

REPORT TO: Planning Committee
Cabinet Member – Regeneration
Cabinet

DATE: 18 August 2010
1 September 2010
2 September 2010

SUBJECT: Informed Assessment of the Economic Viability of
Affordable Housing in Sefton

**WARDS
AFFECTED:** All

REPORT OF: Andy Wallis, Planning & Economic Regeneration Director
Alan Lunt, Neighbourhoods & Investment Programmes
Director

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**EXEMPT/
CONFIDENTIAL:** No

PURPOSE/SUMMARY:

To report the comments received during consultation on the draft Informed Assessment of the Economic Viability of Affordable Housing (available to view online at www.sefton.gov.uk/affordablehousing)

To seek approval of the final Informed Assessment of the Economic Viability of Affordable Housing (available to view online at www.sefton.gov.uk/affordablehousing) as part of the evidence base for the Local Development Framework, taking into account consultation comments.

REASON WHY DECISION REQUIRED:

To comply with national planning guidance on the need to provide a robust evidence base for Sefton's affordable housing policies in the Local Development Framework

RECOMMENDATION(S):

That:

- (i) Planning Committee and Cabinet Member - Regeneration note the comments received during consultation process into the draft study, the responses to those comments, endorse the final Informed Assessment of the Economic Viability of Affordable Housing and recommend that Cabinet approves them to inform the emerging Core Strategy for Sefton;
- (ii) Subject to (iii) below, Planning Committee adopts the key findings of the study to inform the emerging Core Strategy process for Sefton; and
- (iii) **Cabinet notes the comments received during consultation process, the responses to those comments and approves the final Informed Assessment of the Economic Viability of Affordable Housing to inform the emerging Core Strategy process for Sefton.**

KEY DECISION: YES

FORWARD PLAN: YES

IMPLEMENTATION DATE: Following expiry of call in period after Cabinet meeting on 2nd September 2010

ALTERNATIVE OPTIONS:

None

IMPLICATIONS:

Budget/Policy Framework:

Financial:

The cost of the study (£25,000) has been covered by an existing agreed budget line in the Housing Capital Programme.

<u>CAPITAL EXPENDITURE</u>	2009/ 2010 £	2010/ 2011 £	2011/ 2012 £	2013/ 2014 £
Gross Increase in Capital Expenditure				
Funded by:				
Sefton Capital Resources				
Specific Capital Resources				
<u>REVENUE IMPLICATIONS</u>				
Gross Increase in Revenue Expenditure				
Funded by:				
Sefton funded Resources				
Funded from External Resources				
Does the External Funding have an expiry date? Y/N	When?			
How will the service be funded post expiry?				

Legal: N/A

Risk Assessment: N/A

Asset Management: N/A

CONSULTATION UNDERTAKEN/VIEWS

- FD 480 – The Interim Head of Corporate Finance and ICT Strategy has been consulted and has no comments on this report.
- The Head of Corporate Legal Services has been consulted and there are no legal implications in this report.

CORPORATE OBJECTIVE MONITORING:

<u>Corporate Objective</u>		<u>Positive Impact</u>	<u>Neutral Impact</u>	<u>Negative Impact</u>
1	Creating a Learning Community		√	
2	Creating Safe Communities		√	
3	Jobs and Prosperity	√		
4	Improving Health and Well-Being	√		
5	Environmental Sustainability	√		
6	Creating Inclusive Communities	√		
7	Improving the Quality of Council Services and Strengthening local Democracy		√	
8	Children and Young People		√	

LIST OF BACKGROUND PAPERS RELIED UPON IN THE PREPARATION OF THIS REPORT

Affordable Housing Viability Assessment Final Report, Three Dragons, July 2010

INFORMED ASSESSMENT OF THE ECONOMIC VIABILITY OF AFFORDABLE HOUSING IN SEFTON

BACKGROUND:

