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The changing delivery of planning gain through Section 106 and the Community Infrastructure Levy

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Contents

This report was written by Dr Gemma Burgess and Sarah Monk from the Cambridge Centre for Housing and Planning Research. The model to analyse viability was developed with Professor Tony Crook, Emeritus Professor of Town and Regional Planning at the University of Sheffield. This research was funded by the Higher Education Innovation Fund.

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For further information please contact:

Dr Gemma Burgess
Cambridge Centre for Housing and Planning Research
Department of Land Economy
19 Silver Street
University of Cambridge
Cambridge
CB23 9EP

01223 764547
Glb36@cam.ac.uk

1) Introduction

Section 106 (S106) of the English 1990 Town and Country Planning Act provides local planning authorities with powers to require developers to contribute towards site specific infrastructure and provision of affordable housing (Burgess and Morrison , 2013). Whilst S106 worked well in a buoyant market to deliver affordable housing and other planning obligations, the downturn means that delivery is more challenging. There have been major changes to the planning system and the transition to the new Community Infrastructure Levy (CIL) in particular creates uncertainty. The impact on the delivery of affordable housing is not yet known.

The aim of this research is to consider the issues shaping the delivery of planning obligations through S106 and to explore the potential impact of the new Community Infrastructure Levy (CIL), particularly on the delivery of affordable housing. It builds on a previous study exploring the impact of the downturn on delivery of planning obligations through S106 (Crook et al, 2010) and the impact of the transition to the CIL (Burgess and Monk, 2012).

2) Background

The objective of development control in the UK is both to enable and structure new development that is beneficial to the economy and the locality. However, such development will at the same time often generate negative impacts both on the immediate locality and on services and infrastructure more widely. This in turn can result in local opposition to development. An important aspect of the land use planning system has therefore been to mitigate these negative impacts and to provide benefits, especially to the local community.

The UK development control system has always included the potential for local authorities to require developers to mitigate site specific negative impacts of their activities. Since 1990 local planning authorities (LPAs) have had powers to require contributions from developers both in the form of affordable housing and through financial contributions and other contributions in kind such as land. Planning agreements are the outcome of negotiations between planning authorities and those with interests in land ('developers') about matters related to developments (Crook et al, 2010). These agreements, most of which are made under S106 of the Town and Country Planning Act 1990, are 'struck' alongside the process of securing planning permission (Ibid). S106 agreements normally place obligations on developers to make contributions to the community as a way of ensuring that part of the additional development value created by granting planning permission (planning gain) goes to mitigate negative outcomes and positively to benefit local communities. Planning obligations may include affordable housing and contributions to local infrastructure such as education, transport, open space, children's play areas and community facilities.

Research to date has shown that S106 has been quite successful at delivering affordable housing, though what is secured varies by local planning authority (LPA) and the downturn has put pressure on the ability to secure affordable housing, in a context of policy changes to the planning system which create further uncertainty (Burgess and Morrison, 2013; Burgess and Monk, 2012; Crook and Monk, 2011; Crook et al, 2010, 2008, 2006; Burgess et al, 2011; 2007; Whitehead, 2007).

The planning system reforms together with the current economic context have raised a number of concerns, including the fall in new housing supply and a focus on reinvigorating stalled sites. Prior to the recession, planning obligations negotiated through S106 agreements were delivering over half of England's affordable housing output in 2007/08. But as S106 agreements are tied to the market, in the current recession the quantity of affordable housing delivered has inevitably fallen (Crook and Monk, 2011). There are difficulties in upholding the principle of S106 during the economic downturn but LPAs face the challenge of stimulating house building in the short term without losing planning obligations in the long run (Burgess and Morrison, 2013). The introduction of the Community Infrastructure Levy (CIL) has raised further local uncertainties and the impact on the amount of affordable housing that can be delivered is not yet clear (Monk and Burgess 2012).

Research to date

There have been several pieces of research which analysed the delivery of planning obligations. Crook et al (2006; 2008; 2010) examined the value of the planning obligations delivered through the S106 system in England in three national studies in 2003-04; 2005-06 and 2007-8. The most recent study not only analysed the value of agreed planning obligations, but also specifically the delivery of agreed obligations. Questionnaires were sent to 354 LPAs across England, with a response rate of 43% (Crook et al, 2010). Primary data were also gathered on the delivery of planning obligations in 24 case study LPAs and on four sites in each of those LPAs (ibid). In 2011 a further study built on that research by exploring the effect of the economic downturn on the delivery of planning obligations through S106 and the impact of the transition to the CIL (Burgess and Monk, 2012).

