WELBORNE GARDEN VILLAGE

Planning Viability Review

Addendum Report

January 2021

CBRE

CBRE has been instructed by Fareham Borough Council (FBC) to undertake a review of the updated planning viability statement submitted by Buckland Development Ltd (BDL), dated 17th December 2020, in relation to Welborne Garden Village (WGV).

Reliance

In accordance with PS 1.6 of the RICS Valuation – Professional Standards (January 2014 Edition) (the 'Red Book'), the provisions of VPS 1 to VPS 4 are not of mandatory application and accordingly this report should not be relied upon as a Red Book valuation.

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Background

CBRE has previously advised FBC on viability statements prepared by BDL in relation to the viability of WGV. This culminated in the approval of the planning application for WGV in October 2019. CBRE undertook a detailed review of the proposals put forward by BDL in the lead up to the October 2019 planning decision and concluded, on viability grounds, that:-

- The scheme should not be liable to pay the Community Infrastructure Levy (CIL)
- The developer contribution towards M27 Junction 10 costs is capped at £20m
- Affordable housing for the first 1,000 units should be 10%
- The affordable mix for the first 1,000 units is split 50/50 between affordable/social rent and intermediate tenures
- The scheme is unable to provide Lifetime Homes or Passivhaus for the first 1,000 homes

In addition to the above, terms were agreed for a viability review mechanism. The purpose of this was to monitor and review the viability of the scheme over time so that if viability improved it could be possible for the policy requirements to be met either partially or in full. The key terms of the viability review mechanism were as follows:

- First review to be completed following completion of the 1,000th residential unit and occur at a frequency of 750 unit completions thereafter.
- The review will be in accordance with the agreed financial model and a number of agreed financial parameters. Over time, the actual known costs and revenues will replace the original forecasts.
- In addition to 750 unit phase reviews BDL will provide an annual financial return statement as part of the monitoring arrangement with FBC.
- Any additional grant funding received may trigger a standalone viability review.
- Affordable quantum and tenure, Lifetime Homes and Passivhaus will form part of future viability reviews. FBC will have the ability to adjust and prioritise its requirements in relation to these items should the scheme not be able to afford them all.

An important part of the viability position at the time was how the new Junction 10 of the M27 would be funded. The junction must be provided to enable more than 1,160 units to be occupied due to highway constraints. At the point of the planning application determination it was highlighted that there was a funding gap for the estimated £80-90m costs of the Junction scheme. Funding had been allocated as follows:

- £20m developer contribution

- £10m of Housing Infrastructure Funding provided by Homes England, unconfirmed
- £14.15m of Solent Local Growth Deal funding allocated by the LEP
- £14.9m of Solent Growth Deal funding retained by the DfT

Given that all the funding for the junction was not in place, a planning condition was imposed for BDL to revert back with a confirmed junction funding strategy before any development other than the Junction 10 works could commence.

Current Position

The Junction 10 scheme delivery cost is now estimated as in the region of £75m, following the progression of a more cost-effective design.

Of the £14.9m Solent Growth Deal funding retained by DfT, £5.5m has been advanced to progress scheme design. The remaining Solent Growth Deal funding retained by DfT, and the £14.15m locally earmarked Solent Growth Deal funding has been reallocated to other infrastructure projects in the LEP's pipeline that could spend the funding before the end of March 2021.

Discussions with Central Government have resulted in an increase in the offer of Housing Infrastructure Funding (HIF) from £10m to £30m. Discussions on this are progressing at pace and although there is a reasonable prospect of this funding being available for Welborne Garden Village, the funding remains subject to Homes England approval and may require a decision by the Council's Executive.

Even with the scheme costs reducing and the HIF offer increasing, a funding gap of £20m remains.

To enable the scheme to come forward BDL has proposed to increase their total junction contribution to £40m. If the HIF funding is made available and the scheme costs remain at or below £75m, this proposition would address the funding requirement. However, given that the HIF funding contract is not yet in place, FBC officers have advised that the planning condition for BDL to revert back with a confirmed junction funding strategy will need to remain.

