Lynton & Lynmouth Neighbourhood Plan

Viability Assessment Guidance

Introduction

1. Viability is a central material consideration when assessing development proposals.

2. A key element of the Plan is to set out a recognised basis for assessing viability, which can be used as the basis for realistic and transparent negotiations on the content of proposals brought forward. To do this requires the establishment of a fair and open method of appraising viability.

3. This is consistent with the National Policy, which requires that the viability of plan policies must be tested and set out clearly in the plans, and that applications consider viability[1].

4. This appendix sets out the principles of assessing development viability, and their use in the policies of this Plan, particularly policies E2 and H2. The Plan will be accompanied by a Technical Assumptions document, kept up to date by LLTC and ENPA, where the current accepted working assumptions for viability assessments can be found. It will include critical inputs and assumptions for assessments such as typical built costs, land costs, and interest rates, recommended tools to use, a fully detailed worked example, and a collection of actual viability assessments for the parish, built up as they are submitted.

Development Viability

5. Viability appraisal of any development proposal is essentially a consideration of whether it is financially able to proceed when all factors are taken into account. These are listed in the table below - factors affecting viability. Full detail of how to take all of these factors into account in viability assessments, and the current accepted working assumptions and critical inputs can be found in the Technical Assumptions document.

[1] National Planning Policy Framework (2012) para 173-175

Factors Affecting Viability

Viability	**Costs**	Build costs – *including contractors' overheads and profits* On-costs – *professional fees, statutory fees, development finance, marketing* (Land value)
	Value	Sales income Rental income Grant Other funding
Risk	**In Development**	Costs, time, quality
	After Completion	Sales, rental income
Finance	**Capital**	Short term development finance
	Revenue	Long term mortgage finance Management and maintenance
Affordability	**Sales**	Open market prices Controlled occupancy prices
	Rental	Open market rents Controlled occupancy rents

6. To be viable, the value of any completed project must exceed the net cost of its development. This applies whether the developer is selling the completed home, or is providing it for rent long term. It also applies whether the development is for a profit making organisation or not: the only difference in that case is whether or not a profit margin is included in the appraisal. The cost of development includes all costs of construction, fees and other 'on- costs', and the land price. Costs and value are central concerns for viability assessment.

7. As the table shows the costs of development are made up of build costs and on-costs, including development finance. Although the land value is shown as a cost, it is often worked out as what is left over once all other costs have been taken into account – a 'residual' land value.

8. The value of a development is mostly made up of sales, and rental streams. For sales, open market sales can be based on the values of similar properties locally. For principal residence housing there will only be a small reduction in price as a result of the occupancy restriction, if at all. For affordable homes for sale the price is discounted for the first and all subsequent purchasers, using a legal agreement.

9. The value of all rental streams is determined by a Net Present Value (NPV) calculation, as explained below. The rent levels use d for this calculation are the prevailing local market rents for open market housing (including principal residence housing), and for affordable homes are set through nationally agreed approaches, taking local prices and / or local incomes into account. There are two common affordable rent levels – social rents (set in accordance with the National Rent Regime), and affordable rents (up to 80% of the 30% decile of local market rents, but not exceeding the Local Housing Allowance)[2].

10. Grant funding may be available through the Homes & Communities Agency (HCA), and can significantly assist viability. It is available to Registered / Investment Providers that develop regularly, and also through single project applications for small organisations - the Community Grants Programme which is aimed specifically at community led housing projects. Local authorities may also fund affordable housing, and proceeds from the New Homes Bonus may make this more common.

11. This is a time of great change in the delivery of affordable housing, for providers and tenants. Things may change significantly through the life of the Plan. Where grant may be available for affordable housing which would meet the needs of the community it should be pursued in order to achieve greatest benefit for the community.

12. Development carries risk, primarily in relation to costs, time and quality in the development stage, and sales or rental income following completion. The higher the risk, the higher the target profit margin or more cautious appraisal assumptions used, affecting overall viability.

13. The financing of a development needs to be looked at both in terms of capital and revenue. Capital costs are those costs incurred in developing the home. Revenue costs are those associated with managing and maintaining a rented property. Virtually all housing developments are debt financed, both for the developers and the owners of the completed homes. Private house builders buy land, build homes and sell them. Their activities are largely debt financed through that development period. Similarly, most purchasers of housing for sale will require a mortgage. Landlords of rented property will require long term finance. The need for and costs of borrowing are therefore central factors in viability assessment.

14. The affordability of the completed development to the local market is also important. For affordable housing rents and sales prices are controlled by nationally agreed approaches, taking local prices and / or local incomes into account. For open market properties rents and prices still have to be such that

[2] The CLTF tool explains how to work these out.

they are able to be sold or rented. Affordability is a significant issue for the area, as the Plan explains.

