



Financial Viability Appraisal

Regarding the development at:

Southampton Street, Reading RG1 2QL

16 September 2019



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Introduction

S106 Management is instructed by Wexham Homes to produce a Financial Viability Appraisal (FVA) report, in order to determine the level of Affordable Housing that is appropriate to expect from a proposed development at Southampton Street, Reading RG1 2QL.

The existing site is previously developed land, with a total site area of 169m².

Our client proposes to construct a four-storey building with a mix of 7 studios and 1-bedroom flats. In total the development will provide of 283m² residential accommodation.

Reading Borough Council relies upon Policy DM6 of their 'Sites and Detailed Policies Development Plan Document' (adopted October 2012) for the provision of Affordable Housing.

Location Plan



S106 Management

S106 Management is a consultancy run by Robin Furby who has 15 years of experience in the preparation of viability appraisals. During this time, over 500 reports have been completed and these have been successfully used at pre-application discussions with Planning Officers and Affordable Housing Officers, supporting planning applications, written appeals, and planning appeal hearings.

Following qualification as a solicitor in 1985 and 8 years in private practice, Robin has spent the last 20 years as a property consultant specializing on viability issues. His in-depth knowledge and experience concerning site acquisition, planning negotiation and construction, provide a rigorous and informed perspective to viability issues.

Planning Policy

By virtue of section 38 (6) of the 'Planning and Compulsory Purchase Act', planning applications must be determined in accordance with the adopted plan of the Local Authority, unless material considerations indicate otherwise.

Therefore, our starting point is Policy DM6 of Reading's 'Sites and Detailed Policies Development Plan Document':

DM6: AFFORDABLE HOUSING

On development sites of less than 15 dwellings, the following proportions of affordable housing provision will be provided:

- *on sites of 10 - 14 dwellings 30% provision;*
- *on sites of 5 - 9 dwellings 20% provision; and*
- *on sites of 1 - 4 dwellings, a financial contribution will be made that will enable the equivalent of 10% of the housing to be provided as affordable housing elsewhere in the Borough.*

For sites of more than 4 dwellings, provision should be made on site in the first instance with a financial contribution being negotiated to make up the full requirement as appropriate.

Our client's development proposes to build 7 residential units, therefore based on the policy above, we would expect that Reading Council will seek a financial contribution 20%.

The operation of this policy is driven by the 'Reading Affordable Housing Supplementary Planning Document' (adopted July 2013).

These policies have been informed by the Reading BC 'Supporting Development Viability Report', produced by Steve Hicks MRICS (July 2011 hereafter referred to as the SDV), and the 'Critical Review' of the same document by BPS Chartered Surveyors (July 2011 hereafter referred to as the Critical Review).

Where appropriate we use the conclusions of these two documents to inform our report.

National Guidance is a material consideration; therefore, we also consider the 'National Planning Policy Framework' (NPPF) (2019), and the 'National Planning Guidance for Viability' (NPGV) (2019).

National Guidance

National guidance on the delivery of Affordable Housing is provided by the NPPF, which replaced the previous advice in PPS3.

Paragraph 57 of the NPPF is of relevance:

57. Where up-to-date policies have set out the contributions expected from development, planning applications that comply with them should be assumed to be viable. It is up to the applicant to demonstrate whether particular circumstances justify the need for a viability assessment at the application stage. The weight to be given to a viability assessment is a matter for the decision maker, having regard to all the circumstances in the case, including whether the plan and the viability evidence underpinning it is up to date, and any change in site circumstances since the plan was brought into force. All viability assessments, including any undertaken at the plan-making stage, should reflect the recommended approach in national planning guidance, including standardised inputs, and should be made publicly available.

The recommended approach above is set out in the NPGV (<https://www.gov.uk/guidance/viability>). Our report has been written in accordance with the principles set out in both the NPPF, and the NPGV.

The standard approach to viability is explained at para. 10 of the NPGV:

'Viability assessment is a process of assessing whether a site is financially viable, by looking at whether the value generated by a development is more than the cost of developing it.'

Viability

The relevance of viability is accepted in Policy DM6 which states:

In all cases where proposals fall short of the policy targets/thresholds as a result of viability considerations, an open-book approach will be taken and the onus will be on the developer/landowner to clearly demonstrate the circumstances justifying a lower affordable housing contribution.