The increased contribution from BDL impacts the overall viability of the scheme and this has led to BDL seeking to amend the previously approved viability position. Within its revised viability statement BDL has set out its proposed viability position as follows – it should be noted that the some of the statements are as per the consented scheme and others are updates as a result of the increased contribution to Junction 10.

Proposed BDL Financial Viability Position

BDL has stated that as a result of making the additional £20m contribution to the junction, the scheme now generates a return of 1.5% profit on both cost and Gross Development Value (GDV) down from 14.4% profit on cost (12.6% profit on GDV) level that the scheme was showing in October 2019.

Profit on cost is calculated by dividing the gross profit by the total development costs whereas profit on GDV is calculated by showing the profit as a percentage of total revenue. Both metrics are used within the development industry and are therefore also used by planning authorities when negotiating affordable housing quantum and viability. Either calculation of profit is acceptable and the reasonableness of the level applied is assessed by benchmarking against planning viability guidance and industry standards.

It is noted that, other than the additional £20m contribution to the junction, BDL has not sought to change any other assumptions within their model (values, costs, timings etc.), and nor have they considered reducing the £288m of site-wide infrastructure costs set out in the Infrastructure Delivery Plan.

BDL Proposed Viability Parameters

BDL Proposition October 2019	BDL Proposition December 2020	Comments
Profit of 14.4% (12.6% on GDV)	Profit of 1.5% on both profit on cost and GDV	BDL reports a significant reduction in profit and has submitted a revised viability proposition as a result. A 1.5% profit level is significantly below market norms.
The scheme should not be liable to pay the Community Infrastructure Levy (CIL)	The scheme should not be liable to pay the Community Infrastructure Levy (CIL)	No change
The developer contribution towards M27 Junction 10 costs is capped at £20m	The developer contribution towards M27 Junction 10 costs is capped at £40m	The BDL contribution is increased by £20m
Affordable housing to be 10% minimum	Affordable housing to be 10% minimum	No change. The Welborne Plan requires at least 10% affordable housing and up to 30% affordable, subject to viability
The affordable mix is split 50/50 between affordable rent and intermediate for the first 1000 homes. The position would then be reviewed at future viability reviews	The affordable mix is split 50/50 between affordable rent and intermediate for all 6000 homes	Change. The Welborne Plan requires a unit mix of 70/30 affordable rent and intermediate, subject to need and viability
No Passivhaus or Lifetime Homes provided for the first 1,000 homes. The position would then be reviewed at future viability reviews	No Passivhaus or Lifetime Homes provided in the scheme	Change. The Welborne Plan requires 10% Passivhaus and 15% Lifetime Homes, subject to viability
Viability reviews at 1,000th unit and every 750 units thereafter	Viability reviews to be held at 3,000, 3,750, 4,500, 5,250 and 5,750 dwellings	Change. The first viability review is proposed at 3,000 homes rather than 1,000

In addition to the proposed changes BDL has put forward suggested changes to the viability review mechanism and these are outlined below.

BDL Proposed Viability Review Mechanism Changes

Other than the Housing Infrastructure Funding (HIF) funding being a grant to the Council but recoverable from the developer, the detailed requirements of HIF were not known when the planning application was approved in October 2019. FBC & BDL have since progressed discussions with Homes England regarding the offer of £30m HIF. At the time of drafting this report the HIF funding agreement has not been entered into and key principles have still to be finalised.

However, some of the conditions associated with HIF are now understood in more detail. It is a requirement that the grant is repaid if the viability of the scheme improves and this will be secured in the s106 agreement. Where HIF repayments are made, the money is retained by FBC rather than going back to Homes England. It is BDL's proposition that any HIF funding that they repay is used to provide additional affordable housing within WGV. CBRE understands that how HIF repayments are used is not a matter for the Planning Committee to opine on, as such no comment is provided in this report as to the acceptability of this proposal.

Given the specific conditions that HIF funding is subject to, BDL propose that two different recovery mechanisms will be applied to the scheme 1. HIF Repayment and 2. Planning Viability Review

Mechanism. The first complies with HIF conditions and the second should comply with planning viability guidance.