Aims

The aim of this research is to build on Burgess and Monk's 2012 study of the delivery of planning obligations through S106 to assess how the situation is changing and what the impact of the new CIL might be. The key research questions are:

1. What is the situation regarding delivery of planning obligations through S106?

2. What is the likely impact of the introduction of the CIL on the delivery of affordable housing?

Methods

This project involved a review of existing research and literature and a review of policy and current practice through secondary sources. A seminar updating policy and progress on S106 and CIL was attended where policy makers and planning practitioners presented evidence of their experience of the current situation. For the purpose of this research, we have developed our own version of the standard development viability model to use to simulate what might have happened on existing schemes had CIL been introduced. Our information all comes from schemes that have now been completed and have proved viable with S106 contributions. Interviews were also carried out with relevant officers from a range of LPAs (for interview schedules see Appendices A and B), all whom remain anonymous in the research. Some of the LPAs sampled for interview had been interviewed as part of previous studies to see how delivery of planning obligations had changed. Others were interviewed because their CILs were well developed.

3) Delivery of planning obligations

Delivery of planning gain through S106

Previous research showed that the majority of agreed planning obligations were delivered as agreed (Crook et al, 2010). However, the case study S106 agreements had all been negotiated before the housing market downturn. During the research for the 2010 study the first effects of the downturn were being felt, and this was followed up in later research. A fundamental concern with respect to the S106 approach has been the extent to which contributions depend on levels of market activity and on the economic environment. The recession has negatively affected both these factors, and therefore hampered effective delivery of affordable housing (Burgess et al, 2011).

Since the downturn, all case study LPAs in the 2010 study reported a considerable fall in the proportion of planning permissions with agreements that were actually going ahead. The most common reason why planning permissions with agreements do not go ahead is because the agreement is superseded by a new agreement for the same site, usually when the plans for the site change and a new permission and/or agreement are required. LPA officers reported that sites often change hands and the new developers want to alter the developments.

As a result of the property market and economic downturn, the case study LPAs had more instances in which they had to threaten developers with legal proceedings because they were increasingly failing to pay their contributions on time. LPA officers were spending more time chasing payments and there were more breached agreements than ever before. A number of LPAs said that they were pursuing late payments through legal channels, often for the first time. Some were also putting notes on the local land charges register if there was an outstanding contribution on a site, to try to ensure that the obligation could be pursued if the site was sold on so that payment would rest with the new owners in the future. However, the more recent interviews suggest that 2009 to 2011 were the worst years for breaches of agreements and that these were mainly amongst smaller developers.

Local authorities and developers may take a range of responses to the downturn (Burgess and Morrison, 2013). The developer may halt development or not take the site forward at all and decide to wait until the market recovers. They may approach the local authority to renegotiate the planning obligations agreed in the S106 on the grounds that it is no longer viable to deliver the agreed contributions as values have fallen. The case study local authorities in the 2010 study had some examples of sites that were underway where developers had breached the agreed schedule for delivering planning obligations, but also others where the developer had renegotiated the payment schedule to ease cash flow.

In fact many of the case study LPAs had renegotiated payment schedules for financial contributions both formally and informally since the downturn, often moving triggers from early stages such as on commencement to later stages in the development. Recent interviews suggest that pro-active LPAs that want to see development take place are flexible in allowing such alterations to payment schedules.

In the 2010 study, in only one case had the LPA accepted a lower contribution and most said that they were “taking a hard line” and refusing to reduce contributions. Any renegotiation would require developers to submit viability studies at their own cost and also to pay for the LPA’s due diligence on their submitted study. However, more recently the continued market downturn has led to renegotiation on the grounds of viability. The recent interviews suggest that LPAs are realistic about current market conditions and prefer to see development go ahead rather than stall because of viability. Those interviewed said that they will renegotiate agreements where the developer goes ‘open book’ and demonstrates that the scheme is no longer viable. This may result in a reduced affordable housing contribution and/or change in tenure. One LPA said that most renegotiations on the grounds of viability had been on agreements signed in 2005/6 before the downturn when land values had been higher. It is possible to renegotiate lower affordable housing contributions but to also include a claw back clause that would enable the LPA to increase the affordable housing contribution if the market and therefore viability improves. However, this is only useful on large developments that come forward over long time periods, rather than on small sites that will be built out immediately.

