EPOA PLANNING SKILLS 2019
Viability and Capturing Development Value
Advanced Appraisals

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March 6th, 2019
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 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

  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)
COMPLETED DEVELOPMENT VALUE

CONSTRUCTION COSTS, FEES ETC.

PLANNING OBLIGATIONS

AFFORDABLE HOUSING

DEVELOPER’S PROFIT

RESIDUAL LAND VALUE
(Must exceed Existing Use Value)
COMPLETED DEVELOPMENT VALUE

CONSTRUCTION COSTS, FEES ETC.

PLANNING OBLIGATIONS

AFFORDABLE HOUSING

REDUCTION

Percentage/ Tenure/ Value

DEVELOPER’S PROFIT

RESIDUAL LAND VALUE

(Must exceed Existing Use Value)
COMPLETED DEVELOPMENT VALUE

CONSTRUCTION COSTS, FEES ETC.

PLANNING OBLIGATIONS

AFFORDABLE HOUSING

REDUCTION

Percentage/ Tenure and new initiatives?

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!
<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Development Value</strong></td>
<td></td>
</tr>
<tr>
<td>Rental Income 32,000ft² net @ £30</td>
<td></td>
</tr>
<tr>
<td>960,000pa</td>
<td></td>
</tr>
<tr>
<td>Yield @ 8%</td>
<td>12.5</td>
</tr>
<tr>
<td>Completed Value</td>
<td>£12,000,000</td>
</tr>
<tr>
<td><strong>Construction Costs</strong></td>
<td></td>
</tr>
<tr>
<td>Build Costs 40,000ft² gross @ £160</td>
<td>£6,400,000</td>
</tr>
<tr>
<td>Ancillaries</td>
<td>320,000</td>
</tr>
<tr>
<td>Fees</td>
<td>800,000</td>
</tr>
<tr>
<td>Contingency</td>
<td>320,000</td>
</tr>
<tr>
<td>Borrowing @ 8% on Costs for 9mths</td>
<td>470,400  8,310,400</td>
</tr>
<tr>
<td><strong>Developers Profit @ 15% on Value</strong></td>
<td>1,800,000</td>
</tr>
<tr>
<td><strong>Residual Land Value</strong></td>
<td>£1,889,600</td>
</tr>
<tr>
<td>(Less fees and interest on borrowing)</td>
<td></td>
</tr>
</tbody>
</table>

6/3/2019
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

<table>
<thead>
<tr>
<th>RENT</th>
<th>YIELD</th>
<th>MULTIPLIER YEARS PURCHASE</th>
<th>CAPITAL VALUE</th>
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</thead>
<tbody>
<tr>
<td>1000</td>
<td>5%</td>
<td>20</td>
<td>20,000</td>
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<tr>
<td></td>
<td><strong>Low Risk</strong></td>
<td></td>
<td><strong>High Value</strong></td>
</tr>
<tr>
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<td>10,000</td>
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6/3/2019
## Risk and Yield

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<th>CAPITAL VALUE</th>
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</thead>
<tbody>
<tr>
<td>960,000</td>
<td>7.5%</td>
<td>13.33</td>
<td>12,800,000</td>
</tr>
<tr>
<td>960,000</td>
<td>8%</td>
<td>12.5</td>
<td>12,000,000</td>
</tr>
<tr>
<td>960,000</td>
<td>8.5%</td>
<td>11.76</td>
<td>11,290,000</td>
</tr>
</tbody>
</table>
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

Recession – little or no development activity

Demand falls – Rental Growth slows

Capital Values fall

Developments Unviable

Banks stop lending

Bankruptcies

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.
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
Ancillaries  320,000
Fees  800,000
Contingency  320,000
Borrowing @8% on Costs for 9mths  470,400  8,310,400

OTHER COST VARIABLES ????

6/3/2019
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

6/3/2019
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

6/3/2019
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 ?

6/3/2019
## Development Value

£ 21,400,000

## Construction Costs

### Build Costs (Gross)

<table>
<thead>
<tr>
<th>Category</th>
<th>Square Feet</th>
<th>Cost Per $/ft²</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Resid</td>
<td>61,250</td>
<td>£130</td>
<td>£7,962,500</td>
</tr>
<tr>
<td>AH</td>
<td>26,250</td>
<td>£120</td>
<td>£3,150,000</td>
</tr>
<tr>
<td>Offices</td>
<td>20,000</td>
<td>£120</td>
<td>£2,400,000</td>
</tr>
</tbody>
</table>

**Total**                 £13,512,000

6/3/2019
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

6/3/2019
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 gap 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 REVIEW MECHANISMS BUT

6/3/2019
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

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- 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.