DRAFT

Undermining Sustainability – The Rise and Rise of Viability Assessment

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The rise and rise of financial viability assessment in the UK planning system has been one of the most fundamental changes in the UK planning system. It has wide-ranging, and mainly negative implications, for the sustainable development goals of planning cited in the NPPF. It has also reinforced the asymmetry in the relationship between the property industry, and local authorities and the communities they serve.

It is not news that town planning and housing in the UK have become steadily deregulated and marketised over the last 30 years (Taylor, 1998; Allmendinger, 2002). It is also the case that during the 2000s, there was a period on restraint due to popular and government concern for sustainable development which gave environmental and social issues more prominence in planning decisions. However, this shift in emphasis went into reverse after the recession and changes in government policy since 2010, both of which gave pre-eminence to economic factors over all others (HM Treasury 2011). Financial viability has now emerged as a decisive planning issue which has ever stronger prominence and authority.

Housing Growth and Viability

Viability assessment is not new. It was always part of the calculations made by developers and landowners in formulating their schemes. But until the late 2000s the viability of the development projects was not subject to routine assessment by local planning authorities. It was not a material consideration in determining planning applications or planning obligations, nor as far as the public was concerned, was it part of public consultation over Local Plans. Plan making and development control were determined by planning policy irrespective of the commercial constraints placed on development proposals. In effect, if an approved policy precluded a particular form of development or condition which a developer thought made it unviable, the developer had to revise his scheme accordingly, or go elsewhere.

Nevertheless, broad assessments of the profitability of major development or regeneration schemes were an important part in the negotiations between landowners, developers and local authorities. There was no formal assessment process but it was the background to policy and planning strategy.

This background role was evident in our recent study of housing growth during the period of the Sustainable Communities Plan 2013-2010 (Cochrane, Colenutt, Field, 2015). Interviews with developers, local authority officers and politicians, development and other government agencies showed how alongside a rhetoric of sustainable development, profitability and viability considerations critically framed the prospects for sustainable housing growth in the region.

On the one side, the policy assumed that rising land values would provide sufficient levels of profit for developers and landowners to cross-subsidise the infrastructure, community facilities, and low carbon design necessary to enable new development to be sustainable i.e. to create “sustainable communities”.This strategy was arrived at without scrutiny of the business models of the property sector, nor by interrogation of the willingness of the sector to collaborate on major housing growth programmes which relied on cross-subsidy i.e. sharing their profits with the public sector. But in policy terms it almost magically seemed to offer the prospect of delivering material and social infrastructure without the need for increased state spending.

The volume house builders who were expected to deliver Sustainable Communities in the four designated Growth Areas made a quite different set of calculations from those underpinning government plans. As far as they were concerned, the assumption of cross-subsidy was misconceived, or at least so generalised as to be of little use in practice. Their first priority was to achieve a profit benchmark for their shareholders overall, as well as on a site by site basis, and there were only limited opportunities for significant cross-subsidy.

Although required in principle to adhere to local authority policies and standards for sustainable development, the developer view was that sustainability measures such as requirements for affordable housing were highly risky because as indicated above they reduced land value. The level of land value is the key variable for developers. They take their own profit from the scheme, while negotiation with the landowner sets the land value which determines the amount that can be distributed as non-profit planning obligations. In many cases, neither landowners nor house builders were willing to agree to specific sustainability measures unless there was additional government subsidy or relaxation of the sustainability policies themselves.

Thus, during the period of the Sustainable Communities Plan, the goal of sustainable housing development was in conflict with the viability of new housing development, and hence many sustainability measures were not delivered - and this became even more evident as the recession of the late 2000s intensified.

Typical quotes from developers in our study were:

"There is nothing about the word "sustainable" that changes the criteria for development."

"The sustainability agenda is supposed to be about better outcomes. It's here and delivered through a combination of planning and building regulations. They are an additional cost item on the industry. It's a given, the industry adapts to the regulatory burden, and it is reflected in the value of the house. Others should comment on whether is it cost effective, is it viable? Will a purchaser pay the additional cost? I don't know, but there is a significant cost of compliance".