1. **HIF Repayment**

- A developer return of 20% profit on cost is permitted
- 80% of any surplus above 20% profit on cost will be used to repay the HIF funding
- 20% of any surplus above 20% profit on cost will be retained by BDL

The HIF repayment terms are stipulated by Homes England as a condition for receiving the £30m grant. CBRE understands that the acceptability of the HIF conditions is not a matter for the Planning Committee to opine on as such no comment is made by CBRE in relation to this. It should however be noted that HIF repayment ranks ahead of any planning viability review mechanism i.e. the £30m must be repaid prior to any additional planning obligations being provided. As the £30m of HIF is retained by FBC, rather than be repaid to Homes England, FBC could choose to reinvest the £30m into WGV to provide additional affordable housing. If this were the case, the additional affordable housing, estimated at 150 units at current day values, would be counted towards the overall affordable housing percentage at Welborne.

2. **Planning Viability Review Mechanism**

The planning viability review mechanism must be in accordance with planning guidance. The mechanism proposed by BDL is as follows:

BDL Proposition October 2019	BDL Proposition December 2020	Comments
A minimum developer return of 20% on Profit on Cost	A minimum developer return of 20% on GDV	Profit being at 20% on GDV instead of 20% of costs is a higher threshold and less beneficial for the Council. BDL consider it to be a reasonable change as it is taking more risk in the delivery of the scheme due to the reduced viability
Finance Rate to be based on benchmarked prevailing market rates for the Cost of Capital appropriate for the project and be reviewed on a regular basis	Finance Rate to be based on benchmarked prevailing market rates for the Cost of Capital appropriate for the project and be reviewed on a regular basis	No change
Any surplus over 20% profit on cost would go towards meeting planning policy requirements on affordable housing %, tenure split, Passivhaus % and Lifetime Homes %. All surplus profits thereafter would go to the developer	50% of any surplus profit above 20% on GDV will go towards meeting planning policy requirements on affordable housing %, tenure split, Passivhaus % and Lifetime Homes %. All surplus profits thereafter would go to the developer	Previously there was no split of surplus profit
The maximum affordable housing delivered will be 40% in any single phase and 30% overall	The maximum affordable housing delivered will be 40% in any single phase and 30% overall	No change. The Welborne Plan requires this
Where any phase is able to deliver in excess of 40%, financial contributions may be made in lieu	Where any phase is able to deliver in excess of 40%, financial contributions may be made in	No change

of onsite delivery subject to agreement by both parties	lieu of onsite delivery subject to agreement by both parties	
The detailed workings of the mechanism will be secured in the S106 agreement	The detailed workings of the mechanism will be secured in the S106 agreement	No change

CBRE has been asked to advise FBC on the reasonableness of the proposed changes and our findings are detailed below.

CBRE REVIEW OF BDL'S PROPOSED CHANGES

Overall Scheme Viability

CBRE has historically undertaken extensive reviews of the financial appraisals prepared by BDL including detailed reviews of the supporting cost and value information. Our findings are contained in the Site Wide Viability Report and Addendum report prepared for the October 2019 planning committee.

In providing the updated financial appraisal BDL has not made changes to the cost and value assumptions except to include an additional £20m contribution towards the Junction. It should also be noted that within its appraisal BDL assumes: -

- 10% Affordable housing
- Affordable tenure is split 50/50 between affordable rent and intermediate tenures
- No Passivhaus or Lifetime Homes

CBRE has reviewed BDL's financial model and concurs with its assumption that the scheme delivers a profit of 1.5% (on costs and revenue) when undertaken using the above assumptions.

Gross Development Value	**625,271**
Costs (inc interest)	**616,097**
Profit	**9,175**
Profit on costs %	**1.5%**
Profit on GDV %	**1.5%**

Developer Junction Contribution Capped at £40m

BDL has proposed to increase its contribution to the junction to £40m. CBRE's previous report to Planning Committee stated that, "if the BDL contribution towards M27 Junction 10 costs is increased beyond £20m it will adversely affect the viability of the scheme and the ability to meet the various policy requirements". The viability modelling undertaken above shows that BDL is unable to provide more than £40m, without further policy concessions. Indeed, given that a profit of only 1.5% is generated, which is significantly below market norms, a £40m contribution is significantly higher than most developers would provide.

