EPOA PLANNING SKILLS 2019
Viability and Capturing Development Value
Advanced Appraisals

Christopher Marsh FRICS MRTPI

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The Importance of Development Appraisals

- Policy Context
  - Increasingly critical to test Policies in terms of Financial Viability BEFORE adoption
    - PPS3 Para. 29 re Changing Affordable Housing Thresholds
    - Strategic Housing Land Availability Assessments – Section 7C
    - CIL testing and more generally, post Circular 05/05
    - NPPF + Growth and Infrastructure Act
    - Government changes in 2018, especially the new NPPF and PPG
- Site Specific Financial Testing

The Importance of Development Appraisals

- Policy Context
  - Increasingly critical to test Policies in terms of Financial Viability <u>BEFORE</u> adoption
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    - Strategic Housing Land Availability Assessments – Section 7C
    - CIL testing and more generally, post Circular 05/05
    - NPPF + Growth and Infrastructure Act
    - Government changes in 2018, especially the new NPPF and PPG
- Site Specific Financial Testing
- CRUCIAL FOR PLANNERS TO KNOW WHAT TO LOOK OUT FOR !!!!

An understanding of the Basics of Residual Valuations – Quick Summary

- Simple method for appraising development viability
- Initial 'Filtering' of projects before DCF
- To determine maximum value of a Development Site – the 'Bid' value.
- To calculate expected Profit and cost ceiling
- NOTE: Sq.m. and Sq.ft. = 10.76

The Residual Valuation

The Basics

- Simple method for appraising development viability
- Completed Value of the Development

-

Construction Costs

-

Developers Profit

=

Residual Land Value

Purposes

- To determine maximum value of a Development Site – the 'Bid' value.
  – Albeit note Review Mechanisms
- To calculate expected Profit
- To calculate a cost ceiling

COMPLETED DEVELOPMENT VALUE

-

CONSTRUCTION COSTS, FEES ETC.

-

DEVELOPER'S PROFIT

=

RESIDUAL LAND VALUE

(Must exceed Existing Use Value – See NPPF 18)

COMPLETED DEVELOPMENT VALUE

-

CONSTRUCTION COSTS, FEES ETC.

PLANNING OBLIGATIONS /CIL

-

DEVELOPER'S PROFIT

=

RESIDUAL LAND VALUE

(Must exceed Existing Use Value)

REDUCTION

COMPLETED DEVELOPMENT VALUE

-

CONSTRUCTION COSTS, FEES ETC.

PLANNING OBLIGATIONS

AFFORDABLE HOUSING

REDUCTION

-

DEVELOPER'S PROFIT

=

RESIDUAL LAND VALUE

(Must exceed Existing Use Value)

COMPLETED DEVELOPMENT VALUE

Percentage/ Tenure/ Value

-

CONSTRUCTION COSTS, FEES ETC.

PLANNING OBLIGATIONS

AFFORDABLE HOUSING

REDUCTION

-

DEVELOPER'S PROFIT

=

RESIDUAL LAND VALUE

(Must exceed Existing Use Value)

COMPLETED DEVELOPMENT VALUE

Percentage/ Tenure and new initiatives ?

-

CONSTRUCTION COSTS, FEES ETC.

PLANNING OBLIGATIONS

AFFORDABLE HOUSING

REDUCTION

-

DEVELOPER'S PROFIT

=

RESIDUAL LAND VALUE

(Must exceed Existing Use Value)

COMPLETED DEVELOPMENT VALUE

-

CONSTRUCTION COSTS, FEES ETC.

PLANNING OBLIGATIONS

AFFORDABLE HOUSING

CIL

-

DEVELOPER'S PROFIT

=

RESIDUAL LAND VALUE

(Must exceed Existing Use Value)

A Simple Case

- 40,000ft2 Office Building gross
- City Fringe location – not prime
- Pre-let to solid covenant at £30.00psf/pa.
- Developer is competing for the land with others.
- MAXIMISE LAND VALUE or what you think you can get away with – Speculative additional profit !

Development Value

Rental Income 32,000ft2 net @ £30
960,000pa

Yield @ 8%		12.5
Completed Value		£12,000,000

Construction Costs

Build Costs 40,000ft2 gross @ £160	£6,400,000	
Ancillaries	320,000	
Fees	800,000	
Contingency	320,000	
Borrowing @8% on Costs for 9mths	470,400	8,310,400

Developers Profit @ 15% on Value	1,800,000
Residual Land Value	£1,889,600

(Less fees and interest on borrowing)

What's the problem ?

Development Value

Rental Income 32,000ft2 net @ £30 960,000pa

Development Value

Rental Income 32,000ft2 @ £30 960,000pa

Problems:

- Is the rental evidence reliable ?
- Will the pre-let require special terms ?
- Will the lease provide the developer with enough security ?
- Temptation to assume early rental growth to boost bid value ?

SENSITIVE VARIABLE

Development Value

Rental Income	32,000ft2 @ £30	960,000pa
Yield @ 8%		12.5
Completed Value		£12,000,000

Risk and Yield

RENT	YIELD	MULTIPLIER YEARS PURCHASE	CAPITAL VALUE
1000	5% Low Risk	20	20,000 High Value
1000	8%	12.5	12,500
1000	10% High Risk	10	10,000 Low Value

Risk and Yield

RENT	YIELD	MULTIPLIER YEARS PURCHASE	CAPITAL VALUE
960,000	7.5%	13.33	12,800,000
960,000	8%	12.5	12,000,000
960,000	8.5%	11.76	11,290,000

Development Value

Rental Income	32,000ft2 @ £30	960,000pa
Yield @ 8%		12.5
Completed Value		£12,000,000

VERY SENSITIVE VARIABLE INDEED
ESPECIALLY ….

