



Development Viability SPD

March 2016 (Cabinet Version)

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Foreword



Southwark has a strong record of securing new affordable homes, along with a wide range of other benefits for local people through the planning process. We also know that public support and understanding of the development process is important, and this Development Viability SPD sets out how we will make the process more transparent.

In Southwark there is a desperate need for homes of all kinds, but especially new affordable homes. This is why we have the most ambitious council home building programme in the country, but we know that to meet demand we also need to secure as many new affordable homes from developments as possible and this is why we have a policy that all new developments should provide at least 35% affordable housing. We want to work with housebuilders and developers in a straightforward, efficient and clear manner to attract investment into our borough.

Viability is playing an increasingly pivotal role in the development process. Development will only go ahead where a scheme provides acceptable returns to landowners and developers. As such, where a proposed scheme faces genuinely challenging finances, we may negotiate on certain planning policy requirements, where this flexibility will allow development to proceed. Simply demonstrating viability is not enough. We will still want to be satisfied that the proposal is of a high quality and makes a positive overall contribution for the future our borough and our residents.

Inconsistency in the assessment of viability is a risk to the sustainable development of our borough. For this reason we need to provide clear guidance to applicants regarding the viability assessment process and the standard of proof and quality of evidence in assessing viability. This SPD does just that. It shows when a financial viability appraisal is necessary to support an application, what information is required, when it is required and how it will be assessed. This provides clarity to applicants and ensures our residents have confidence that we apply our policies consistently and impartially. Where a viability appraisal is required to inform a planning application then the full viability assessment will be published ahead of that application being determined.

Councillor Mark Williams
Cabinet Member for Regeneration and New Homes

Development viability guidance summary

Pre-applications

DVG1 Applicants are strongly encouraged to submit a draft financial viability appraisal when seeking pre-application advice where a proposal is likely to trigger a requirement to provide affordable housing or where viability is likely to be a relevant consideration in respect of achieving planning policy compliance.

Applications

DVG2 A financial viability appraisal should be provided for a planning application to be validated where there is a planning policy requirement to provide affordable housing or where the proposed development departs from other planning policy requirements due to viability.

DVG3 Applicants should meet the cost of reviewing financial viability appraisals, or provide a solicitor's undertaking to pay, for an application requiring a financial viability appraisal to be validated.

DVG4 Financial viability appraisals should be accompanied by an executive summary which outlines the key conclusions being drawn from the appraisal.

DVG5 A revised executive summary should be submitted to the council prior to determination where the financial viability appraisal changes throughout the planning application process.

DVG6 Financial viability appraisals should be accompanied by a fully testable and editable electronic/software model which explicitly shows the calculations and assumptions used in the planning application.

Transparency

DVG7 Financial viability appraisals which support pre-application discussions will be treated as confidential.

DVG8 Financial viability appraisal executive summaries will be published upon the validation of planning applications.

DVG9 Financial viability appraisals supporting applications for full planning permission, outline planning permission and hybrid applications, will be published in full prior to determination.

DVG10 Any revised financial viability appraisal executive summaries will be published prior to determination of the planning application.

DVG11 The council will publish its assessment of financial viability appraisals one week prior to the determination of the planning application.

Market value of the proposed development

- DVG12 The market value (MV) of the site for the proposed scheme of development will be assessed in accordance with the RICS Valuation Information Paper 12 (VIP12) and the RICS Red Book. This assessment will assume planning consent for the proposed scheme of development.
- DVG13 The market value (MV) of the site should be calculated using the residual method of valuation to determine the amount available to pay for the site. This is the residual land value (RLV). The residual land value (RLV) should be cross-checked against market site comparables to ensure that the residual land value is consistent with prices being paid for sites in the market.
- DVG14 Where land is purchased unconditionally the onus is on the purchaser to make sufficient allowance for planning policy requirements and any other uncertainties with regard to site conditions, title, abnormalities, prevailing costs and revenues that may affect the viability of a policy compliant scheme

Calculating the benchmark land value

- DVG15 Benchmark land values (BLV) will usually be calculated with reference to the current use value (CUV) of the site, plus a financial incentive that would ensure the release of the land from its current use. This is called current use value plus (CUV+). The uplift (the “+” of the CUV) above the current use value (CUV) is calculated by deducting the current use value (CUV) from the market value (MV) where the market value (MV), takes full account of planning policy requirements for the proposed use. This approach clearly shows the uplift in value arising from the grant of planning permission.
- DVG16 Flexible application of planning policy requirements may be justified to enable the proposed scheme of development to proceed viably where the uplift from CUV to MV is insufficient to provide a competitive return to the landowner. In such cases any uplift above the CUV should be fully justified by the applicant and will generally be expected to be around 20% above the CUV.
- DVG17 An alternative use value (AUV) is the value of a hypothetical scheme of development that is an alternative to the proposed scheme. Where an applicant intends to demonstrate that an alternative scheme of development meets planning policy requirements and that there is market demand for the alternative use, the council will require an explanation why the applicant does not intend to proceed with an alternative scheme of development where it generates a higher value.

Viability appraisal inputs

- DVG18 Financial viability appraisal inputs should include all reasonably available details deemed necessary for the council to understand the valuations submitted for the market value (MV) of

the proposed scheme of development and the current use value (CUV) of the site.

- DVG19 Financial viability appraisal inputs should be clear, justified, in line with market norms and supported with appropriate comparables or other supporting evidence.
- DVG20 A schedule of site comparables should be provided with a fully justified analysis to enable a crosscheck of the residual land value (RLV).
- DVG21 There should be a clear and reasoned link between the evidence submitted and the conclusions drawn from the financial viability appraisal.
- DVG22 The assessment of viability is a calculation based on market assumptions. It should not take account of any specific inputs or assumptions peculiar to the applicant.