Two Review Mechanisms – HIF & Planning

CBRE has been involved in other HIF schemes either working for Homes England in reviewing and conducting due diligence on funding applications; or for applicants, where local authorities have

sought to obtain funding. We are aware of a number of similar situations where there are two or more recovery mechanisms applied to schemes and consider this to be acceptable.

HIF Repayment

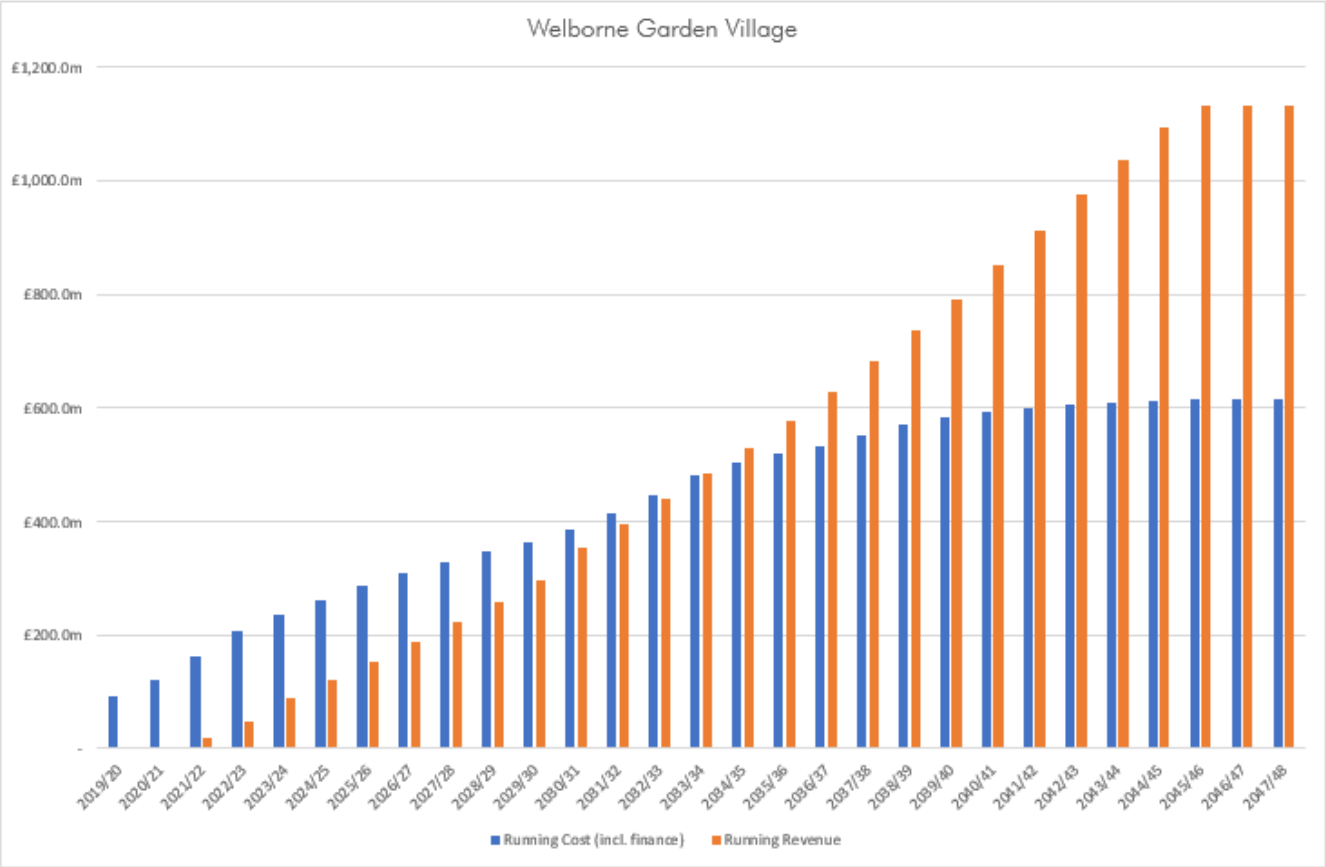
The HIF profit threshold is lower than the proposed planning viability mechanism, as it is based on costs rather than revenue. The HIF share of profit, above the 20% profit on cost threshold, is 80%.Based on the most optimistic sensitivity analysis undertaken, it is estimated that HIF can start to be recovered at around 2034 or 3750 homes as this is when the 20% profit on cost threshold could be exceeded.