The issue of viability is developed further by the Reading Affordable Housing SPD and its guidance is also adopted in this report. We particularly note the reference at paragraph 4.38 relating to the examination procedure leading to the adoption of policy DM6:

The Inspector's Report on the examination of the Sites and Detailed Policies Document noted that the policy will be applied flexibly to take account of market conditions or difficulties on particular sites.

These policy statements should be seen in the context of the NPPF, and indeed subsequent Government guidance.

The concept of viability is well expressed by the NPGV, in particular para 12 which sets out the costs that should be included in any viability statement, and paras 13-17 which seek to ensure that the landowner should receive the Existing Use Value (EUV) of the site plus a premium, thus providing an incentive to the landowner to bring the site forward for development.

There are several proprietary spreadsheets in use to justify viability. We use the Housing Corporation Economic Appraisal Tool (HCEAT), developed by GVA Grimley in partnership with the Housing Corporation (now HCA); it is one of the Toolkits commonly used when considering development viability.

Our report and its conclusions are based on the application of this tool.

The next section sets out the assumptions that have been made in the preparation of the HCEAT spreadsheet examining the viability of this site; the spreadsheet is shown in **Schedule 1** of this report. The comments below address the inputs to the spreadsheet sequentially and an electronic copy can be provided to the LPA on request.

Spreadsheet Inputs

Proposed Development (input sheet 1)

The development is summarised by the table below (plans are shown at **Schedule 2** to this report):

Unit	Area m2
1	31.00
2	48.00
3	38.00
4	48.00
5	38.00
6	48.00
7	32.00
Total area m2	283

Affordable Housing Values (input sheet 2)

We approach this issue by firstly modelling a scheme with no Affordable Housing; if the Residual Value of this model exceeds the Benchmark Value of the site (as described below) then we produce further modelling to illustrate the maximum level of Affordable Housing that can viably be delivered by the development.

Open Market Housing Values (input sheet 2)

In order to determine appropriate Open Market values for the proposed flats, we turn initially to data provided by Zoopla regarding average prices in the RG1 area.; the results are displayed below:

Property value data/graphs for RG1

Property type	Avg. current value	Avg. £ per sq ft.	Avg. no. beds	Avg. £ paid (last 12m)
Detached	£573,672	£381	4.0	£511,307
Semi-detached	£412,732	£351	3.5	£456,740
Terraced	£297,833	£363	2.9	£313,799
Flats	£253,582	£414	1.7	£243,500

Therefore, Zoopla suggest the average value for flats in the RG1 area is approximately £4,455 per m².

We have conducted further research on Rightmove for flats sold recently in the area of the proposed development; shown table below. All transactions occurred in the last year within ¼ mile from the proposed development:

Sold within 1/4 mile

Address	Type	Sale Date	Area	£/m2	Price
Flat 5, 68 London Street, Reading, RG1 4SQ	Flat	05/07/2019	26	£5,192	135,000
Flat 11, Simmonds Malthouse, Fobney Street, Reading, Reading RG1 6BS	2 bedroom flat	28/06/2019	98	£5,867	£575,000
28 Maltings Place, Reading, Reading RG1 6QG	1 bedroom flat	14/06/2019	45	£5,221	£234,950
Flat 8, 20, South Street, Reading RG1 4FG	Flat	07/06/2019	34	£6,074	£206,500
52, Aveley House, Iliffe Close, Reading RG1 2QF	flat	24/05/2019	64	£3,906	250,000
23, Aveley House, Iliffe Close, Reading RG1 2QF	Flat	10/05/2019	69	£3,696	£255,000
Flat 4, Archway House, 72a, London Street, Reading RG1 4SJ	Flat	16/04/2019	72	£4,306	£310,000
17 Compass House, South Street, Reading, Reading RG1 4GP	2 bedroom flat	11/04/2019	58	£4,569	£265,000
9 New Bright Street, Reading, Reading RG1 6QQ	2 bedroom flat	13/03/2019	79	£3,608	£285,000
Average £/m2				£4,617.34	

Our Rightmove research leads us to expect average values of £4,617/m² for flats. These figures are marginally higher than the data extracted from Zoopla. This is because the data taken from Zoopla encompasses the entire RG1 postcode, whereas the Rightmove data is specific to the area of our client's development.

There is also evidence of the commonly seen inverse correlation between unit area and £/m², therefore we expect larger flats to achieve lower £/m² values.