Thus, prior to 2012, viability calculations were the background to the process of negotiation over sustainability between developers and local authorities. Although details were invisible to the public and even the planners, it was a set of shared assumptions between developers and local authorities that risks to viability resulting from planning conditions and obligations were a constraint of the delivery of fully sustainable development. Planning policies were not directly challenged or altered on the basis of viability considerations, but delivery of sustainable communities was affected. Local authorities were often prepared to reduce their affordable housing requirements to get development on site.

Formal Viability Assessment post 2012

From 2012 onwards with the publication of the National Planning Policy Framework (NPPF), viability assessment moved to the foreground. The NPPF emphasised the central aim of "deliverability", and to ensure this, made VA a requirement for both for Local Plan policies, and for testing the validity of local authority planning obligations, particularly affordable housing obligations.

"*Pursuing 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". Para 173*

The National Planning Practice Guidance 2014 elaborated:

" Decision-taking on individual schemes does not normally require an assessment of viability. However viability can be important where planning obligations or other costs are being introduced. In these cases decisions must be underpinned by an understanding of viability, ensuring realistic decisions are made to support development and promote economic growth." (ref)

The definition of viability in the NPPF was expressed firmly in commercial terms;

"To ensure viability, the costs of any requirements likely to be applied to development, such as requirements for requirements should, when taking account of the normal cost of development and mitigation, provide competitive returns to a willing land owner and developer to enable the development to be deliverable"" Para 173.

From this point on, the technical aspects of viability became of central concern to both the development industry and local authorities. Viability toolkits became common place (e.g Three Dragons Toolkit) with some local authorities customising their own toolkits (e.g. GLA). An industry of property consultants, valuers, and surveyors sprang up offering their services on the use of toolkits for both local authorities and developers.

Yet there was no agreement over the methodology or practice of viability assessment. The standard industry model employed the Residual Valuation method. This compared total scheme development costs with its final development value to predict a Residual Land Value (RLV). The RLV would indicate whether there was enough surplus land value (after the landowner and developer had taken their share) to allow planning obligations such as affordable housing to be met.

It was inevitable that many developers would use lower range house prices and rents and higher range construction and finance costs in their models to suggest that land value was insufficient to meet local authority planning requirements. There were no rules to standardise costs or place checks on these practices, allowing developers to input data into viability models that best met their case. LB Islington argued that viability assessments were often deliberately pessimistic, undervaluing development schemes so that it appeared that planning obligations made their schemes unviable (Douglas, 2014; LB Islington, 2015).

Perhaps the most controversial issue was that there were no guidelines or benchmarks to indicate what would be a "competitive return to a willing landowner or developer". With wide differences in the profit levels and internal rates of return expected by developers in different parts of the country, viability assessments were subjective and unreliable.

For example, most viability assessments put in a 20% profit for developers as a conventional measure of their expected margin. Yet this figure is at the top end of developer calculations, suggesting erroneously that developers will not start a development where there is a lower rate of return. Many schemes proceed on the basis of a 12-15% rate of return. The importance of this difference is that in the viability model the developers profit is put in as a cost to the scheme. Hence, the higher the developer profit the lower the land value and the less land value is available to distribute as planning obligations, such as affordable housing. The 20% convention deprives local authorities and communities of very large numbers of affordable housing units.

Where developers use an internal rate of return over the lifetime of the project this too can be subject to manipulation. As the excellent recent draft LB Islington SPG on Development Viability says, developers can load in their costs at the beginning of the project to make the internal rate of return appear lower than it is in reality. (para 6.28, LBI, 2015)

The sensitivity of viability models to differences in input data and assumptions produces a wide range of possible land values and viabilities for a given site. Yet in practice this sensitivity analysis is either not undertaken as part of the assessment, or if it is, it is not made public. Usually just one residual land value is presented for a site, or one profit figure, with no analysis of the range or sensitivity of predicted values. Thus, as McAllister and others who have written extensively on viability modelling have concluded, the NPPF guidance on viability led to a fundamental change in planning policy without a robust or consistent methodology to back it up (McAllister et al, 2014).