- 1.1 Members may recall earlier this year (i.e. Planning Committee 10th March 2010, Cabinet Member – Regeneration 17th March 2010) that a draft Informed Assessment of the Economic Viability of Affordable Housing was reported before going out for public and stakeholder consultation. The need to carry out such an assessment is set out in Planning Policy Statement 3 and reinforced by the landmark Blyth Valley Legal Decision. This essentially concluded that a Core Strategy could be found unsound if its affordable housing policies were not supported by such an assessment. This line has subsequently been firmly supported by the Planning Inspectorate at Core Strategy public inquiries.
- 1.2 The assessment was produced on the Council's behalf by its retained specialist consultants Three Dragons (the commissioning of whom was reported to Planning Committee on 6th May 2009, Cabinet Member – Regeneration on 6th May 2009, and Cabinet on 14th May 2009). The assessment was informed by a range of evidence (such as data on past affordable housing projects, residential land values and house prices) and through information gathered from an initial workshop held with representatives from developers, registered social landlords, private sector landlords, neighbouring authorities and government housing and development agencies in August 2009.
- 1.3 In line with best practice the draft assessment was made available for wider public and stakeholder consultation, before being finalised.

CONSULTATION UNDERTAKEN:

- 2.1 The consultation period for comments to be made on the draft Assessment began on 25th March 2010. In line with our Statement of Community Involvement the draft Assessment was made available to view in a number of locations throughout Sefton, including the Planning offices in Bootle, at Bootle, Crosby, Formby, Maghull and Southport libraries and on the Sefton website. The availability of the draft Assessment was advertised in the local press, in the London Gazette and on the Sefton website. We also sent letters to over 200 organisations our Local Development Framework database.
- 2.2 Additionally we held a further workshop, hosted by our consultants Three Dragons during the consultation period. The workshop was held on 17th May 2010 in Bootle Cricket Club and was attended by representatives from developers, registered social landlords, private sector landlords and neighbouring authorities. At the workshop the discussions centred on the key findings of the draft assessment, including the level of affordable housing we should seek in different locations, the size of developments that we should apply affordable housing policies to and the potential use of commuted sum

payments in lieu of affordable homes that cannot be provided on site as part of a development.

- 2.3 Overall the consultation period ran for 9 weeks and concluded on Friday 28th May 2010. This was longer than our usual 6 week consultation but allowed the consultation to straddle the Easter holidays and for comments to be made following the second workshop to be taken into consideration. In total we received comments from 9 organisations. These comments are set out in a report of consultation available to view at www.sefton.gov.uk/affordablehousing along with our response and changes made to the assessment as a result.

SUMMARY OF COMMENTS RECEIVED DURING CONSULTATION:

- 2.4 The comments received to the draft assessment were wide-ranging and detailed but some common themes were identified.

(i) Study Methodology

- 2.5 It was questioned whether there was too much reliance on findings that are based primarily on a model. Given the wealth of information that Sefton has from its recently completed Strategic Housing Land Availability Assessment (SHLAA) and Strategic Housing Market Assessment (SHMA) couldn't the assessment be based more on empirical evidence?
- 2.6 *Three Dragons Response – In their experience of undertaking these studies an approach that is based on actual sites will inevitably suffer from lack of detailed information. It is very difficult to draw policy conclusions in a systematic way based on a sample of sites. Rather a more generalised approach is needed to draw out the key policy lessons. Analysis of actual sites may also undersell policy where the sample is often, in their experience, weighted too heavily towards high abnormal development costs. Using a High Level testing approach allows policy to be assessed on the basis of normal costs and revenues across a range of sub markets. Nonetheless, those sites that have particular issues that would affect the viability of affordable housing would be subject to detailed discussions using the assessment as a starting point.*
- 2.7 The methodology assumes that higher levels of affordable housing do not affect market house prices. Anecdotal evidence shows that there is a correlation between higher levels of affordable housing and a decrease in market prices. The methodology should factor in this when determining viability.
- 2.8 *Three Dragons Response – We are unaware of any systematic body of evidence that suggest that prices change in line with the percentage of affordable homes and accordingly do not accept this point. This information was requested from the workshop but none was forthcoming. It is the consultants' view, in line with similar studies carried out elsewhere, that a 'stigma' effect should not be attached to the analysis, particularly where*

housing needs are pressing. If a developer can prove such an impact on a particular site, then this should be evidenced in the site specific data provided.

