



# ASSET



## THE AUTHOR:

Anthony is a Senior Director at chartered surveyors BNP Paribas Real Estate, leading one of the industry's longest established affordable housing consultancy teams. He is a specialist in development economics, financial modelling and valuation, and advises clients in the public and private sectors on a range of affordable housing issues. He has recently advised local authority and developer clients on major strategic residential developments in London (e.g. New Wembley, Stratford City) and Bristol (Stoke Gifford), providing a total of circa 33,000 housing units. His team is currently advising London Borough of Wandsworth on the redevelopment proposals at Battersea Power Station.

In 2009, Anthony was appointed to the RICS panel, Expert Advisors in Planning Service, to advise the Planning Inspectorate on affordable housing viability evidence submitted by local authorities at Local Development Framework examinations. He has recently completed assessments of viability studies at Stockton, Hinckley & Bosworth and East North Northants.

# PLANNING AND VIABILITY: DELIVERING AFFORDABLE HOUSING IN CHALLENGING MARKET CONDITIONS

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## CONTENTS:

AFFORDABLE HOUSING

VIABILITY

FOUNDATIONS OF THE RECOVERY

BUILD COSTS

HOW ARE LOCAL PLANNING AUTHORITIES REACTING?

DEFERRED / CONTINGENT OBLIGATIONS

CASCADES AND FOUNTAINS

CASE STUDIES

AFFORDABLE RENT TENURE

WILL THIS NEW TENURE HELP THOSE IN GENUINE NEED OF AFFORDABLE HOUSING?

VIABILITY AND APPEALS

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## Affordable housing

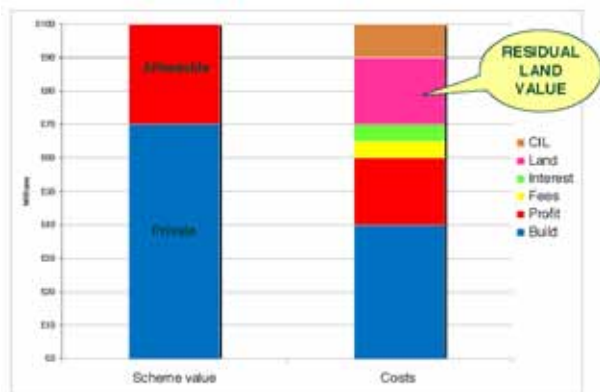
This is clearly a priority for Local Authorities. More and more affordable housing has been delivered through the Planning system and s106 agreements but, as a result of falling house prices, that system is now very much under pressure. Increasingly we now see the Planning system mediating between the various interest groups in development, such as landowners, developers and Planners themselves as representative of a body that wants to secure part of the value of a scheme. Any scheme has value and that value needs to meet a number of requirements for any scheme to go ahead.

The costs of a scheme are as follows:

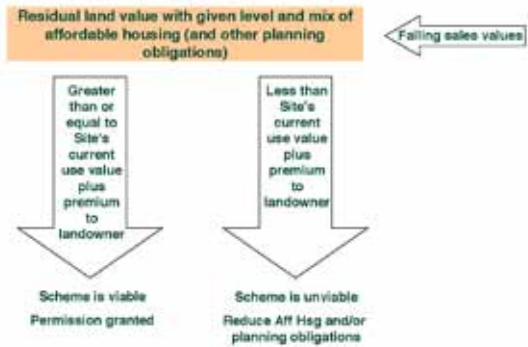
- The cost to build the scheme;
- The profit to the developer;
- Fees and interest charges to go to the bank or lenders
- The financial contribution towards infrastructure / affordable housing;
- The value of the land. If there is no land value to bring the site forward, it will not come forward.

## Viability

The planning system is grappling with those issues when at a time when scheme value is falling. The planning system will define viability by reference to the residual value of the scheme with any given level of affordable housing at hopefully target levels and any other planning obligations. It is then considered whether or not that residual value is greater than or less than the value of the site in its current use. So if the scheme exceeds that test then the scheme will proceed. If not then the scheme will not proceed and you will need to reduce the affordable housing or other planning obligations.



With falling sales values, more sites become unviable and so require a reduction in affordable housing unlike viable sites that meet policy requirements.



## House Prices

The potential for planners to capture land value is currently difficult given the significant fall in house prices in London and throughout the UK.



House prices saw a significant increase up to 2007, a significant fall in 2008 and then a recovery from the middle of 2009. Even with the recovery now going flat, we are still in a better position than at the time of the Lehman Brothers collapse.