Viability reviews

- DVG23 A viability review will be required for development that does not provide a policy compliant level of planning obligations, such as affordable housing, due to viability. This review may use actual costs and/or revised sales values, and will assess whether the approved scheme has become more viable from the date that planning permission was granted to the date of substantial implementation.
- DVG24 Where a viability review demonstrates an improvement in a scheme's viability, 50% of the increase in the scheme's value will be returned to the developer and 50% to the council, up to the level that would be required for a policy compliant scheme. All additional surplus profits will return to the developer.
- DVG25 The timing of the viability review will depend on the nature and scale of the approved scheme. Generally, the viability review should be undertaken prior to occupation of no more than 25% of the development. The timing of viability reviews for schemes that have multiple phases will be agreed with the council.
- DVG26 Viability contingent payments to the council should usually be made prior to the occupation of 75% of the development. The review process for schemes with multiple phases may result in additional affordable housing in later phases, in place of a financial contribution.
- DVG27 In the event that secured planning obligations, including affordable housing, are reduced through negotiations or by statutory provisions, a viability review to actual costs and revenues will take place in order to identify any subsequent increase in viability at substantial implementation of the approved scheme.

1. Introduction

This Supplementary Planning Document (SPD) sets out our requirements for viability appraisals to be made public and the process for assessing viability appraisals. It will ensure the assessment of the viability of planning applications is efficient, consistent and transparent. The guidance supports the Development Plan by providing further detail on how we will implement our planning policies where viability is an issue. This SPD is not planning policy.

We expect all development proposals that trigger a planning policy requirement to provide affordable housing to provide the homes at social rent and not affordable rent. Where a proposed development is not viable we may apply our planning policy requirements flexibly to ensure that the development can take place. For example, we may accept less affordable housing than the minimum required through policy.

A viability appraisal is a statement that shows:

1. the existing value of a site, excluding hope value (its current use value);
2. the value of a site assuming planning permission has been granted for a new development (the market value);
3. whether a competitive return for the landowner and developer can be achieved, relative to the risk of development; and
4. the costs of building the proposed development that includes meeting planning policy requirements, and whether these requirements can be met, such as securing affordable housing.

Appendix 1 provides non-technical examples of how the viability of a theoretical scheme of development to build 50 homes would be assessed.

2. Policy context

The National Planning Policy Framework (NPPF), Planning Practice Guidance (PPG), the London Plan (2015), the saved policies of the Southwark Plan (2007) and our Core Strategy (2011) establish that the key purpose of planning is the delivery of sustainable development. Sustainable development requires new housing, including affordable housing, to meet our housing needs, competitive economies, thriving town centres, efficient transport and effective infrastructure.

The NPPF states in Paragraph 173 that careful attention to viability should take place to ensure that the burden of required or necessary planning obligations, such as affordable housing, do not threaten the viability of development, and provide a competitive return to willing land owners and developers when taking the normal costs of development into account.

Assessing viability demonstrates the scale of planning obligations which are appropriate. However, the National Planning Policy Framework (NPPF) is clear that where safeguards are necessary to make a particular development acceptable in planning terms, and these safeguards cannot be secured, planning permission should not be granted for unacceptable development.

Paragraph 23 of the Planning Practice Guidance (PPG) states that the assessment of land or site value is a key consideration and an important input into a financial viability assessment. It states there are a range of acceptable approaches to assess the value of land, but there are common principles which should be reflected in all cases. Land valuations should:

- Reflect policy requirements and planning obligations and, where applicable, any Community Infrastructure Levy charge;

- Provide a competitive return to willing developers and land owners (including equity resulting from those wanting to build their own homes); and be informed by comparable, market-based evidence wherever possible. Where transacted bids are significantly above the market norm, they should not be used as part of this exercise.

The approach to assessing land value set out in this SPD reflects these common principles

There are many important planning documents that are used to make planning decisions and provide further information on viability appraisals. The most important document for Southwark is our Development Plan which consists of the saved Southwark Plan (2007), the Core Strategy (2011) and the London Plan (2015). The London Plan is the Mayor of London's planning document for London. The saved Southwark Plan and Core Strategy define how regeneration and planning should take place in Southwark. Canada Water, Peckham and Nunhead and Aylesbury are also the subject of adopted Area Action Plans which are part of our Development Plan. We are currently preparing the New Southwark Plan which contains our emerging planning policies. The Development Plan policies for which this SPD provides guidance are:

Saved policies of the Southwark Plan (2007)

- Policy 2.5 Planning obligations
- Policy 4.4 Affordable housing
- Policy 4.5 Wheelchair affordable housing

Core Strategy (2011):

- SP5 Providing new homes
- SP6 Providing homes for people on different incomes
- SP8 Student homes
- SP14 Implementation and delivery

London Plan (2015)

- Policy 3.8 Housing choice
- Policy 3.9 Mixed and balanced communities
- Policy 3.10 Definition of affordable housing
- Policy 3.11 Affordable housing targets
- Policy 3.12 Negotiating affordable housing on individual private residential and mixed use schemes

The Mayor's Draft Interim Housing SPG (2015) is also an important document. Paragraph 4.4.28 states that the market value or current use value plus a premium approach to identifying the benchmark land value can satisfy the NPPF's requirement to ensure a competitive return to a willing landowner. The GLA has found the current use value plus a premium approach is generally more helpful for planning purposes. This SPD is consistent with the favoured methodology in the draft Interim Housing SPD (2015).