(ii) Impact of section 106 requirements

- 2.9 The assessment assumes a standard level of section 106 contributions of £5000 per unit. It isn't clear what this includes, for instance the requirement to build homes to meet the Code for Sustainable Homes Standard. In many cases the contributions can be significantly greater and this may be exacerbated by the future introduction of a tariff-based system such as Community Infrastructure Levy (CIL). The level of contributions and other associated costs are important factors in assessing viability of affordable homes.
- 2.10 *Three Dragons Response – We accept that in some cases costs are greater than £5000 per unit. A per unit levy was tested in the report and acts as a proxy for any form of CIL or tariff. In addition, the assessment commented on a level of £10,000 per unit. Notwithstanding this, the Council will have to be flexible in weaker market locations to ensure costs do not make affordable housing unviable.*

(iii) Financial assumptions and modelling

- 2.11 The assessment needs to establish the actual land values at which land will be brought forward for development. Judgement will need to be made about the uplift over and above existing land use values and how this 'planning gain' will affect the viability of affordable homes.
- 2.12 *Three Dragons Response – There is a difference between land value and residual value. The market process will settle the value of land. Where the market does not discount land for the policy then what is paid for land could be higher than what it is worth. Uplift will not necessarily be the whole basis of the process in setting policy. The consultants would not wish to prescribe this uplift too tightly as it will vary for different types of sites. The workshop did not provide any standard assumptions for uplifts although the consultants have taken into account the experience of other similar authorities when recommending the policy target options.*
- 2.13 The assessment does not differentiate between the financial assumptions of small sites (those below 15 homes) and larger sites. Small sites are self evidently unable to benefit from the economies of scale and fixed costs are likely to represent a larger share of the development budget.
- 2.14 *Three Dragons Response – Numerous workshops have been held in most parts of the country where small sites have not been seen as being systematically more expensive to develop than large ones. The consultants accept the argument about economies of scale and costs may be higher on smaller sites. However, evidence from the Valuation Office tends to support the argument that smaller sites, in general, tend to generate higher land values*

than larger ones. This is likely to suggest that although costs may be higher, values are also higher (and 'exclusivity' factor).

- 2.15 The assessment does not assume any costs relating to the acquisition and holding of land. Land is an 'upfront' cost in the development process and the cost of holding land throughout the development process can be significant.
- 2.16 *Three Dragons Response – There is a land finance deduction of 10% off residual to take account of this. Inevitably this may not be enough in some instances but will be too much in others. Site by site testing for negotiations will discover the actual scale of this cost in any given location.*
- 2.17 The assessment assumes a reasonable developer profit as 15% but it should be noted the level of profit a developer would expect is reflective of the risk involved. Other well established residual land valuation models advise 17.5 – 20% developer profit with some other specialist types of accommodation expecting a profit of 20-25%.
- 2.18 *Three Dragons Response – A 15% margin has recently been held (at the Hinckley and Bosworth Core Strategy Development Plan Inquiry) as being a reasonable figure for plan making purposes. However the Council may possibly be prepared under very difficult market conditions to accept a higher margin subject to justification. It is always important in these situations to make a distinction between profit on (gross development) value and cost. In our experience a 15% margin on value will usually generate a 20% return on cost. In higher value areas this will be higher still. Recent developments in the Sefton area have gone ahead with a margin below 15%. The Council may be prepared, according to market circumstances, to accept a higher margin in site-specific cases.*