Yet this flaw in the assessment methodology was not the most important element in the NPPF viability policy. The key shift in emphasis was that for local plans to be sound they had to be deemed viable. And secondly, in relation to planning obligations, viability (however measured) could over-ride other planning considerations such as housing mix, urban design, or environmental sustainability (DCLG, 2013). The broader conclusion is that the "presumption in favour of sustainable development" favoured by the NPPF is increasingly interpreted in practice as a presumption in favour of viability.

In other words, if a developer was able to show though a viability assessment that the planning standards or obligations of a local planning authority made his scheme unviable, he was able to seek exemptions or modifications of the planning requirements - and if these modifications were refused he would be able to appeal to the Secretary of State and was expected to obtain an approval, in spite of the evident variation in the measurement of viability. The balance between economic, social and environmental factors in planning was radically changed.

Viability assessment and affordable housing

The most controversial implication of viability assessment is its impact on local authority affordable housing policies under section 106 agreements. This refers to a local authority planning obligations for a standard percentage of affordable housing from housing developments of more than 10 housing units. Given that for most local authorities this had become the principal means by which affordable housing could be delivered, it was of major concern (ref.) Many local authorities require 30%-40% of all new housing on large sites to be affordable i.e. sub-market housing usually bought and managed by a housing association. From a landowner point of view any reduction of the maximum amount of market housing on his site reduces the price of his land and reduces his incentive to sell to a developer. The developer on the other hand, is not usually willing to reduce his profitability; he will move to another site where he can achieve his benchmark profit level.

Thus, together developers and landowners aim to minimise the percentage of affordable units as far as possible; and viability assessment provides a means for them to do this. If they can show that the value of a completed development with the required policy percentage of affordable housing minus the costs of the scheme produces a land value that is below their benchmark, the scheme can be deemed unviable. Under the NPPF, the planning authority will then be required to reduce its planning obligations for affordable housing until they reach the profit benchmark of the developer.

Local authorities and viability

Viability assessment places local authorities in a major dilemma because planning policies for planning obligations such as affordable housing for a local plan area become readily challengeable. With high profit benchmarks, developers can argue successfully in many cases that local authority affordable housing obligations make their schemes unviable. Given the high level of profit demanded, policy compliant schemes can be deemed unviable in low to medium demand areas and even in property hot spots such as central London or Oxford.

National Planning Practice Guidance advises local authorities to develop an evidence base of market information, to collaborate with developers and landowners, and ensure they have “a comprehensive and consistent understanding of viability across their areas”

Most local authorities do not have the level of technical resource needed to develop such a comprehensive evidence base, or contest the well-funded technical and legal teams fielded by big developers. They employ consultants to undertake independent assessments to check developers’ viability claims. Yet there is a question mark over the use of consultants who typically work for developers as well as local authorities. They do not usually interrogate the assumptions and conventions of the viability models because these conventions are accepted part of valuation practice. Community groups in London in Southwark and Greenwich have found that the so-called independent assessments of developer models do not adequately challenge the data and assumptions, leading to substantial losses of affordable housing. (35% Campaign; Mathiason and Eriksson, 2015)

There is a further point that might explain why in some cases the local authorities do not undertake a full interrogation of developer viability assessments. Local authorities are often in a position where they believe that if they do not compromise on their affordable housing targets, nothing will get built and sites will remain derelict with consequent negative political outcomes. Or if they contest the developer case, they will be faced with a costly planning appeal which they are quite likely to lose because of the wording in the NPPF.

With some exceptions, where there are high profile HCA-funded development schemes, for example, there is indeed little prospect that Government will step in and fill the viability gap for affordable housing or other planning obligations. This may well be the deliberate intention of Government policy on viability but it places local authority planning policies in disarray. Faced with challenges on viability grounds, local planning policies cannot be consistently applied across a plan area; and each successful challenge becomes a precedent for the next. Any alternative policy on affordable housing percentages is likely to meet the same fate.