This SPD should also be read alongside:

- Southwark's Affordable Housing SPD (2008)
- Southwark's (draft) Affordable Housing SPD (2011)
- Southwark's Section 106 Planning Obligations and Community Infrastructure Levy SPD (2015)
- the Mayor of London's draft Interim Housing SPG (2015)
- the Mayor of London's Use of Planning Obligations in the Funding of Crossrail
- the Mayoral Community Infrastructure Levy (2013)

We have fully considered the cumulative impact of our planning policy requirements on development viability as part of the examination of our Core Strategy (2011) and CIL Charging Schedule (2015). The

New Southwark Plan Evidence Report Housing Policy Viability Study (2015) confirmed our housing planning policy requirements were set at a level that would be sustainable for most developments. This evidence-based approach is supported and required by the NPPF and PPG.

Our Development Plan documents are available on our website:
www.southwark.gov.uk/planningpolicy

The London Plan (2015) and the draft Interim Housing SPG (2015) are available on the GLA's website:
www.london.gov.uk/priorities/planning/london-plan
www.london.gov.uk/what-we-do/planning/implementing-london-plan/supplementary-planning-guidance/draft-interim-housing

3. When do we require a financial appraisal?

3.1 Pre-applications

DVG1 Applicants are strongly encouraged to submit a draft financial viability appraisal when seeking pre-application advice where a proposal is likely to trigger a requirement to provide affordable housing or where viability is likely to be a relevant consideration in respect of achieving planning policy compliance.

In accordance with the Planning Practice Guidance (PPG paragraph 001), we encourage potential applicants to seek pre-application advice prior to the submission of a full planning application. This is to ensure emerging development proposals comply with our adopted planning policies.

We strongly encourage the submission of a draft financial viability appraisal at the pre-application stage where a proposal is likely to trigger a requirement to provide affordable housing or where any subsequent full application is likely to rely on a financial viability appraisal to justify a departure from planning policy requirements. Failure to present a financial viability appraisal which has been prepared in accordance with the principles set out in this SPD will limit the quality of advice council officers are able to provide.

We acknowledge the level of detail that can be provided at the pre-application stage will vary from scheme to scheme and will depend largely on scale of the proposed development and how advanced the emerging proposal is. The draft financial viability appraisal will act as a useful tool in refining emerging proposals prior to submission of a full application.

3.2 Applications

DVG2 A financial viability appraisal should be provided for a planning application to be validated where there is a planning policy requirement to provide affordable housing or where the proposed development departs from other planning policy requirements due to viability.

DVG3 Applicants should meet the cost of reviewing financial viability appraisals, or provide a solicitor's undertaking to pay, for an application requiring a financial viability appraisal to be validated.

DVG4 Financial viability appraisals should be accompanied by an executive summary which outlines the key conclusions being drawn from the appraisal.

DVG5 A revised executive summary should be submitted to the council prior to determination where the financial viability appraisal changes throughout the planning application process.

DVG6 Financial viability appraisals should be accompanied by a fully testable and editable electronic/software model which explicitly shows the calculations and assumptions used in the planning application.

All planning applications which trigger a planning policy requirement to provide affordable housing or where viability is relied on as a material consideration are required to provide a financial viability appraisal. Failure to submit a financial viability appraisal will prevent officers having sufficient information to

determine the application. The financial viability appraisal should be prepared and presented in accordance with the guidance in this SPD.

The requirement to submit a standardised financial viability appraisal will reduce delays in processing and determining planning applications. It will ensure that we have the information we need to review effectively financial viability appraisals at the outset, thereby reducing the likelihood that further evidence will be required during the application process.

Financial viability appraisals should be accompanied by sufficient details to enable us to understand the scheme value and valuation assumptions relied upon by the applicant. Following a detailed review of a financial viability appraisal, we may identify a need for further justification to support the chosen inputs in the financial viability appraisal. Failure to provide further information may result in delays to the application or may affect an officer's recommendation.

A revised financial viability appraisal should be submitted where material changes are made to a proposal prior to determination that could affect the viability of the proposal.

All financial viability appraisals should be accompanied by a fully working Argus Developer¹ software model that can be tested. We recognise that for larger and more complex schemes, bespoke financial models are often produced using alternative software. We will accept alternative models provided they explicitly show the calculations and can be fully interrogated and the inputs varied.

An executive summary of the financial viability appraisal which summarises the key findings and conclusions of the financial viability appraisal for the lay reader should be submitted alongside the financial viability appraisal in order for the council to validate an application. The executive summary should provide a full supporting narrative to substantiate the inputs and assumptions made in the appraisal. This is to be a simplified version of the viability assessment that may aggregate costs and sales information. Table 1 details the key viability information that should be presented and explained in a financial viability appraisal executive summary.

Table 1: Financial viability appraisal executive summary key viability assumptions

Assumption	Amount
Gross Development Value	£
Acquisition Costs	£
Construction Costs	£
Professional Fees	£
Marketing and Letting	£
Disposal Fees	£
Finance	£
Developer Profit	£
Contingencies	£
Residual Land Value	£

Financial viability appraisals will be reviewed by the council or may be referred to appointed assessors. Applicants will be expected to meet the costs, as specified by the council, associated with reviewing financial viability appraisals in advance, including legal costs if appropriate. In the absence of a solicitor's undertaking to pay, fees should be upon validation of an application.

¹ Argus Developer is an industry standard software package widely used to assess the viability of development proposals.