(iv) Site specific issues

- 2.19 Formby should not have higher affordable housing targets than elsewhere. There should be a single target for the whole of Sefton set at the indicative national standard of 15 homes.
- 2.20 *Three Dragons Response – The sites with the greatest potential for affordable housing are the higher value areas. The report underlines the difficulty in delivering affordable housing in lower value areas. A large amount of Sefton's available land for development is on small sites. By not lowering the threshold for affordable housing it would limit the amount that would be delivered.*
- 2.21 Is the absence of any mention of Melling due to the lack of sites in the area and therefore the affordable housing policy is not applicable?
- 2.22 *Three Dragons Response – The assessment refers to the main settlement areas only. Melling, for the purposes of this assessment, is included in the Maghull area. Although there may not be identified sites in Melling at present,*

such sites could become available in the future and affordable housing policies should therefore cover the whole of Sefton.

KEY FINDINGS AND POLICY RECOMMENDATIONS OF FINAL ASSESSMENT

3.1 Although changes have been made to the draft Assessment as a result of comments made, essentially the key findings remain unchanged in the final assessment (available to view at www.sefton.gov.uk/affordablehousing). The key findings set out in the assessment are:

(i) Identification of housing sub-markets in Sefton

3.2 It is apparent that the local variation in house prices has a significant impact on the viability of affordable housing in a particular scheme. A broad analysis of house prices in Sefton using HM Land Registry data was undertaken and identified seven viability sub markets -

- Prime Sefton (broadly Birkdale, Ainsdale and Blundellsands)
- Formby
- Crosby, Hightown and Rural Hinterland
- Maghull and Aintree
- Southport
- Litherland, Orrell and Netherton
- Bootle and Seaforth

3.3 These different sub-markets have significant differences in the residual value able to cross-subsidise affordable housing. For example, a housing scheme in Prime Sefton with 30% affordable housing, at 40 dwellings per hectare (dph), will generate nearly £3 million residual value per hectare. The same scheme in Bootle will have costs of almost £0.5 million per hectare greater than its revenue (i.e. will have a negative residual value). On this basis, the study advises that a single affordable housing target for the Borough would be a very difficult policy position to defend.

(ii) Testing the viability of a range of housing developments to deliver affordable housing

3.4 A number of development models were tested, using a range of size, house types and densities. These examples were chosen to reflect the range of sites that have been and are currently or likely to be available for development in Sefton. This testing showed that higher density development (over 80dph) looks marginal even without an affordable housing element in locations such as Bootle, Seaforth, Litherland and Orrell. However, in higher value areas, affordable housing contributions on higher density schemes should be viable.

3.5 The introduction of external grant makes a significant difference in the mid to lower sub markets, although in the weakest sub-market areas grants may not be enough to 'rescue' schemes seeking an affordable housing element.

- 3.6 The analysis also shows that residual values are very sensitive to changes in house prices, both in the short and long term, and that additional costs, such as remediation works or the Code for Sustainable Homes can have significant impacts on scheme viability, most clearly in the lower value sub-markets. Viability is also highly sensitive to the relationship between existing (or, where relevant, alternative) use value. In this regard, affordable housing will often be viable on sites, for example, in back or garden use. However, small-scale redevelopment and conversion schemes (typically under 5 units) 'will be significantly challenging on viability grounds'.
- 3.7 The analysis of Sefton's supply of sites (based on extant unimplemented planning consents and the five-year land supply) suggests that smaller sites (less than 15 units) make a significant contribution (i.e. about 30%) to housing supply. Given this, Sefton's current policy approach (i.e. applying affordable housing requirements to sites 15 dwellings or more) is likely to 'miss' a significant opportunity to provide affordable housing in some parts of the Borough. From a housing management perspective the study did not find any, in principle, objections to the on-site provision of affordable housing on small sites, although a financial payment for off-site approach could be considered in certain circumstances.