The Peak of the Market

Demand falls – Rental Growth slows

Capital Values fall

Developments Unviable

Banks stop lending

Bankruptcies

Recession – little or no development activity

Increased Demand as Recovery begins

Reduction in Over-supply

Rents Rising

Development Activity

Capital Values Rising

WHAT TIME IS IT?

Development Value

Rental Income	32,000ft2 @ £30	960,000pa
Yield @ 8%		12.5
Completed Value		£12,000,000

Construction Costs

Build Costs 40,000ft2 @ £160 £6,400,000

PROBLEMS: Better Information base: Reliable Estimates: BUT Unexpected changes and problems.

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OTHER COST VARIABLES ????

Developers Profit @ 15% on Value
1,800,000

PROBLEMS:

-Does the margin adequately reflect risk ?

-Temptation to prune profits if capital values rising in order to raise land value and win the scheme

Residual Land Value

£1,889,600

(Less fees, interest on borrowing and present value)

Question of Confidence ?

Your Case

- Mixed Use Development Proposal
  - 100 Residential Units
    (Average 700ft2 net) 70,000 ft2
  - Office use net 16,000 ft2
- Town centre fringe location – not prime
- Offices pre-let to solid covenant at £30.00psf/pa.
- Developer is competing for the land with others.
- 30% Affordable Housing Policy – 70-30 split BUT tenure types may vary?
- Obligations £10,000 per unit + some commercial

Gross Development Value

Residential Sales Values

- 70 units x £250psf (Gross/Net 80%)	
- Capital Value	£12,250,000
- 30 Affordable Units @ 55-65% OMV	3,150,000
Offices Rental Income 16,000ft2 @ £30	480,000pa
- Yield @ 8% - YP Multiplier	12.5
- Capital Value	£6,000,000
Total Gross Development (Capital) Value	£21,400,000

Questions ?

- Quality of comparable residential evidence
- Confirmation of RSL offers (conditional ?)
  - Grant assumptions – No Grant - Mixed tenures?
- Evidence of commercial rents and yields
  - Investment transactions – keeping a record?
- Exaggerating Gross to Net – better layout?
- Missing items
  - Income/ sales from Car Parking ?
  - Ground rents from flatted units – small but count ?

Development Value		£ 21,400,000
Construction Costs		
Build Costs (Gross)		
Private Resid	61,250ft2 @ £130psf	£7,962,500
AH	26,250ft2 @ £120psf	£3,150,000
Offices	20,000ft2 @ £120psf	£2,400,000
Total		£13,512,000

Development Value	£ 21,400,000
Construction Costs	£13,512,000
Ancillaries 5% on Cost	675,600
Fees 12.5% on Cost	1,689,000
Contingency 5% on Cost	675,600
Planning Obligations	
£10,000 per Residential unit	1,000,000
Commercial space say	200,000
Borrowing (18mth build)@8% for 9mths	1,065,000
(half time or half amount)	
Total Costs	£18,817,332

Questions ?

- Can the costs be justified?
- What has been included? Exceptional costs – specify costs?
- Code level (CfSH) 3 or 4+ or equivalent?
- Confusing Gross and Net floorspace ?
- Parking costs but no income ?
- Where are the savings – fees, borrowing ?
- Can the Obligations be substantiated ?

Development Value	£ 21,400,000
Total Costs	£18,817,332
Profit on Value/ Cost - 15% on Value	 3,210,000
Residual Land Value	- £627,332

Questions ?

- Is the return justifiable?
- Has a profit margin been applied to affordable housing ?
- Will the Banks lend?

Overall

- Can the financial variables be proven?
- Is there sufficient supporting evidence ?
- Is there any <u>gap</u> funding ?
- Will circumstances improve in later phases?
- How does Residual Value compare to real Existing Use Value?
- LPA capacity to claw back shortfalls up to policy compliance
- Short and longer term strategies
- ALL ABOUT <u>REVIEW</u> MECHANISMS **<u>BUT</u>**

Key Questions

- How do the values compare?
- Local Housing Needs Assessments
- Local Plan policy on AH
- Whatever happened to Localism and Decentralisation?
- The devil is in the detail

NPPF and PPG 2018

- New Plans specify contributions – compliant proposals assumed to be viable
- > GDV and Costs at plan-making stage. Profit 15-20% of GDV. Optimistic?
- Land Value is EUV+ (Existing use +). Major task for LPAs
- Aff Housing on all 10+ schemes
- Price paid for land no justification for schemes not being policy compliant

Contacts

- Chris Marsh FRICS MRTPI
- marshc@suspc.o.uk
- 01233 612575
- 07940063781

Feedback please!

Please mention any points with me as you leave.

Let me know how the session was for you.
Have you gained? And did it meet your expectations?

And please email PlanningSkills@essex.gov.uk
with any comments on the session.

> Any improvements you want to suggest ?
> And any subjects/aspects you want to added in future training

We will be introducing online feedback at the end of sessions
later in the series – using Smartphones.