FBC will have received £30m in HIF repayments prior to any planning viability review benefits being received. The Borough Council can decide whether to invest the HIF funding in affordable housing at Welborne or elsewhere in the Borough, although this is not a decision for the Planning Committee. At present day values, £30m of HIF repayments equates to circa 150 additional affordable homes at Welborne.

First Planning Viability Review at 3,000 Homes

On today's costs and today's values the scheme will not be able to provide any more than 10% affordable housing at any point – this scenario generates a profit of 1.5%. To opine on the reasonableness of moving the first review from 1,000 homes to 3,000 homes CBRE has undertaken sensitivity modelling. The sensitivity modelling is based on the most optimistic scenario included within the Site Wide Viability Report produced for the October 2019 Planning Committee. Within this it was assumed that values could grow at 3% and costs at 2%. In addition, a placemaking premium of 20% was also included.

The cashflow of this sensitivity scenario was examined and this showed that the scheme is unlikely to deliver sufficient levels of profit prior to 3,000 units and this is illustrated by the graphic below.



The blue bars show costs incurred and the revenue is shown in orange. It shows that it takes circa 15 years for the scheme to break even and that most of the profit is delivered towards the back end of the scheme. It is important to note that this chart is derived from the most optimistic scenario described above. CBRE therefore concludes, on viability grounds, that it is not unreasonable for the first viability review to be moved from 1,000 homes to 3,000 homes.

Profit of 20% of Gross Development Value

BDL proposes that it can achieve a profit of 20% of Gross Development Value (GDV) before it must make additional payments towards affordable housing. Previously profit was assessed as being 20% on cost, however both methods are acceptable and used within the development industry. With regard to profit level the National Planning Policy Guidance (NPPG) states the following:-

"*…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: 018 Reference ID: 10-018-20180724).

The profit level proposed by BDL sits within the range identified within the NPPG albeit at the top end of range. When determining the level of profit that should be applied it is necessary to consider the risks associated with the scheme, with higher risk schemes allowed higher returns and vice versa. The viability modelling shows that WGV generates a developer's profit of 1.5% on today's costs and values. This is at a level below which developers would generally consider bringing schemes forward and significantly below the range identified within the NPPG. BDL is therefore proceeding at risk in the hope that values will increase over time enabling it to achieve a return in line with market norms. In consideration of the risk being undertaken by BDL a profit of 20% on GDV is considered reasonable. It is worth noting that committing to deliver 10% affordable housing on a scheme generating a 1.5% profit is unusual. Most developers would seek to reduce affordable housing further in this scenario.

50/50 Profit Share above 20% Profit on GDV

FBC will have received £30m in HIF repayments prior to any planning profit share being received. CBRE is not aware of any formal planning viability guidance in relation to profit share. As such we have reviewed the proposal to provide a 50/50 profit share on a commercial basis. CBRE has been involved in multiple projects and joint ventures where profit share is agreed between the parties. A 50/50 profit share above 20% profit on GDV is considered to be an equitable position particularly as developers need to be incentivised to generate surplus profit. If 100% of any surplus profit was claimed by FBC there would be no reason for BDL, or indeed any developer, to seek to achieve any additional value.

Even without the benefit of FBC potentially receiving £30m of HIF repayments, CBRE considers a 50/50 share of surplus profits to be reasonable and equitable to both parties.

Additionality through improved viability

The Welborne Plan requires 30% affordable housing, a 70:30 affordable rent: intermediate tenure mix, 10% Passivhaus and 15% Lifetime homes to be provided unless viability considerations demonstrate that this is unaffordable. Through the planning viability review mechanism, the council has a choice about what should be provided if the scheme begins to make higher profits. These choices are to increase

the number of affordable housing units, vary the affordable tenure or deliver Passivhaus homes or lifetime homes, or a combination of any of the above.