Nevertheless it is a patchy recovery. The London Boroughs of Islington and Newham are still attracting buyers strongly due to a number of factors including its central location to the city. Newham on the other hand has seen a lesser recovery with, possibly, a slight reverse from last year.



So the recovery across London is consistent and the picture outside London is different again. Some areas such as the

North East have seen no recovery whereas in Yorkshire and Humber and the Northwest only a slight recovery has taken place.



It is therefore difficult to make schemes work outside London.

## Foundations of the Recovery

Is this recovery built on solid foundations? If we look at sales volumes we can see that historically sale volumes were much higher. Current sale volumes are insufficient to show that the market has recovered strongly and it is likely that sale volumes will continue in their current fashion over the next couple of years until we see volumes increasing again.



## Build Costs

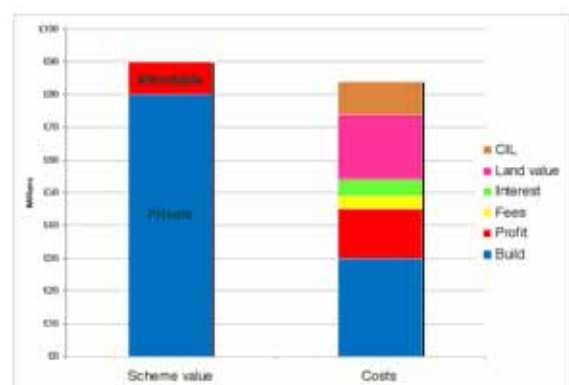
On the other hand viability has been aided to some degree by the fall in build costs as contractors have cut their margins and profits to secure work. This has helped to partly offset the fall in sales values and to help schemes proceed. The RICS is predicting a slight increase in build costs over the next few years but that does not take into account the cost irregularity in terms of the Code for Sustainable Homes, anything of that nature would increase costs even further. But then we also need to consider that the commercial value of sites has also increased. The value of commercial sites has followed a similar pattern to residential values in that they fell and started to rise again.



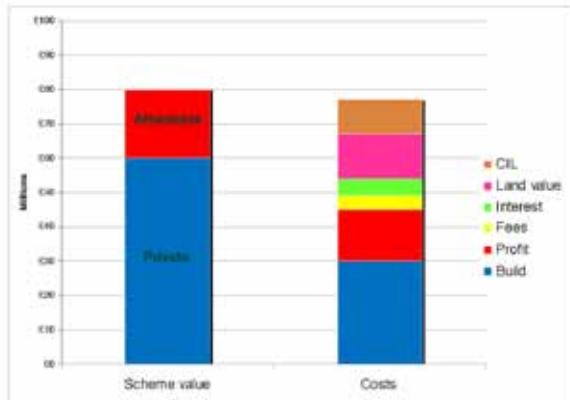
Focussing on the blue shaded area the value of all other types of use that might come forward as residential sites is also increasing so retaining those uses is becoming more attractive again and the driver to convert to residential may be less strong. This will present difficulties for planners in securing sites for residential at the values they need to be at.

## How are Local Planning Authorities reacting?

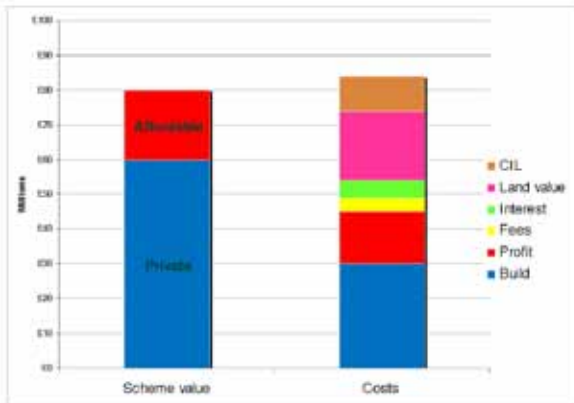
LPA's are being told by Greg Clarke to renegotiate all those S106 requirements that are making schemes unviable and preventing development from proceeding. I would argue that it is the lack of finance rather than S106 requirements that has been preventing development. How can an LPA respond? Well the obvious thing to do is to look at the affordable housing level in those schemes, in order to improve the scheme's viability and bring things back into balance.



The difficulty is that this increases the risk of the scheme as you have got more to sell which is clearly undesirable for Local Authorities. Alternatively the developer could be encouraged to accept a reduction in the land value.



That may be possible on a greenfield site where there is no alternative use as opposed to on brown field where the opposite would most probably be true. Finally what you could do is look at decreasing the financial contributions for CIL if you have it, although this does have its own negative implications.