In addition to the sold research above, we have also looked at comparable units which are currently for sale within ¼ mile of the subject site:

For sale within 1/4 mile

Address	Type	Sale Date	Area	£/m2	Price
Aveley House, Iliffe Close, Reading, RG1	2-bedroom flat with river views	for sale	75.6	£4,166.67	£315,000.00
East Street, Reading, Berkshire, RG1	studio flat in central location with river views	for sale	23.6	£6,991.53	£165,000.00
Thomsons Yard, 106 Southampton Street, Reading, Berkshire, RG1	studio flat with outside space	under offer	34.5	£5,507.25	£190,000.00
London Street, Reading, Berkshire, RG1	1-bedroom apartment	under offer	52.3	£3,728.48	£195,000.00
Indigo Apartments, Crown Street, Reading	1-bedroom apartment	for sale	68.9	£3,265.60	£225,000.00
Maltings Place, Reading, Berkshire, RG1	1-bedroom apartment	sold STC	44.3	£5,079.01	£225,000.00
average £/m2 value				£4,395.05	

The average 'for sale' price is marginally lower than the average 'achieved' which is evidence of market stagnation caused by the current socio-political uncertainty.

We have also looked at a development on Pell Street (c. 500m from the subject site), asking prices are summarised below:

New flats for sale 1/4 mile

Address	Type	Sale Date	Area	£/m2	Price
Pell Street, Reading, Berkshire, RG1	2-bedroom flat with allocated parking and shared garden	for sale	64.9	£5,239	£340,000
Pell Street, Reading, Berkshire, RG1	2-bedroom flat with allocated parking and shared garden	for sale	63.68	£5,261	£335,000
Pell Street, Reading, Berkshire, RG1	2-bedroom flat with allocated parking and shared garden	for sale	63.48	£5,120	£325,000
Pell Street, Reading, Berkshire, RG1	2-bedroom ground floor flat, no parking	for sale	63.98	£5,002	£320,000
average £/m2 value				£5,155	

The flats in the subject development are smaller than those at Pell Street, however they do not benefit from allocated parking.

Based on the data above we have projected sales values of £165,000 (£5,323/m²) for the smallest flats, and adjusted the value of the larger flats to follow the inverse correlation referred to previously:

Unit	Area m2	£/m2 value	PRICE
1	31.00	£5,323	£165,000
2	48.00	£5,188	£249,000
3	38.00	£5,263	£200,000
4	48.00	£5,188	£249,000
5	38.00	£5,263	£200,000
6	48.00	£5,188	£249,000
7	32.00	£5,156	£165,000
Total area m2	283	£5,219.0813	£1,477,000

The above figures have been arrived at following thorough examination of the market, and after in-depth discussions with local agents. They represent the 'top-end' of what can be achieved by the subject development, and should therefore be viewed as robust.

For the sake of simplicity, we have run the HCEAT using the average £/m² value, which is £4,946.99.

We have included a capital sum of £35,000 in the spreadsheet to reflect the value of the Freehold Ground Rent Income from the 8 flats; this is calculated assuming an annual rent of £300, and a yield of 6%.

Timing (input sheet 2)

This report is to accompany a planning application, which it is hoped will be granted within the next 3 months. There will be a further 3-month period required after the determination of the application to prepare the building regulation drawings, obtain fixed price quotations and all other regulatory consents.

Construction is projected to proceed over a 12-month period with the sales occurring between months 12 and 14.

The 'Holding cost' prior to commencement is disregarded for the purposes of our report. The spreadsheet has been run with a corresponding figure under the 'build cost' section.

Construction Costs (input sheet 2)

We have obtained a cost schedule from Mr David Parker (MRICS). The full schedule is shown in full at Schedule 4 and summarised below:

Work required	Cost £
Demolitions & clearance	£2,500
Foundations	£29,400
Frame	£25,000
External walls	£118,600
Roofs	£35,700
Upper floors	£27,700
Staircases	£21,000
Windows, doors & screens	£59,000
Internal partitions	£26,500
Internal doors	£8,800
Joinery	£66,000
Floor finishes	£19,500
Wall finishes	£7,200
Ceiling finishes	£24,100

(continued on the next page)

Decorations	£26,000
Sanitary installation	£34,500
Plumbing installation	£64,700
Electrical installation	£57,500
Incoming services	£30,000
Acoustic testing	£3,500
Underground drainage	£20,400
External works	£14,300
Contractor's prelims/scaffold	£93,000
Total cost	£814,900
Total area	330
£/m2 cost	£2,469.394

The GIA of the flats (283m²), represents 85.75% of the buildings total GIA; the HCEAT has been run with a corresponding correction factor.