4. Transparency

DVG7	Financial viability appraisals which support pre-application discussions will be treated as confidential.
DVG8	Financial viability appraisal executive summaries will be published upon the validation of planning applications.
DVG9	Financial viability appraisals supporting applications for planning permission, outline planning permission and hybrid applications, will be published in full prior to determination.
DVG10	Any revised financial viability appraisal executive summaries will be published prior to determination of the planning application.
DVG11	The council will publish its assessment of financial viability appraisals one week prior to the determination of the planning application.

There is a public interest in financial viability appraisals being available for scrutiny when relied upon to secure planning permission for development proposals that depart from the planning policy requirements of our Development Plan or where they have triggered a requirement to provide affordable housing. Public scrutiny strengthens public confidence in the evidence used to influence the decision of a planning application.

We will publish financial viability appraisal executive summaries upon the validation of planning applications. Where the viability of a development proposal changes during the application process revised viability appraisal executive summaries will be published prior to determination. Financial viability appraisals will be published in full one week prior to determination for all applications supported by a financial viability appraisal. The financial viability appraisal will be published as a PDF document. We will publish our assessment of the financial viability appraisal in the case officer report considering the application.

5. Viability appraisal methodology

5.1 Overview

We assess the viability of proposed development schemes to identify whether our planning policy requirements can be met. Viability is assessed by calculating the uplift in value arising as a result of planning permission being granted for a proposed development. Where the uplift is sufficient, the land will be released from its current use for development and the landowner will have received a competitive return.

Financial viability assessments require two calculations to determine whether the uplift provides a competitive return and that the proposal is viable. These are set out in sections 5.2 and 5.3 of this SPD. The first calculation is to ascertain the market value (MV) of the site assuming planning permission for the proposed scheme has been granted. The second calculation identifies the benchmark land value (BLV) of the site. The benchmark land value (BLV) is the value below which the current use of the site will be continued and is usually calculated by reference to the current use of the site.

Where the market value (MV) of the site for the proposed scheme is higher than the benchmark land value (BLV) then the development is viable. This assumes the proposal meets planning policy requirements.

Where the market value (MV) of the site for the proposed scheme, assuming it meets planning policy requirements, is equal to or less than the benchmark land value (BLV) then the development is unviable and the land will be retained in its current use. In these circumstances, the flexible application of planning policy requirements may be justified to enable the proposed scheme of development to viably proceed.

5.2 Market value of the proposed development

- | | |
|-------|--|
| DVG12 | The market value (MV) of the site for the proposed scheme of development will be assessed in accordance with Valuation Information Paper 12 (VIP12) and the RICS Red Book. This assessment will assume planning consent for the proposed scheme of development. |
| DVG13 | The market value (MV) of the site should be calculated using the residual method of valuation to determine the amount available to pay for the site. This is the residual land value (RLV). The residual land value (RLV) should be cross-checked against market site comparables to ensure that the residual land value is consistent with prices being paid for sites in the market. |
| DVG14 | Where land is purchased unconditionally the onus is on the purchaser to make sufficient allowance for planning policy requirements and any other uncertainties with regard to site conditions, title, abnormals, prevailing costs and revenues that may affect the viability of a policy compliant scheme |

The market value (MV) of the site for the proposed scheme of development will be assessed in accordance with the RICS Valuation Information Paper 12 and the RICS Red Book. This assessment will assume planning permission has been granted for the proposed scheme of development. The market value (MV) is calculated by using two methods of valuation.

Firstly, the residual method determines the amount available to pay for the land and is called the residual land value (RLV). It is defined by calculating the gross development value of the completed development proposal and deducting the costs of delivering the development, including the developer's risk-adjusted profit (the competitive return for the developer).

Secondly, the comparison method of valuation should be used in order to cross-check the residual land value against market site comparables to ensure that the residual land value is consistent with prices being paid for comparable sites in the market.

Market data arising where developers are acquiring sites and delivering development are the best indicator of market value. All sites and planning consents have different characteristics. However, an analysis of comparable sites will show a trend of value which demonstrates the amount that developers are willing to pay for sites having made appropriate assumptions with regard to build costs, finance costs, contingencies, profit levels, marketing and sales costs and revenues. In most cases developers require funder support. In order to secure funding, the value paid for the site and the cost, revenue and profit assumptions made would have been approved by the funding institution on the basis of a Red Book valuation. For this reason, cross-checking the residual land value (RLV) against market site comparables ensures that the residual land value (RLV) provides an accurate reflection of the market value (MV).

Where the residual method is used without the cross-check to market site comparables there is a risk that the market value (MV) of the site can be understated or overstated, given the sensitivity of the residual method in calculating the residual land value (RLV).

In circumstances where we consider that insufficient reference has been made to market site comparables, we may commission a Red Book valuation with the cost being part of the assessment costs payable by the applicant. Where the applicant chooses to submit a Red Book valuation as part of their viability assessment then the instructed valuer should report jointly to the local planning authority and to the applicant as joint client with the basis for the instruction to the valuer and the reporting thereof being agreed by the parties in advance..

5.3 Calculating the benchmark land value

DVG15 Benchmark land values (BLV) will usually be calculated with reference to the current use

value (CUV) of the site², plus a financial incentive that would ensure the release of the land from its current use. This is called current use value plus (CUV+). The uplift (the “+” of the CUV) above the current use value (CUV) is calculated by deducting the current use value (CUV) from the market value (MV) where the market value (MV), takes full account of planning policy requirements for the proposed use. This approach clearly shows the uplift in value arising from the grant of planning permission.

DVG16 Flexible application of planning policy requirements may be justified to enable the proposed scheme of development to proceed viably where the uplift from CUV to MV is insufficient to provide a competitive return to the landowner. In such cases any uplift above the CUV should be fully justified by the applicant and will generally be expected to be around 20% above the CUV.