Local Authorities are saying, quite fairly, that if they forgive planning obligations then they should share in any upside of that scheme. There is whole range of examples where policy requirements are being applied more flexibly to reflect the change in values.

## Deferred / Contingent Obligations

With these obligations there are a number of points to consider. For a single phase scheme there is only the option to review before the scheme has started, but in schemes with multiple phases it may be possible to look again after the first phase to determine how to proceed with the latter phases. You would need to think about when you would review scheme viability and what the trigger points are. There are many points where you could review, each with its own benefits and problems. It would also be necessary to think about how long a review should last before it is discarded and reviewed again. For example, it might be put to the developer that if they do not proceed within a year, they must allow the LPA to consider if anything has changed.

In that scenario, consider what the minimum and maximum affordable housing levels might be. An option could be to agree

with the developer to reduce the requirement for affordable housing in the first phases of a development, and to build in the capacity to require that the amount can be increased, over policy levels, in the later phases so that the overall required level is attained.

## Cascades and Fountains

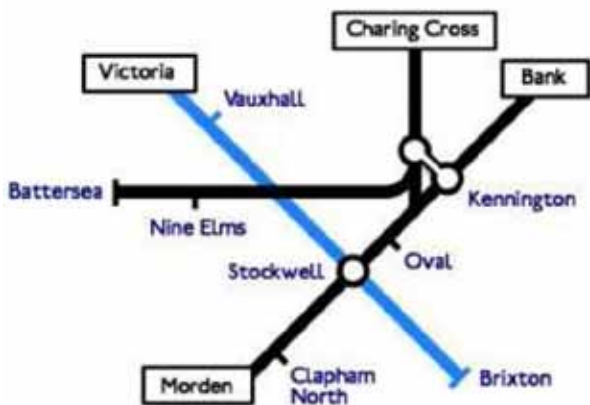
These are related to grant funding. Grant funding has now gone, so the idea that we had a 'cascade' where we start with one level of affordable housing and this would come down if the level of grant decreased, has ceased to exist. Instead, there is now a 'fountain' situation where we fix the level without grant and then increase the affordable housing requirement if, by some miracle, grant does later become available.

## Case Studies

The Leamouth Peninsular is one example of where policy is being implemented flexibly by the London Borough of Tower Hamlets to allow a developer to provide a limited amount of affordable housing on the initial phase of the site so the scheme retains viability. However, if the trigger level is reached in subsequent phases whereby the value of the development has increased then the developer will provide a cash contribution to the Authority to provide affordable housing in other parts of the Borough.

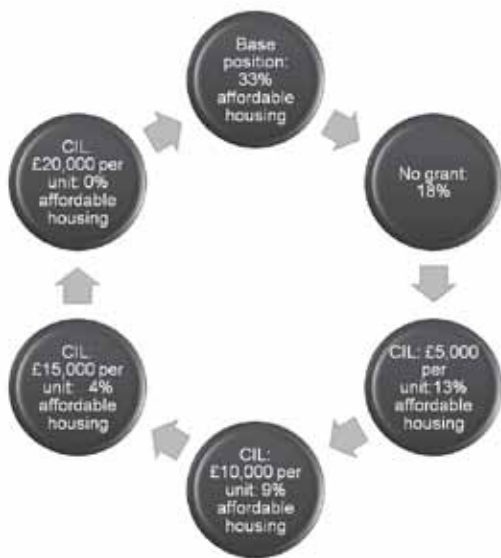


The Battersea Power Station redevelopment is an example of where the timing of obligations is important. The key to this success of this scheme is the Northern Line extension that will serve the site. Without this the scheme is compromised as the commercial elements will probably not be let and the residential sales values may be at risk. There are a number of parties involved in this discussion including Treasury UK, the investors who will fund the scheme, the London Borough of Wandsworth and Transport for London. They share a common interest to maximise the value of that scheme as that unlocks finance from the investors, unlocks the Treasury holdings and secures affordable housing and S106 payments for Wandsworth. The party that benefits least from this scheme is TfL that says that whilst they will deliver the Northern Line extension, they are not going to put the money up front. The Treasury and the investors on the other hand argue that paying upfront will not result in an acceptable IRR so there is a stalemate between these parties in terms of when that money is delivered.



Within that context it is important to say that there are many competing demands from schemes from the Planning system but we cannot always meet all those needs at all times. For example there will always be tension between delivering infrastructure and delivering affordable housing.

Here we have a hypothetical scheme.