Fees (input sheet 2)

10% for fees is the default value of the HCEAT Spreadsheet and is the commonly accepted industry standard allowance.

Contingency (input sheet 2)

5% for contingencies is the default value of the HCEAT Spreadsheet and also the commonly accepted industry standard allowance.

Section 106 Payments (input sheet 2)

Reading Borough Council adopted their CIL Charging Schedule in January 2015. This stipulates that all residential developments should pay £120 for every additional m² of accommodation provided; following indexation this figure now stands at £150/m². The proposed development will provide an additional 330m² of residential accommodation, therefore will be expected to contribute £49,500 towards CIL.

Abnormal Development Costs (input sheet 2)

The Cost Report referred to previously is inclusive of abnormal and external works, thus no additional allowance has been made.

Site Acquisition Costs (input sheet 2)

The EUV of the site as discussed subsequently is £420,000. We have included acquisition costs of £10,000 which incorporates an allowance for SDLT.

Finance Costs (input sheet 2)

Typically, banks are prepared to lend only the building cost (£814,900) of this type of development, with an arrangement fee at 2%. We omit the arrangement fee in this instance; however, reserve the right to revisit this issue if necessary.

While base rates are at a historic low level, cost of funding expressed as a percentage above LIBOR is at historically high figures; an interest figure of 7% is used in the spreadsheet.

Marketing Costs (input sheet 2)

The HCEAT spreadsheet has default values of 6% for marketing and £600 per unit for legal fees; as a compromise, we have adopted a marketing cost of 3% and legal fees of £1,000 per unit.

Developer Profit (input sheet 2)

The NPGV contains the following advice at paragraph 18:

How should a return to developers be defined for the purpose of viability assessment?

'Potential risk is accounted for in the assumed return for developers at the plan making stage. It is the role of developers, not plan makers or decision makers, to mitigate these risks. The cost of complying with policy requirements should be accounted for in benchmark land value. Under no circumstances will the price paid for land be relevant justification for failing to accord with relevant policies in the plan.'

'For the purpose of plan making an assumption of 15-20% of gross development value (GDV) may be considered a suitable return to developers in order to establish the viability of plan policies. Plan makers may choose to apply alternative figures where there is evidence to support this according to the type, scale and risk profile of planned development. A lower figure may be more appropriate in consideration of delivery of affordable housing in circumstances where this guarantees an end sale at a known value and reduces risk. Alternative figures may also be appropriate for different development types.'

Paragraph 008 of the NPGV provides further guidance:

'How should a viability assessment be treated in decision making?

'Where a viability assessment is submitted to accompany a planning application this should be based upon and refer back to the viability assessment that informed the plan; and the applicant should provide evidence of what has changed since then.'

We have referred to the Reading Borough Council Viability Testing Report (BPS; March 2018). This document states that, 'developer profit levels span 17% - 20% of GDV', furthermore, it goes on to reference the PPG which states, 'For the purpose of plan making an assumption of 20% GDV may be considered a suitable return.'

The Reading Viability Study has been run assuming a return of 20% on GDV, thus we have modelled our appraisal at the same level.

Benchmark Value

The NPGV provides a standard methodology for determining Benchmark Land Value (BLV):

Paragraph 15 requires that the EUV of the site should be identified:

'Existing use value (EUV) is the first component of calculating benchmark land value. EUV is the value of the land in its existing use. Existing use value is not the price paid and should disregard hope value. Existing use values will vary depending on the type of site and development types. EUV can be established in collaboration between plan makers, developers and landowners by assessing the value of the specific site or type of site using published sources of information such as agricultural or industrial land values, or if appropriate capitalised rental levels at an appropriate yield (excluding any hope value for development).

Sources of data can include (but are not limited to): land registry records of transactions; real estate licensed software packages; real estate market reports; real estate research; estate agent websites; property auction results; valuation office agency data; public sector estate/property teams' locally held evidence.'