DVG17 An alternative use value (AUV) is the value of a hypothetical scheme of development that is an alternative to the proposed scheme. Where an applicant intends to demonstrate that an alternative scheme of development meets planning policy requirements and that there is market demand for the alternative use, the council will require an explanation why the applicant does not intend to proceed with an alternative scheme of development where it generates a higher value.

In most cases, benchmark land values (BLVs) will be assessed with reference to current use value (CUV) of the site, excluding hope value, plus a financial incentive that would ensure the release of the land from its current use. This is called current use value plus (CUV+). The percentage uplift above the current use value (the “+” in the CUV+) will be calculated by subtracting the current use value (CUV) from the market value (MV) of the site.

The process of calculating a benchmark land value (BLV) for a viability assessment indicates whether a scheme is viable or not. A development is viable if the market value (MV) of the site is equal to or higher than the benchmark land value (BLV). The benchmark land value (BLV) is the minimum value at which it is considered that the landowner has received a competitive return. Where the benchmark land value (BLV) is higher than the market value (MV) of the site a proposed scheme of development would be unviable and the land will not be released from its current use. In accordance with the NPPF, at this point it is appropriate to consider flexibility in planning policy requirements in order to increase the development site value above the benchmark land value (BLV). This may be achieved, for example, through reducing the amount of affordable housing provided or by changing the tenure mix within the affordable element of a residential scheme.

An acceptable uplift above current use value (CUV) will generally be around 20%.

When assessing their bid for the land, the development site value of alternative schemes of development may be considered by purchasers/developers. There are often multiple alternative uses which are acceptable in planning terms in Southwark. When preparing a bid to buy the site, a developer will choose a scheme that creates the highest site value (having regard to minimum planning policy requirements) to maximise their chance of being the highest bidder and successful purchaser. The council will require an explanation for why the applicant does not intend to proceed with an alternative use where it generates a higher value than the proposed scheme of development.

² The CUV of the site will exclude ‘hope value’. Hope value refers to any element of open market value of a property in excess of the current use value, reflecting the prospect of a more valuable future use or development. It takes account of the uncertain nature or extent of such prospects, including the time which would elapse before one could expect planning permission to be obtained or any relevant constraints overcome, so as to enable the more valuable use to be implemented.

6 Viability appraisal inputs

- DVG18 Financial viability appraisal inputs should include all reasonably available details deemed necessary for the council to understand the valuations submitted for the market value (MV) of the proposed scheme of development and the current use value (CUV) of the site.
- DVG19 Financial viability appraisal inputs should be clear, justified, in line with market norms and supported with appropriate comparables or other supporting evidence.
- DVG20 A schedule of site comparables should be provided with a fully justified analysis to enable a crosscheck of the residual land value (RLV).
- DVG21 There should be a clear and reasoned link between the evidence submitted and the conclusions drawn from the financial viability appraisal.
- DVG22 The assessment of viability is a calculation based on market assumptions. It should not take account of any specific inputs or assumptions peculiar to the applicant.

Applicants should provide the information set out in Appendix 2 ‘Financial viability appraisal inputs’, together with any other information considered necessary by the applicant to explain the inputs, assumptions and conclusions within the financial viability appraisal. The basis for the estimate(s) and the drawings/specifications/quotes used should be stated. We will request further details and clarification if the level of detail initially provided is considered insufficient. The level of detail that we require will be commensurate with the scale of the development and the nature of the scheme. It is accepted that the same level of detail may not be available for all elements of a development scheme that has multiple phases when compared to a single build out development.

7. Viability reviews

- DVG23 A viability review will be required for development that does not provide a policy compliant level of planning obligations, such as affordable housing, due to viability. This review may use actual costs and/or revised sales values, and will assess whether the approved scheme has become more viable from the date that planning permission was granted to the date of substantial implementation.
- DVG24 Where a viability review demonstrates an improvement in a scheme's viability, 50% of the increase in the scheme's value will be returned to the developer and 50% to the council, up to the level that would be required for a policy compliant scheme. All additional surplus profits will return to the developer.
- DVG25 The timing of the viability review will depend on the nature and scale of the approved scheme. Generally, the viability review should be undertaken prior to occupation of no more than 25% of the development. The timing of viability reviews for schemes that have multiple phases will be agreed with the council.
- DVG26 Viability contingent payments to the council should usually be made prior to the occupation of 75% of the development. The review process for schemes with multiple phases may result in additional affordable housing in later phases, in place of a financial contribution.
- DVG27 In the event that secured planning obligations, including affordable housing, are reduced through negotiations or by statutory provisions, a viability review to actual costs and revenues will take place in order to identify any subsequent increase in viability at substantial implementation of the approved scheme.

Where a development proposal cannot meet planning policy requirements due to viability and the council resolve to grant planning permission we will require a revised financial viability appraisal following the substantial implementation³ of the scheme. This will ensure that improvements in scheme viability between the date that the planning permission was granted and the date the development was substantially implemented contribute towards meeting minimum policy requirements that were not possible at the date of consent. This approach is encouraged in relation to affordable housing in Policy 3.12 of the London Plan (2015) (and supporting text paragraph 3.75)⁴.

The build costs, value and other factors of a scheme can alter significantly from the point it is granted planning permission to when it is substantially implemented. Viability reviews enable the applicant to continue to receive the level of profit required, as agreed at the date of consent. This means that viability reviews will not increase risk for the applicant as it will still allow for a competitive return. Where an applicant agreed to proceed with a development generating an uncompetitive return⁵, any surplus will be calculated from the point a competitive return is realised.