The relationship between local authorities and developers is often characterised as adversarial and on the face of it, viability assessment might be expected make things a lot worse. However, as indicated above the relationship is more complicated in practice. Local authorities want to do deals with developers or landowners over major sites and regeneration areas where they seek a partnership which can deliver a range of outcomes over the long term – for example, opening up development land, fostering regeneration or growth, making environmental improvements or achieving certain urban design objectives. In this context, the process of negotiation may lead to the emergence of what looks more like a shared a shared agenda, in which one set of planning goals and planning obligations is traded against others

Local communities and viability

There is a strong NIMBY sentiment in many housing growth areas but where opposition is more muted, the promise of high quality development or the creation of "sustainable communities" potentially makes new development more palatable. This was certainly the hope of the planners in the MKSM growth area. One of the common complaints of residents facing plans for new urban extensions is that they do not believe they will be "infrastructure-led" i.e. the promised community facilities will probably never materialise. Indeed their experience was that in many cases sustainability measures were compromised e.g. the Upton case in Northampton where an “exemplary” sustainable communities scheme in land developed by English Partnerships was unable, even after ten years, to deliver an essential medical centre and local shops.

These concerns are sharpened in the context of the NPPF, which undermines even limited requirements for new development to be of high quality in terms of sustainability criteria or delivered with a full range of social and other infrastructure. . Sustainability measures in Local Plans are being regularly undermined by the new viability assessments with developers even in 2015 "pleading poverty" (http://www.northamptonchron.co.uk/news/local/developers-in-northamptonshire-too-often-plead-poverty-over-money-for-cheap-housing-firefighters-and-libraries-1-6803824).

On top of this, the details of viability assessment are often concealed by confidentiality clauses, preventing communities and even local councillors having the opportunity to challenge developer sums. Many of the recent Freedom of Information appeals against viability assessment centre on the veracity of the claims that "open book" assessment will breach "commercial confidentiality" and cause "commercial harm". Viability reports are routinely published with redactions covering critical issues of profitability benchmarks, projected house prices, and costs of finance. (Colenutt, 2015 and see http://www.theguardian.com/cities/2015/jun/25/london-developers-viability-planning-affordable-social-housing-regeneration-oliver-wainwright)

Exposure of these critical data to the public allows communities to judge whether the local authority is doing its job in interrogating viability reports. Hiding these data increases the suspicion that developers and local authorities together are doing "private" deals behind the backs of communities that have engaged in good faith in extensive consultations over local authority affordable housing policies, but are now finding these policies compromised without proper public scrutiny.

Yet there is a further complication suggested above. Some local authorities are happy to agree to confidentiality clauses over VA. In the much publicised cases of the Heygate and Greenwich Peninsula cases for example, the local authorities were making commercial deals with developers for reasons other than maximising the level of affordable housing (Mathiason and Eriksson, 2015). They were willing in these cases to trade off affordable housing against calculations over sales of local authority owned land or political factors such removing complex planning controversies from their responsibility. The lack of transparency around VAs in these cases was not contested by local authorities, and they even added to it by failing to undertake rigorous interrogation of

VAs. Indeed in the case of Greenwich it is likely that the reduction in affordable housing from 38% of all units to 25% of habitable rooms was agreed in principle on political grounds before the VA, with the VA becoming a way of legitimising a decision already taken.

Conclusions

Viability assessment adds a layer of distrust to the already difficult and complex relationship between developers, local authorities and local communities over housing growth. Sustainable development, though still given prominence in the NPPF, is in practice now subordinated to financial viability. This was informally the case before the NPPF but has now been formalised and given legislative force. It makes all aspects of the planning for housing growth even contested – with the balance of housing mix, urban design, and community infrastructure, and other sustainability measures under threat.

Note

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