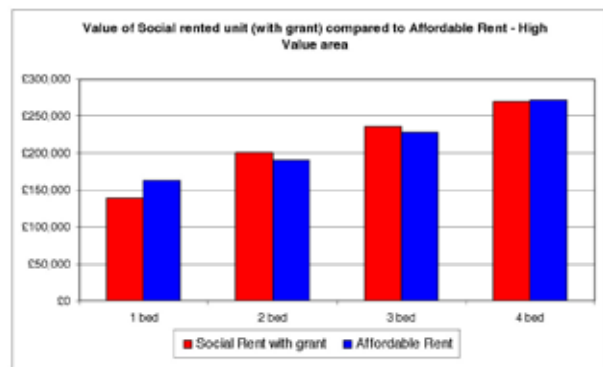


We start with that scheme delivering 33% affordable housing as the base position at the top. If you were to take the grant away you are down to 18% of affordable housing already before we even start to introduce infrastructure requirements and then as we go round what we are doing is imposing increasing levels of CIL with the result that the potential for those schemes to deliver affordable housing becomes ever more eroded until eventually you squeeze out the potential for affordable housing altogether. In future the idea that it is possible to secure everything we need from development is clearly going to be challenging. In terms of Government reforms for affordable housing, it is important to question at this point the type of affordable housing that authorities want and need and whether the new system will deliver?

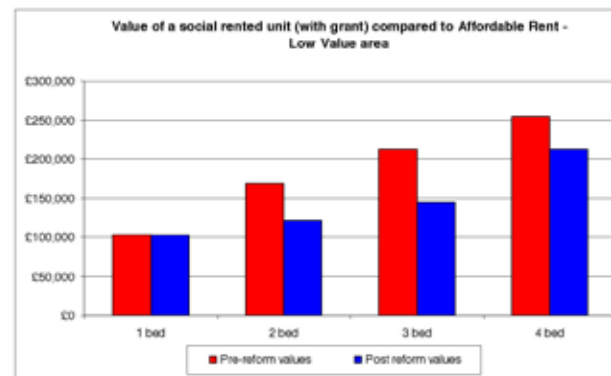
## Affordable Rent Tenure

In February 2011 Government announced an affordable housing programme framework for the next 5 years to guide affordable housing delivery through the RSL sector and the planning system. Government says that it expects to not to any grant for schemes delivered through S106 agreements but they expect the RSLs who acquire this job from developers to pay the value of the rental stream and nothing more. RSLs are therefore being expected by Government to increase the rents for affordable housing in some cases to up to 80% of market rent, whereas at the moment affordable housing rents tend to be around 40-50% of market rents; clearly a very significant increase.

Will this still provide viability for affordable housing schemes? The answer is 'yes but no but', and if we look at the current system (social rent with grant).

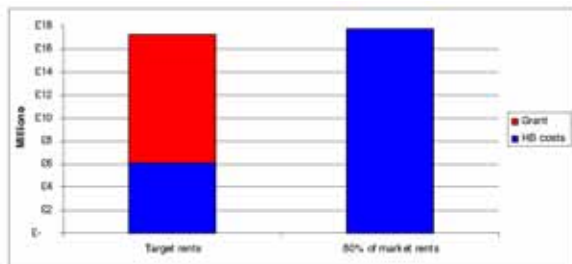


And then compare that to what would happen under the new Affordable Rent tenure we can see that in high value areas, where Tower Hamlets would be typical, the value the RSL would pay under the old system compared to the new is more or less the same. However, as soon as we move out of Central London to the outlying boroughs and beyond we can see that the values the RSL would pay under the new system compared to the old will fall substantially. This will certainly affect the level that affordable housing schemes can provide, a big concern for Local Authorities in those areas.



To compound that there will be possible future changes and Government might possibly roll back from where they are at

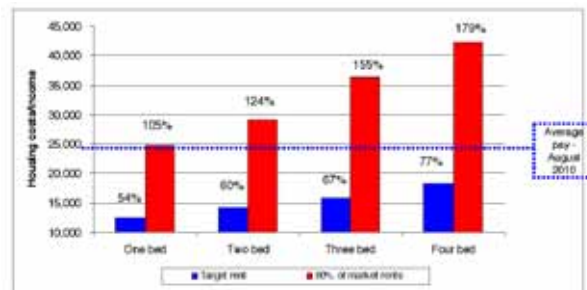
the moment. Yes we will save money on grant funding, and the RSL stock becomes more valuable because the rent is higher and so the capacity to borrow from the private sector increases. But the long term cost of what Government is doing, and if compare the cost of upfront funding to the long term cost of Housing Benefit, which will inevitably increase, it is apparent that more difficulties lie ahead.