³ Substantial implementation requires a development to have completed all ground preparation works and constructed the foundations for the core of the development.

⁴ Paragraph 3.75: In making arrangements for assessing planning obligations, boroughs should consider whether it is appropriate to put in place provisions for re-appraising the viability of schemes prior to implementation. To take account of economic uncertainties, and in respect of schemes presently anticipated to deliver low levels of affordable housing, these provisions may be used to ensure that maximum public benefit is secured over the period of the development.

⁵ A competitive return will be benchmarked against prevailing market norms and regarding the risk profile of the specific development.

Developers will be required to work with the council on an open book basis for the viability review to demonstrate the actual costs incurred to complete a project. The basis for the viability review is set out below:

1. The base position as agreed at the date of consent and specified in the Section 106 legal agreement for the approved scheme for:

- Gross development value (GDV) £
- Residential average value per square foot (psf)
- Commercial rent (psf) and yield
- Professional fees (amount and %)
- Finance
- Developer's profit (amount and %)
- Build costs (£ total and psf/psm)
- £ Prelims/enabling costs/overheads and profit/contingency
- £ Abnormal costs
- Residual land value (RLV)

2. Increase in value (uplift) of the scheme at substantial implementation:

- Revised gross development value (GDV)
- Actual/revised average residential sales value per square foot (psf)
- Actual/revised rents and yields
- Actual fees
- Actual finance
- Actual build costs
- Actual prelims/enabling costs/overheads and profits
- Actual abnormal costs
- Input residual land value (RLV) at date of consent

The surplus will be shared 50:50 (council:developer) until a policy compliant contribution has been achieved.

Given the uncertainty at the early stages of designing a scheme, it is common for estimated costs to be reduced as elements of the design are finalised (usually post-planning) and the contract to build the scheme is tendered. A small percentage change in the build cost could equate to a significant change in the scheme's viability. Therefore this input into the residual cash-flow could present considerable uncertainty in the accurate assessment of a scheme's value and whether there is an accurate assessment of the scheme's ability to viably meet planning policy requirements.

Viability reviews will be undertaken following the substantial implementation of a scheme and prior to more than 25% occupation of the development in the scheme. It is easier to identify actual costs and values between these date. The trigger for the payment will be negotiated for each application but it will typically be no later than prior to occupation of 75% of the development.

The value of the payment will be determined at the point the date is undertaken (or, in the case of phased development, at an appropriate pre-determined point in the development programme). There will only be a requirement to make a payment where a scheme generates a surplus profit in excess of the returns necessary to make a development viable.

Viability review contingency payments will be capped at a level that reflects any foregone benefits of the proposal which would have been required to achieve full planning policy compliance. This figure is referred

to as 'the review dependent in lieu payment'. Any surplus profits, up to the review dependent in lieu payment, will be shared between the applicant and the council on a 50% to 50% split. This provides an incentive for applicants to achieve cost savings and to maximise scheme value. The purpose of the viability review is not to enter into an open-ended profit share arrangement. Additional surplus profits will pass to the developer in their entirety.

Viability reviews will require developers to keep clear financial records, invoices, labour sheets and any other information necessary so that actual construction and project wide costs can be easily audited and ratified. Any costs that cannot be evidenced will be referred to an independent quantity surveyor for fair valuing. Developers should grant their cost manager(s) however long is reasonably required by the council to undertake the audit and clarify cost issues so that a final decision can be reported. Evidence of any agreed sales and lettings should be provided. Any residential unit should be clearly referenced to the accommodation schedule used for the calculation of viability at the date of consent (e.g. so that plot numbers can be matched with postal addresses).

In the event that secured planning obligations, including affordable housing, are reduced through negotiations or by statutory provisions subsequent to the granting of planning consent, the Section 106 legal agreement will require a viability review at substantial implementation to determine actual costs and revenues. This ensures that the actual revenues and costs when the scheme is implemented are used to determine the viability at the point of delivery. The value of reduced planning obligations will be the review-dependent in lieu payment that is required in the event that a scheme improves in viability subsequent to the revision of planning obligation requirements through negotiation or by statutory provisions.

Glossary

Alternative Use Value (AUV) - An alternative use value (AUV) is the value of a hypothetical scheme of development that is an alternative to the proposed scheme of development..

Benchmark Land Value (BLV) – The benchmark land value the value below which the current use of the site will be continued. This is the value at which a reasonable landowner will be willing to release their site for development.

Current Use Value (CUV) – Market value for the continuing existing use of the site or property assuming all hope value and any value arising from any planning permission or alternative use is excluded.

District Valuer Service (DVS) – The DVS is the specialist property arm of the Valuation Office Agency (VOA). They provide independent professional property advice and valuations to public sector bodies.

Existing Use Value (EUV) – The estimated amount for which a property 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.

Note: EUV is a specific definition relating to reporting values of operational business assets. It is sometimes used in a viability context to refer to the CUV.

Gross Development Value (GDV) – Market value of the proposed development assessed on the special assumption that the development is complete as at the date of valuation in the market conditions prevailing at that date.

Hope Value – Hope value refers to any element of open market value of a property in excess of the current use value, reflecting the prospect of a more valuable future use or development. It takes account of the uncertain nature or extent of such prospects, including the time which would elapse before one could expect planning permission to be obtained or any relevant constraints overcome, so as to enable the more valuable use to be implemented.

Incentive – Benchmark land values (BLV) will usually be calculated with reference to the current use value (CUV) of the site, plus a financial incentive that would ensure the release of the land from its current use. This is called current use value plus (CUV+). The incentive is the “+” of the “CUV+”.

