

FAO: Steve Jackson, Capita

30 October 2024

Roger Hannah Viability Response Note: Cown Top, Trows Farm, Rochdale

We have prepared this note in response to the various discussions that took place with Capita at the meeting on 25 October 2024 between ourselves, Barratt Homes, WSP and Capita (representing the Council).

The meeting focussed on the viability of the proposed scheme following Capita issuing various documents for review and discussion on 23 October 2024. We have covered the salient areas of discussion below.

Gross Development Value

Across a scheme of this scale, the overall difference between us in GDV is relatively nominal, with the RH GDV totalling £132,053,000 and the Capita GDV totalling £134,169,000. We have reviewed the Capita pricing schedule in more detail.

The main areas of difference relate to the 2.5 storey house types and the larger detached dwellings. When reviewing in more detail, we note that no discount has been applied to the 2.5 storey house types, which is not reflective of the nature of these house types.

The increased circulation space of stairs/landing space generally means these house types are less efficient because there is less usable space. A more traditional 2 storey house type will also have a 50:50 balance between living and sleeping accommodation. This is not the case with 2.5 storey house types which often have 30 – 40% living accommodation, or less traditional layouts with a lounge on the first floor. These factors all serve to reduce value on a per sq ft basis.

This is evidenced by the sales of 2.5 storey house types. With reference to the market research we provided in August, examples are as follows:

- At the Calico Grove scheme by Countryside there is 2 storey 3 bed detached house of 1,002 sq ft listed for £304,995 (£304 per sq ft). There is another 2.5 storey 3 bed semi-detached house of 1,005 sq ft listed for £269,995 (£269 per sq ft). This represents a discount in the order of 11.5%
- At the East Hollinsfield scheme by Taylor Wimpey there is a 2 storey 4 bed detached house of 1,099 sq ft listed for £376,995 (£343 per sq ft). There is also a 2.5 storey 3 bedroom semi-detached house of 1,085 per sq ft listed for £320,995 (£296 per sq ft). This reflects a discount of c. 13.7%.

The 2.5 storey house types within the Capita assessment therefore need to be discounted accordingly.

The other area of difference relates to the larger detached dwellings. We have reviewed the Capita pricing and note there is a minimal discount applied to the larger detached dwellings. Just over 20% of house types are sized 1,225 sq ft and above, which we understand is driven by the Council's desire for 'executive' housing on site.

This is important here because ceiling values within Rochdale will affect achievable values. The active schemes of scale in Rochdale itself have estimated net pricing ranging from £213,703 - £318,245 for house types sized between 759 – 1,232 sq ft. In the case of the subject, c. 20% of the scheme is priced above this level and a rate of sale needs to be maintained in order for the scheme to be profitable.

We therefore believe a greater discount should be applied to the 5 bedroom detached dwellings on this basis. We also note on further review that the 5 bedroom detached dwellings have been over-valued in our pricing and we would expect values in the order of £250 per sq ft and associated values of between £381,250 - £387,750.

We also note that there is no variation across house types within some of the Capita pricing, for example the mid and end terraced properties are priced the same, but mid terraced properties typically achieve a small discount as they are generally less desirable than an end terrace that is only neighboured on one side. The mid terraced properties therefore need to be reduced accordingly.

With the above in mind, we have re-adjusted the Capita pricing as per the attached spreadsheet, and this results in a GDV of £133,070,000, which we have adopted within our updated appraisal.

Abnormal Costs

These total £20,334,327 across various items, with a more detailed breakdown and additional information that addresses the queries raised included in this response.

It is worth noting that these costs are exclusive of contingency because they are at the budget cost stage and have been budgeted exclusive of this. All items are based on market rates against quantities, as such there remains a risk which is why a contingency has been applied. We have therefore applied a 5% contingency with further commentary provided by the cost consultant in the correspondence attached.

Finance

We are at 8.5% and Capita are at 7.5% as a debit rate. The 8.5% was adopted in August following the Bank of England base rate being reduced from 5.25% to 5% earlier that month. The rate has since been maintained at this level in September, but there has been an expectation over 2024 that the rates will slowly reduce further and 'normalise' to 3.5 – 4% by the end of 2025.

This has been factored into our assessment of our finance rate, as has the benefit of being volume plc housebuilder. Rates adopted are however inclusive of lender margin. This was similarly the case prior to high inflation when rates were at 0.5% and the finance rates that went into appraisals were often between 5.5 – 6%. Lenders have however increased margins to reflect increased market risks and rates agreed on a site-specific basis are typically between 10 – 12%.

Here, we would expect a volume housebuilder to have a rolling credit facility and exposure to improved rates, which is why we have adopted a reduced rate (and therefore reduced lender margin) of 8.5%. This factors in a decline in interest rates as has already occurred and expected to occur in 2025, as it is only 3.5% above the current base rate.

Profit

We have adopted a profit margin of 19% on GDV which is considered a minimum acceptable level in this case. It has been common place for the purpose of site specific viability assessments to adopt a margin of 18% on GDV since the changes to the guidance in 2018/2019.

There has however been a shift in market conditions over the last 2 years when a sharp rise in inflation and interest rates caused market conditions to change. Prior to this the market was buoyant, with high demand across the region, and housebuilders maintained strong sales rates and asking prices without any or very limited incentives. This was against a backdrop of increasing house prices.

The drop in consumer confidence and reduced affordability across the market has however led to different market conditions now being apparent. Sales rates are slower, values are stagnating (after a period of decline), and incentives of 3 – 5% are common across all sales for housebuilders. This is against a backdrop of increasing costs, and changing building regulations that create additional cost burdens on development schemes.