The viability modelling supports BDL's view that the scheme cannot afford to provide more affordable housing units, a more beneficial tenure split, Passivhaus or Lifetime Homes. We would however advise that FBC retains the ability to assess if these requirements can be delivered at future viability reviews.

SENSITIVITY ANALYSIS

As the viability of the scheme is impacted by the proposed change, CBRE has re-run the sensitivity analysis undertaken previously to show how viability could be improved in different growth scenarios. The analysis incorporates both the HIF and Planning viability review mechanisms. It therefore shows the potential for HIF to be repaid and the potential level of affordable housing that could be delivered under each scenario. In addition, it shows how much money could be available to Fareham to improve the housing proposition at Welborne as above or to invest in affordable housing elsewhere in the Borough

	Base Case (Nil growth)	3% Value Growth & 2% Cost Growth Only	20% Placemaking & 3% Value & 2% Cost Growth
Gross Development Value	**£625.3m**	**£871.4m**	**£899.7m**
Cost (ex. Finance)	**(£451.6m)**	**(£535.1m)**	**(£535.1m)**
Finance Costs	**(£164.5m)**	**(£106.5m)**	**(£98.8m)**
Gross Profit/Deficit (pre HIF repayment and provision of additional affordable housing)	£9.2m	£229.7m	£265.8m
Profit as % of costs	*1.5%*	*36%*	*42%*
Profit as % of GDV	*1.5%*	*26%*	*30%*
Developer Profit/Deficit (Post HIF repayment & Planning Viability Reviews)	**£9.2m**	**£184.1m**	**£194.8m**
Profit as % of costs	*1.5%*	*29%*	*31%*
Profit as % of GDV	*1.5%*	*21%*	*22%*
Affordable Housing			
Guaranteed Affordable Housing %	*10%*	*10%*	*10%*
Guaranteed Affordable Housing units	*600*	*600*	*600*
HIF repayment			
HIF Repaid to FBC	-	£30.0m	£30.0m
Additional Affordable Housing units If HIF converted to affordable housing at Welborne (at current day values)		150	150
Planning viability recovery			
On-site additional Affordable Housing % up to 40% on each phase	0%	3.75%	3.75%
On-site additional Affordable Housing Units up to 40% on each phase	0	225	225
Additional funds available to	-	£15.6m	£41.0m

Fareham for an improved housing proposition at Welborne or off-site Affordable Housing at FBC discretion			

The sensitivity analysis shows, that subject to growth occurring as per the assumptions outline above, there is a reasonable prospect for additional affordable housing to be provided on site. The analysis shows that it may be limited to circa 14% on site and this is due to:-

- The overall viability position as outlined within the report
- The scheme not generating surplus profit until the back end of the scheme – as shown in the chart under the 'First Viability Review at 3,000 Homes' section most of the profit is generated towards the end of the scheme A maximum of 40% affordable housing within each phase – there could be situations, at viability review stage, where the scheme could financially afford to provide more affordable housing but the 40% phase cap would be reached resulting in a financial contribution to FBC.

The sensitivity analysis focuses on the ability to provide additional affordable housing. However, where a surplus is generated FBC could choose to improve the housing proposition at Welborne as above (subject to the agreement of BDL) or invest its funds in offsite affordable housing provision.

CONCLUSIONS

CBRE is of the view that the revised proposition put forward by BDL is reasonable on viability grounds. We therefore concur with BDL that as a result of making an additional £20m contribution to the junction:-

- Overall, the scheme produces a profit of 1.5% based on today's costs and values
- The scheme should not be liable to pay the Community Infrastructure Levy (CIL)
- The developer contribution towards M27 Junction 10 costs is capped at £40m
- Affordable housing should be 10% minimum
- Viability reviews should be held at 3,000, 3,750, 4,500, 5,250 and 5,750 dwellings
- The affordable mix is split 50/50 between affordable rent and intermediate tenures but this should be re-assessed during future viability reviews
- The scheme is unable to provide Passivhaus or Lifetime Homes but this should be re-assessed during future viability reviews
- It is appropriate to have two recovery mechanisms – HIF repayment & Planning viability review
- The Profit at 20% on GDV proposed for the Planning viability review is in line with planning guidance
- The 50/50 profit share proposed for the Planning viability review is reasonable