The left hand side of this chart shows the cost over a 20-year period of the old system of target rents paid largely through Housing Benefit and upfront grant subsidy from Government. We see that on a 100 unit scheme the cost is around £17million, but then if you compare that to the cost over the same period of the new Affordable Rent tenure we can see that the cost is almost the same. The result is that Government does not save any money, but is effectively storing up a problem, as there are potentially 2.24 million existing tenancies that might transfer over to these higher rents, largely backed by Housing Benefit that could lead to an explosion in the Housing Benefit bill. This creates problems for viability and may have to be rolled back in future.

## Will this new tenure help those in genuine need of affordable housing?

If we consider that rents will increase threefold in many cases, the income level you need to pay that level of rent, without benefit support, will clearly be much higher and we need to consider that Government is capping Housing Benefit claims to £26,000 per household per annum so if your rent was, for example, £20,000 per annum for your family home it does not leave much to pay other bills and for food. I do not think that many Local Authorities in high value areas will accept rents at 80% of market rent therefore who is this new tenure for? Clearly it is not for people in the most urgent housing need. The question is, and the graph underlines this point, under the current target rents you need to be earning 54% of average earnings in order to pay the rent on a one bedroom flat, but under the new system you would need to be earning 105% of average earnings to afford the same flat and the problem becomes worse with family housing; for a 4 bed flat you needed to be earning 77% of average earnings before, but that goes up to £179% of average earnings on the new tenure.



## Viability and Appeals

Many schemes go to appeal and Inspectors can effectively set precedents through their decisions. Some schemes have gone to appeal offering zero affordable housing, for example

154 -160 Croydon Road The inspector argued that policy 30.10 of The London Plan is subject to viability; therefore if a developer proves that no affordable housing is viable that can be deemed policy compliant. In this particular case the scheme value was less than existing use value so the Inspector concluded that there was no justification for a requirement for 35% affordable housing and the scheme proceeded with zero affordable housing.

516 – 520 Commercial Road The Inspector here took a completely contrary view on the question of affordable housing and said that the developer had bought the site at the peak of the market and it was not for the Planning system to unwind the developer's problem that they had got themselves into. The Inspector saw that the scheme was unviable with or without affordable housing so therefore all removing the affordable housing would do is make the loss slightly lower so he took the view that he may as well grant consent but require some level of affordable housing. The Secretary of State often has to mitigate between these issues of affordability and viability so whose side is he on?

Ram Brewery, Wandsworth (November 2009) Under the former Labour Government the Secretary of State took the view that 11% was simply too far below the lowest level of the policy aim in Wandsworth so therefore it did not comply with the aims of the LDF and could not be granted.

Goldhawk Road, Hammersmith (October 2010) Mr Pickles, the current Conservative Secretary of State, took the view that that whilst in excess of 6% affordable housing at that scheme was preferable, the appellant proved that 6% was all that can be afforded, and therefore that is the maximum amount the scheme can reasonably provide. It is interesting to consider whether Planning Inspectors are shifting their views on viability as the recession has gone on and many are dealing with a proposition put to them by Local Authorities, i.e. Cannot we simply wait until we have a better market condition when the scheme can provide more affordable housing?

High Wycombe (May 2009) The appellant argued that Council would not have a 5-year land supply if affordable housing were required on every site. The Inspector thought there was

a healthy land supply (historically) and therefore there was no urgent need for the appeal site to come forward.

Banbury Park, Waltham Forest (October 2010) Both parties agreed this was a strategic site and therefore important that development goes ahead but both parties also agreed there was a lack of viability. The council's own borough wide study said that 20% was the maximum viability amount for affordable housing but on this particular appeal site the level was at 40% so by taking this approach they would simply have switched off all the land supply across the borough. The decision has not yet been reached so it will be interesting to see what happens.

## Conclusions

Clearly affordable housing needs are will never be fully satisfied through the Planning System. There will always be a greater need than can be supplied and the challenge is to try to strike the balance between viability and maximising affordable housing supply as it is clear that we cannot tap the landowner for unlimited requirements of both affordable housing and payments for infrastructure. It is essential to recognise that there is only one pot to be shared out amongst all the parties. In the current market, the short term capacity to meet all the Local Authorities' requirements will be limited so a balance needs to be struck between affordable housing and other payments. In my view the Affordable Rent tenure will not be the answer to the problems raised by lack of grant and may not be the answer for Local Authorities who are trying to meet housing needs.

Finally it is important to stress that flexibility from all parties will be key to delivery.