussions about hypothetical alternative uses which are not the subject of the planning application and which will not be determined for their suitability in any formal planning process. This approach is consistent with GLA Guidance issued on definition of alternative use

4.2.41 2) The general approach to establishing the element of "uplift" available in addition to EUV should relate to site specific circumstances. Where a land owner holds a vacant property, which is vacant and functionally obsolete, he will be liable for empty rates, security and insurance. These are substantial costs. In some circumstances redevelopment may be the only route to minimise these outgoings. In this instance the land owner will require much less of an incentive to release land for development than compared to say a land owner running a viable business who would be faced with substantial relocation costs and possible business disruption. Equally a developer who has been involved in assembling a site should also be entitled to a return on the risks involved.

4.2.42 3) The burden of proof should remain with the applicant to prove the case for the degree of "uplift" required to release the land for development and relate this to the circumstances of the site

4.2.43 The Council guidance therefore not only reflects an approach which is based on EUV plus which is consistent with available sources of guidance apart from the RICS. It reflects a site specific approach which is consistent with the logic of a site specific viability appraisal. It also reflects an approach which seeks to apportion the margin of value created by the grant of planning consent between the land owner and the delivery of planning obligations.

4.2.44 Further support for the EUV plus approach is set out below:

4.2.45 The Affordable Housing – Development Control Toolkit: Guidance Notes (2012). This guidance has no formal planning status but is a source of published guidance on this subject. It states that the benchmark value should relate to its existing use value (EUV); this being the value of the site in its existing use according to the current planning land use designation and disregarding its development potential. However, it adds that there is a well-established and accepted precedent from appeal rulings and several Core Strategy examination processes, that an 'EUV Plus' approach should be considered appropriate. This approach reflects the fact that a landowner is unlikely to release land for development unless it generates a value above existing use.

4.2.46 The Local Housing Delivery Group Report, "Viability Testing of Local Plans"[3] published in June 2012 suggests that the site value benchmark, "Threshold Land Value" should represent the value at which a typical willing landowner is likely to release land for development. It states that different approaches to Threshold Land Value are currently used within models, including consideration of:

- Current use value with or without a premium
- Apportioned percentages of uplift from current use value to residual value
- Proportion of the development value
- Comparison with other similar sites (market value)

3 The Local Housing Delivery Group is a cross-industry group set up in 2011 to respond to the Government's challenge to boost the delivery of new homes