Market Site Comparable – A transaction of a development site which evidences prevailing market site values and where the price paid has either assumed an optimum development on the basis of an assessment of Development Plan policies or on the basis of an existing planning consent.

Market Value (MV) – The estimated amount for which an asset or liability 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 each acted knowledgeably, prudently and without compulsion, subject to the special assumption that planning consent has been granted for the proposed scheme of development.

Planning Performance Agreement (PPA) – A planning performance agreement is a project management tool which the local planning authorities and applicants can use to agree timescales, actions and resources for handling particular applications. It should cover the pre-application and application stages but may also extend through to the post-application stage

Red Book Valuation – The Red Book sets out mandatory practices for RICS members when carrying out a valuation.

Residual Cash-flow – A financial appraisal methodology that is used to calculate the Residual Land Value.

Residual Land Value (RLV) – The RLV is a calculation of the MV of the site assuming planning consent for the proposed scheme of development using the residual method of valuation.

RICS Red Book – Royal Institution of Chartered Surveyors (RICS) Valuation – Professional Standards 2014. The 'Red Book' contains mandatory rules, best practice guidance and related commentary for all RICS members undertaking valuations.

Royal Institute of Chartered Surveyors (RICS) – The RICS is a professional body that accredits professionals within the land, property and construction sectors.

Substantial Implementation – Substantial implementation requires a development to have completed all ground preparation works and constructed the foundations for the core of the development.

Uplift – See Incentive.

Valuation Information Paper 12 - RICS information paper that describes the applicable processes for the valuation of development land, including valuing by the comparison method and the residual method, assessing the land value and reporting the valuation.

Viability Appraisal (VA) – A financial viability appraisal is an assessment of a scheme's financial viability. It can be used to assess whether a proposed scheme of development will proceed and whether planning obligations may need to be applied flexibly to enable a marginally viable proposed scheme of development to proceed.

Appendix 1: Example viability assessment scenarios

These simplified theoretical examples are intended to assist readers to better understand the key principles and stages of establishing whether a proposed development is viable or not.

Example 1 – A viable scheme

An applicant proposes to build 50 homes on a site which is currently in use as a car park and the design and principle of the development is acceptable. It is assumed that this represents the maximum development potential for the site.

1. The value of the land in its current use as a car park is calculated at £1m. This figure ignores any development potential.
2. The proposed scheme of 50 homes should provide 35% affordable housing as required by planning policy. Each private home will sell for £400k and each affordable home for £200k. This means that the total value of the private housing is £13m (65% of the total homes) and the total value of the affordable housing is £3.5m (35% of the total homes). The total value of the proposed scheme is calculated at £16.5m.
3. The development costs to deliver the proposed scheme are calculated at £8m. This is a simplified figure for the purposes of this example and includes all build costs, fees, developer profit, finance and other development costs.
4. The market value (MV) of the site, assuming planning permission is granted for the 50 homes, is calculated by subtracting the development costs (£8m) from the value of the proposed scheme (£16.5m). Therefore the amount available to pay for the site is £8.5m. The developer would check this figure against the amount that other comparable development sites have sold for in the local area.
5. The increase in value from the use of the site as car park to the site with planning permission for 50 homes is 750% (£1m to £8.5m). It is unlikely that the landowner would be unwilling to release the site from its current use as a car park.
6. The following table illustrates the calculation:

The current value of the site as a car park (excluding any development potential)	£1m
The value of the completed scheme of 50 homes	£16.5m
Development costs to build the 50 homes (including the developer's profit)	£8m
The amount available to purchase the car park site (Market Value)	£8.5m (In this example, as the site in its current use as a car park is worth £1m, the remainder of £7.5m is the uplift the landowner would expect to receive when the site is sold. This represents an uplift of 750%.)

Example 2 - A marginally viable scheme

An applicant proposes to build the same 50 homes on a site which is currently used as an office. The design and principle of the development is acceptable. It is assumed that this represents the maximum development potential for the site.

1. The value of the site in its current use as an office is calculated at £7.05m. This figure ignores any development potential.
2. The same policy requirement of 35% affordable housing is applicable and the value of the completed 50 homes (£16.5m) and the development costs (£8m) are assumed to be the same as Example 1. The amount available to purchase the office site would also be £8.5m.
3. The increase in value from the use of the site as an office to a site with planning permission for 50 homes is 20.5% (£7.05m to £8.5m).

In this example, the increase in value of the site from the office use to a site with planning permission for 50 homes is just above 20%. The decision of the landowner to sell the site is therefore much more marginal than Example 1, as the increase in value is 20% rather than 750% in Example 1. If the increase in value was less than 20%, the landowner may choose to retain the existing office use until market conditions improve.

If the landowner is unwilling to sell the site with a marginal increase in value, an alternative option is to reduce planning policy requirements by allowing more private housing in place of some affordable housing. This would increase the value of the overall proposal as private housing are greater in value than affordable housing (£400k > £200k). Assuming the development costs stay at £8m, the developer could afford to pay more for the site thereby increasing the market value and improving the chances that the landowner would sell site and released from its use as an office.