The site is Brownfield with an area of 169m². A historic map of the site evidences the fact that it has been previously developed:



To determine an appropriate EUV for the site we refer to the Reading Borough Council Viability Testing Report:

- 6.15 To place the surplus in a measurable quantum we have applied the surplus to increase the plot value from the base plot value of £60,000 to show an overall average of £81,979. This breaks down to the following plot value averages by scenario grouping:

Table 11: Adjusted Plot Values

	Adjusted Plot Value	Percentage Increase
Original Scenarios	£91,461	52%
AMR Derived Scenarios	£84,709	41%
Local Plan Allocations	£81,879	36%

We have adopted the base plot value of £60,000, to produce an EUV of £420,000. It should be noted that the Local Plan Allocation plot value is £81,879, which would produce an EUV for the site of £573,153.

Paragraph 16 requires that a premium should be added to the EUV (EUV +) to incentivise the landowner to bring the site forward for development:

'The premium (or the 'plus' in EUV+) is the second component of benchmark land value. It is the amount above existing use value (EUV) that goes to the landowner. The premium should provide a reasonable incentive for a landowner to bring forward land for development while allowing a sufficient contribution to fully comply with policy requirements.

*Plan makers should establish a reasonable premium to the landowner for the purpose of assessing the viability of their plan. This will be an iterative process informed by professional judgement and must be based upon the best available evidence informed by cross sector collaboration. **Market evidence can include benchmark land values from other viability assessments.** Land transactions can be used but only as a cross check to the other evidence. Any data used should reasonably identify any adjustments necessary to reflect the cost of policy compliance (including for affordable housing), or differences in the quality of land, site scale, market performance of different building use types and reasonable expectations of local landowners. Policy compliance means that the development complies fully with up to date plan policies including any policy requirements for contributions towards affordable housing requirements at the relevant levels set out in the plan. A decision maker can give appropriate weight to emerging policies. Local authorities can request data on the price paid for land (or the price expected to be paid through an option or promotion agreement).'*

In this instance we have not made any allowance for a landowner premium, however reserve the right to revisit this issue if necessary.

Paragraph 17 allows the BLV to be determined by an Alternative Use Value (AUV):

'For the purpose of viability assessment alternative use value (AUV) refers to the value of land for uses other than its existing use. AUV of the land may be informative in establishing benchmark land value. If applying alternative uses when establishing benchmark land value these should be limited to those uses which would fully comply with up to date development plan policies, including any policy requirements for contributions towards affordable housing at the relevant levels set out in the plan. Where it is assumed that an existing use will be refurbished or redeveloped this will be considered as an AUV when establishing BLV.'

'Plan makers can set out in which circumstances alternative uses can be used. This might include if there is evidence that the alternative use would fully comply with up to date development plan policies, if it can be demonstrated that the alternative use could be implemented on the site in question, if it can be demonstrated there is market demand for that use, and if there is an explanation as to why the alternative use has not been pursued. Where AUV is used this should be supported by evidence of the costs and values of the alternative use to justify the land value. Valuation based on AUV includes the premium to the landowner. If evidence of AUV is being considered the premium to the landowner must not be double counted.'

In this case it is not appropriate to consider the AUV of the site.

The standard approach to viability is to compare the BLV of the development site with the Residual Value calculated by the (HCEAT) viability spreadsheet. It is only if the Residual Value of the development exceeds the Market Value (Benchmark), that it will be viable for a contribution to be made towards Affordable Housing

HCEAT Spreadsheet Conclusions (spreadsheet summary)

The full spreadsheet appears at **Schedule 1**, and the key conclusions are set out in the summary section. They are also repeated for convenience below:

Residential value	£1,512,000
Less Costs	
Construction Costs	£814,900
Other Site Costs	£185,810
Marketing	£38,240
Finance Costs	£48,668
Developer Profit	£302,400
Residual Site Value	£121,983

To determine the viability of the provision of Affordable Housing, the Benchmark Value of the site (**£420,000**), is deducted from the Residual Value calculated by the HCEAT spreadsheet; if the result is negative, as it is in this case (**-£298,017**), it is not viable for the development to provide Affordable Housing.

Conclusion

The following table has been compiled using data from the HCEAT spreadsheet to reveal the profit that the developers will earn from this project:

Spreadsheet Residual Value	£121,983
Plus Spreadsheet Developer profit	£302,400
Less Benchmark Value	£420,000
Actual Profit	£4,383

This presents a return of 0.2%, which is considerably lower than the accepted 20% referred to in the guidance mentioned previously.

Any contribution towards Affordable Housing would further reduce this level.

This report demonstrates that the scheme can be considered policy compliant without the provision of any Affordable Homes or S106 contributions towards Affordable Housing.