It therefore follows that this higher risk market, which is now the norm, would attract higher profit margins on a risk adjusted basis. There should have been a shift upwards in margins across viability assessments, but this has not materialised due to a reluctance from Council's and their advisors to accept this position in the context of attempting to maximise planning gain. This is contradictory to the guidance which sets out a need to consider risk profile when setting profit margin.

The scale of the development also means the IRR should be considered in more detail alongside the profit margin. A minimum return on this basis is typically 25%, with most developers targeting much higher rates on this basis. We note the IRR in the Capita appraisal is 22.06% with an 18% margin on GDV. This therefore needs to be increased and is further justification for 19% on GDV being a minimum margin in this case.

Benchmark Land Value

This is the greatest area of difference between us and often the most contentious area of viability in planning. The EUV is agreed between us at £10,000 per acre (£470,000), but the minimum premium that would apply in addition to this is not agreed.

A minimum premium above the EUV should apply as per the PPG to incentivise the landowner to release the land for development. This is an important part of viability assessment because if a landowner is not sufficiently incentivised land will not be released for development because landowners can wait for planning policy to become less onerous or choose to retain land for an existing or alternative use.

Viability in planning therefore needs to consider a minimum reasonable return to a landowner, as if a landowner perceives the planning gain to be disproportionate to their return, they will not release land for development. This is considered in the definition of BLV in the PPG, which should consider the impact of abnormal costs and planning policy, with this minimum return benchmarking intended as the minimum threshold against which to assess viability.

When viability is constrained, in reality a site cannot deliver full policy compliance and account for all abnormal costs. The whole purpose of a minimum premium is to therefore establish a 'cut off' point at a minimum level that a reasonable landowner would expect. This then forms the basis of benchmarking the viability of a scheme in the context of viability being constrained (and full policy compliance and all abnormal costs not being possible) and will mean that planning policy needs to be adjusted to reflect a reasonable minimum return to a landowner.

This is what we have done when assessing the BLV, adopting a minimum rate per acre that we believe a reasonable landowner would accept in the context of a constrained site. This results in a BLV of £5,730,500. The Capita approach has been to establish the EUV of £10,000 per acre and apply a 50% uplift to this value across the net developable area at a rate of £15,000 per acre. This equates to a BLV of £1,085,550.

It is unclear what the justification for this approach is. Whilst approaches to BLV can take a percentage uplift above EUV approach, this is typically the case when there is some underlying commercial value and a percentage return above this is considered reasonable for a landowner. As an example, brownfield industrial land that has an EUV of say £250,000 per acre, would attract a minimum premium of between 20 - 50%, resulting in a BLV between £300,000 - £375,000 per acre. This is a generally accepted principle that has some grounding in the market, with the underlying value justifying a percentage uplift.

The same is not the case for agricultural development land, to the point where I am unaware of any evidence from Local Plan Viability Assessments that assesses the BLV of greenfield sites such in this way. The low value base, which in this case is £10,000 per acre, means the uplift in real terms is minimal, going from £470,000 to £1,085,550 for a 47 acre that can accommodate 445 new homes.

For an agricultural landholding there needs to be more of an incentive to justify not retaining any income over the medium/long term, or holding the land for a future alternative use, or waiting for a change in planning policy to be less onerous in recognition of the need to incentivise landowners to release land for development.

In addition, the spend that a landowner is likely to incur (or incur at a later date through a promoter/housebuilder who would deduct any spend from a land receipt) to get a site allocated would not justify this level of return. The risks of no return or a significantly reduced return above EUV would be too high.

This is why we take a per acre approach to assessing the minimum premium for greenfield development land, because it has a grounding in the market and how landowners view their land holdings.

Minimum land values are difficult to evidence but they are often included within Option Agreements for land that is due to be promoted through the Local Plan process and acquired by a developer if a planning consent is later obtained. At the point at which an Option Agreement is entered into, the site in question is unlikely to be allocated for residential use, and the potential development constraints, including abnormal development costs, are unknown. The value of the site is therefore unknown, hence why minimum land values are often inserted into contracts. My experience of minimum land values in these types of agreements ranges from £150,000 - £500,000 per acre.

When looking at the Local Plan evidence base, the Greater Manchester Places for Everyone ("Pfe") considers this site specifically and applies a BLV of £250,000 per gross hectare, which equates to just under £102,000 per gross acre. This is applied to all strategic greenfield sites, and it is recognised within the reporting that consultation responses objected to this BLV on the basis it was too low. For context, our assessment of BLV at £5,730,500 equates to just under £122,000 per gross acre.

The local plan evidence base relevant to Rochdale therefore supports our approach. That said, we recognise that this is a particularly constrained site and that viability professionals are encouraged to try and reach an agreement through an iterative process. We have therefore reduced our assessment of BLV to £100,000 per gross acre in line with the Local Plan evidence base. This equates to £4,700,000 and is considered an absolute minimum level in this case because of the particularly high abnormal costs affecting the site.

Appraisal

We provide an updated appraisal, that includes the amendments detailed above. A copy of the appraisal summary is provided with this response, which produces a residual land value of £7,438,468.

Against a BLV of £4,700,000, this creates a surplus of £2,738,468 for S.106 contributions. Please note, we have not included a specific cost for bio-diversity net gain because we understand the timing of the application means that this is not a legal requirement and the overall S.106 'pot' can be used by the Council for other items such as education and affordable housing.

We trust that this conclusion is agreeable and will enable a local decision to be made at the November planning committee. Should anything further be required we would be happy to assist.

Note Produced by:

A handwritten signature in black ink, appearing to read 'Laura Mackay'.

Laura Mackay MRICS
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