Appendix 2: Viability appraisal inputs

Construction costs	<p>The estimated construction cost of the proposed building should be substantiated by a detailed schedule showing each element of the proposed scheme with elemental costs and total costs in per sqm and per sqft.</p> <p>There should be a clear relationship and justification between the standard/quality of the specification and the values achievable for the completed units.</p> <p>If the proposed scheme includes several buildings or is a large/complex multi-use structure the scheme should be disaggregated into clear/manageable parts with their own cost substantiation.</p> <p>The proposed scheme should be accompanied by a clear schedule of accommodation and areas and should clearly relate to the areas entered in to the cash-flow. All floor areas should be gross internal floor areas (GIFA). The GIFA of each storey should be identified along with the GIFA split between uses/functions i.e. residential/retail/circulation (along with a short narrative to explain what is included within those areas if the proposed building(s) are complex).</p> <p>The construction costs need to be substantiated using the New Rules of Measurement (NRM) Order of Cost estimate format with summary sheets evidenced by the elemental measured cost plan including the measured areas/units and rates.</p> <p>Hard copy drawings, plans, schedules and other details requested will be provided directly to the council’s quantity surveyor.</p> <p>Evidence supporting the estimated cost plan may be requested for scrutiny.</p>
Construction programme	<p>The proposed project programme should be a true representation of the expected timescales until the completion of the project on site, including all pre-construction activities.</p>
Contingencies	<p>Contingency allowances should:</p> <ul style="list-style-type: none"> • be accompanied by an explanation as to what they are for; • be clearly identified; • show how they were calculated
Design specification	<p>The estimated construction costs should be accompanied by an elemental specification. This does not have to be detailed but should demonstrate what the elements are in order to justify their costs.</p>
Developer profit	<p>Developer’s profit should be included at a rate reflected by the specific risk in the market and having taken account of other risk mitigation included elsewhere in the cash-flow costs. The appropriate metric to assess profit will depend on the scale of the scheme and its financing. We would expect schemes to demonstrate profit on cost and profit on value. The council will take Internal Rate of Return (IRR) into account</p>

	if requested by the applicant, provided the development programme and timings of costs and values are fully justified. The cross-referencing exercise to market site comparables will give a good indication of the profit levels assumed in the market for schemes being built out supported by institutional funding.
Development programme details	In addition to the construction programme details, the assumed percentage of sales to be completed at practical completion and the assumed sales rate needs to be clearly referenced and compared to comparable schemes.
Enabling and demolition costs	Enabling works costs, including demolition, decontamination or utilities should be stated separately.
Exclusions and assumptions	The cost plan(s) should be accompanied by a list of any exclusions and assumptions.
Finance costs	Finance costs should be included at a level which is evidenced by reference to the prevailing market rate
Income from existing uses	<ul style="list-style-type: none"> • Full details of rental income receivable pending vacant possession and/or throughout the proposed development.
Income from proposed uses	<ul style="list-style-type: none"> • Estimated sales values for the residential units. • Anticipated rental income for any element of the scheme together with appropriate investment yield. • Ground rent income for the private residential units including rent review basis and adopted investment yield. • Income from any off-street car parking spaces • Any other income receivable during the cash-flow period not accounted for in the above. • Details of any incentives, voids and rent free periods assumed for either the subject property or the comparables should be specified.
Legal fees	Legal fees should be fully justified by reference to market rates.
Market comparables	Comparable evidence should be provided to support the assumed value and yield levels. This should include sufficient detail to enable the council to understand the relevance of the comparable to the subject in terms of its physical age and construction, its condition, its location and the valuation date. A plan should be provided showing the proximity to the subject scheme. Contact details should be included for the source of each comparable to be relied upon and that party's involvement in the transaction. Investment yield information should include an assessment

	<p>of the equivalent yield where the passing rents are not rack rented.</p> <p>The value of the affordable housing element showing assumed rent levels, management costs, the proportion of equity sales and assumptions made with regard to prevailing affordability criteria.</p>
Marketing costs	Estate agency sale and letting fees and other marketing costs should be fully justified.
Overheads and profit	An explanation is required if the overheads and profit figure relating to the contractor's allowance is to be stated separately and whether this is an average rate or would apply to all works.
Preliminaries	The construction preliminaries should be shown separately and be relatable to the proposed on site duration.
Professional fees	The level of professional fees should be stated separately for each discipline included, both as a percentage and the amount. Evidence from recently delivered schemes will assist any explanation and agreement.
Risk	<p>Risk allowances should:</p> <ul style="list-style-type: none"> • be accompanied by an explanation as to what they are for; • be clearly identified; <p>show how they were calculated.</p>
Schedule of proposed development	<p>A full accommodation schedule showing measurements for each element of the scheme (to be measured in accordance with the RICS code of Measuring Practice) is to be provided. This is to be fully reflected in the scheme cash-flow and should accord with the measurements in the planning application.</p> <p>For residential accommodation the accommodation schedule should be either fully reflected in the cash-flow or provided on a separate Microsoft Excel sheet which confirms each unit's:</p> <ul style="list-style-type: none"> • tenure (private, social rent or intermediate, or other); • capital value per sqm and per sqft (or rental yield if covenanted private rented accommodation); • location within the development, including the floor level, its orientation, the size (Net Sales Area) in sqm and sqft; • number of habitable rooms and bathrooms and kitchens; • exclusive amenity space (per sqm and per sqft). <p>Any circulation and common/communal areas should be identified and measured separately with a total GIA in sqm and sqft for each floor and cumulatively for the development.</p>

	<p>The number and location of any exclusive or shared off-street car parking spaces.</p> <p>The gross-to-net ratio should be clearly identified and justified for both the residential and commercial elements.</p> <p>Where residential units are included which exceed the minimum sizes stated in the council's Residential Design Standards (SPD) then justification needs to be provided and an appropriate premium on the sales value needs to be shown.</p>
<p>Section 106 and CIL costs</p>	<p>S106 and CIL costs should be included at the appropriate rate to be agreed with the planning case officer.</p>