Viability Assessments Through the Development & Planning Process

15. Viability should be reviewed throughout the development process. It is normal to undertake appraisals not only before purchase negotiations, but similarly before acquisition and before building work commences.

16. Similarly, the viability assessment must be considered before a planning application is submitted. It is good practice to produce the viability assessment to inform consideration of any pre-application discussions.

17. Open book viability assessment is a vital component of this Plan. It is required that viability assessments are available to be checked by all as a central part of the planning application. This means that viability assessments will not be treated as confidential.

Techniques & Tools

18. In assessing a development, the financial viability comparing net cost with value, can be calculated as follows:

Costs	minus	Value
Total cost of development	minus	Grant income Other funding Sales income – market sales Sales income – shared ownership NPV of rental streams

19. To be financially viable the cost of development needs to be lower than the value – i.e. the costs are lower than the value of the development.

20. The value of sales is relatively straightforward - the prices that can be achieved in local housing market conditions, subject to any occupancy conditions, less development period finance charges and the costs of marketing and sales.

21. The value of a rental streams is calculated by projecting forward the income and expenditure of the homes over time and then discounting these cash flows back

to today's value. The cash flows are discounted to recognise that the same money in 30 years time is worth less than it would be today. This is known as a Discounted Cash Flow (DCF). The result of this DCF is known as the Net Present Value (NPV) (the CLTF tool does this automatically). This must include allowances for void levels, expenditure on management, repairs and long-term renewal of components such as heating and electrical installations, kitchens, doors, windows, roofs, etc.

22. There is a broad range of viability tools available. For this Plan the use of the tool provided by the Community Land Trust Fund (CLTF) is recommended as it is designed for use in small projects such as will be brought forward in the Plan area, and is recognised for use in rural locations.

23. The approach outlined above is used in the CLTF appraisal tool, which can be accessed using the following link: www.cltfund.org.uk/tool. The web site also provides comprehensive guidance notes on how to use the tool.

24. The Technical Assumptions document contains fuller guidance on the use of this tool, a full worked example, and over time will also include actual examples from the Plan area. A simplified version of the worked example is run through below, to give an overview of how viability assessment can work in practice.

Simplified Worked Example

25. This is a hypothetical scheme using the CLTF appraisal tool. Full detail and a working copy of this appraisal are part of the Technical Assumptions document.

26. The scheme is based on a six unit development of three bedroom houses. It is a mixed tenure site, with two principal residence properties for sale at £200,000 and four properties to be rented at affordable rents at 80% of market rents. The market rents have been assumed to be £140 per week, and the affordable rent set at 80% of that, i.e. £112.

27. A build cost of £1100/m^2 is assumed and taken the default values in the CLT model for all other variables. It is important to understand what is included in – and excluded from – a build cost figure. Using a house of 85 m^2 floor area as an example, a typical rural developer on a smaller site, building to a reasonable environmental standard such as Code for Sustainable Homes Level 3, might expect to be able to build the house for £76500 or £900/m^2 . External works, roads, sewers, etc. could account for an additional £8,000, and statutory fees, bonds and charges £2,000. In addition, if the developer uses a general contractor, the contractor requires a contribution to overheads and profit – say

£8,000. This brings us to an all-in figure of £95,500 i.e. just over £1100/m^2 . Professional fees add an estimated 10% to the total project cost, and planning and building regulations fees also have to be added. This gives a total project cost of £1235.80/m^2 .

28. Factors such as the use of modern methods of construction or involvement of social enterprises can help reduce build cost.

29. Part of the viability assessment will be to ensure that suggested build costs are reasonable and well justified.

30. Overall the scheme has a surplus of £91,006 and so is viable. The sum of £91,006 is effectively the value of the land. What is also happening here is that the principal residence housing is cross subsidising the affordable housing, allowing both to proceed, as the Plan requires. If the developer is for a non-profit distributing organisation such as a Community Land Trust then there will be no further cost, but if the developer is a commercial developer, then part of the surplus would be a contribution to gross profit, which would reduce the land value.

Costs	**minus**	**Value**
Total cost of development Build cost £561,000 Fees £61,100 Development interest £8,159	minus	Grant income – none Other funding – none Sales income – market sales - £400,000 Sales income – none NPV of rental streams - £321,266
£630,258	minus	£721,266
= £91,006		

31. Cash flow deficits in the early years of a development, interest cover, and the point in time at which all borrowing could be paid off are also important to take into account and explained in greater detail in the Technical Assumptions document.

32. The Technical Assumptions document, kept up to date by Lynton & Lynmouth Town Council and Exmoor National Park Authority, is where the current accepted working assumptions for viability assessments can be found. It will include critical inputs and assumptions for assessments such as typical built costs, land costs, and interest rates, recommended tools to use. These should be used as starting points for any appraisal.