(iii) Conclusions and Policy Recommendations

- 3.8 The report recommends that Sefton adopt the following key affordable housing policy positions through its Local Development Framework:
- Based on strict viability approach apply a dual target broadly splitting the main urban area of Sefton, including Bootle and Seaforth and Litherland, Orrell and Urban Sefton (called 'lower value Sefton' in the report) versus the remaining higher value sub-markets. On this basis, Three Dragons propose a 30% target for the higher value areas and a 15% target for the lower value areas. Alternatively, the report suggests that the Council could consider a more location specific based approach, including a three-way policy target, to the level of affordable homes required in housing schemes. This would set a target of 30% for Prime Sefton (Ainsdale, Birkdale and Blundellsands) and Formby; 25% for Crosby, Maghull and Southport; and, 10% for Litherland, Orrell, Bootle and Seaforth.
 - That the Council should adopt a dual threshold approach for when the affordable housing target is implement, with a size threshold of 15 dwellings in the Pathfinder area and a size threshold of 5 dwellings elsewhere. Three Dragons think a size threshold below 5 dwellings would be difficult to justify in viability terms anywhere in the Borough.
 - Importantly if there is any doubt about viability on a particular site, Three Dragons note that it will be the responsibility of the developer to make a case that applying the Council's affordable housing requirement for their scheme makes the scheme not viable. (Members may be aware that this is currently the

approach that Sefton applies where the viability of a proposal to deliver affordable housing is in question).

- In cases where it may not be feasible or appropriate to provide affordable housing on-site, Three Dragons consider that a commuted sum payment (based on the equivalent amount which would be contributed by the developer/landowner were the affordable housing provided on site) could be sought. This would require the Council to have a clear strategy to ensure the money is spent effectively on delivering affordable housing elsewhere and in a timely manner.

Implications of Assessment and Key Conclusions

- 4.1 The final assessment will be a key piece of evidence for the Core Strategy and when taken together with the already completed Strategic Housing Market Assessment (and any updates to it that may be produced) will underpin our affordable housing policies. In short, the findings of the assessment will be evaluated in combination with evidence on housing need and will enable future policies to seek affordable housing in the areas where it is most needed and most viable.
- 4.2 At this point in time and ahead of the potential development of any new affordable housing policies through the emerging Core Strategy process, it is **not** proposed to make any immediate changes to the Council's current negotiating position with regard to affordable housing, as set out on the website at www.sefton.gov.uk/planningstudies
- 4.3 In this regard, Members will be aware that where there is a disagreement about the economic viability of a scheme, with regard to affordable housing, consistent with PP3 advice, Three Dragons, are normally instructed to undertake a site specific viability assessment (e.g. the former Leaf site at Virginia Street, Southport, is a case in point). This is in full recognition of the key point that the Council can only seek an affordable housing contribution (either in terms of on site provision or an off-site commuted sum in lieu) where it is economically viable to do so.
- 4.4 To conclude, this very important further study reaffirms the importance and prudence of the transparent viability approach we are currently adopting with regard to negotiating affordable housing in Sefton. Whilst providing a thorough overview of the viability of affordable housing at the Borough and sub-Borough level as a basis for affordable housing policy development, the study recognises that individual sites may vary from the norm. Accordingly, it further anticipates, notwithstanding any new affordable housing policy framework that may emerge through the Core Strategy process, that the current 'bespoke' viability approach will need to continue in the future on a site specific basis where economic viability is in question. This will ensure that the Council's position is protected at potential planning appeal and will also ensure that development viability is not prejudiced by unrealistic affordable housing

requirements. In this regard, what we are doing closely accords with PPS3 advice on affordable housing.

Recommendations

That:

- (i) Planning Committee and Cabinet Member - Regeneration note the comments received during consultation process into the draft study, the responses to those comments, endorse the final Informed Assessment of the Economic Viability of Affordable Housing and recommend that Cabinet approves them to inform the emerging Core Strategy for Sefton;
- (ii) Subject to (iii) below, Planning Committee adopts the key findings of the study to inform the emerging Core Strategy process for Sefton; and
- (iii) Cabinet notes the comments received during consultation process, the responses to those comments and approves the final Informed Assessment of the Economic Viability of Affordable Housing to inform the emerging Core Strategy process for Sefton.