Whilst the recession and market downturn have reduced the amount of planning gain that can be extracted from schemes, and there have been renegotiations to reduce the proportion of affordable housing on some developments, delivery of affordable housing through S106 still continues. Some LPAs saw increased amounts of affordable housing delivered as developers sold whole developments to RPs (Crook et al, 2010). Some schemes that had a proportion, for example, 30 per cent, of the housing agreed to be affordable in the S106 agreement were selling the whole scheme to RPs. Some developers were building the affordable housing first to help their cash flow. There were a few instances in the 2010 study of reducing the amount of shared ownership units as these have become more difficult to sell recently and instead increasing the amount of social rent, or exploring 'Rent to Buy'[1]. Recent interviews suggest that RPs can be relatively active developers in local markets as they have access to funding that enables them to continue developing.

New Government legislation now enables developers to request renegotiation on the grounds of viability. It has been argued that some planning obligations negotiated in different economic conditions now make sites economically unfeasible – resulting in no development, no regeneration or community benefits (DCLG, 2012). The Growth and Infrastructure Act 2013 inserts new sections 106BA, BB and BC into the Town and Country Planning Act 1990 to introduce a new application and appeal procedure, to review affordable housing obligations on the grounds of viability on S106 agreements agreed prior to April 2010. The measure aims to bring stalled sites forward by reducing affordable housing contributions.

The new application and appeal procedures do not replace existing powers to renegotiate S106 agreements on a voluntary basis (DCLG, 2013). The application and appeal procedure will assess the viability of affordable housing requirements only. It will not reopen any other planning policy considerations or review the merits of the permitted scheme. An application may be made to the local planning authority for a revised affordable housing obligation. This application should contain a revised affordable housing proposal, based on prevailing viability, and should be supported by relevant viability evidence (ibid). Operation of the clause will cease on 30 April 2016, as the ability to renegotiate is seen by government as a reflection of the current difficult market conditions, and not a permanent change. The review and appeal guidance also introduces a test of viability. It is strongly encouraged that existing methodologies for testing viability are used, and whilst no particular method is prescribed, Annex A identifies variables which could be relevant in the reassessment of viability (DCLG, 2013). The recent interviews suggest that some LPAs use consultants to conduct site specific viability assessments as part of renegotiations but others do it in-house, although all appear to use external consultants for their CIL viability modeling.

Delivery of planning gain through the Community Infrastructure Levy

In addition to the impact of the downturn and new legislation to deal with viability issues, there have recently been significant changes to the way in which planning gain will be secured in the future. The main change is the introduction of the Community Infrastructure Levy (CIL). The CIL is a new planning charge that came into force on 6 April 2010 through the Community Infrastructure Levy Regulations 2010 (now amended by the Community Infrastructure Levy (Amendment) Regulations 2011 (DCLG, 2011). It allows local authorities in England and Wales to raise funds from developers undertaking new building projects in their area (DCLG, 2011). The money can be used to fund a wide range of infrastructure that is needed as a result of development. This includes new or safer road schemes, flood defences, schools, hospitals and other health and social care facilities, park improvements, green spaces and leisure centres (ibid). In principle the levy can be applied to all development, not just sites above a certain threshold, although LPAs have discretion over whether they implement this or make exceptions for either types of development or different parts of the district.

The Community Infrastructure Levy is intended to be fairer, faster and more certain and transparent than the current system of planning obligations which has been accused of causing delays as a result of lengthy negotiations (DCLG, 2011). Levy rates are intended to be set in consultation with local communities and developers and it is anticipated that CIL will provide developers with much more certainty ‘up front’ about how much money they will be expected to contribute (ibid).

Example Community Infrastructure Levies

Shropshire

Shropshire was the second LPA to adopt a CIL charging schedule and the charge began operating 1st January 2012. The LPA used consultants to assess the viability of CIL rates across the area. The viability evidence led to the adoption of a charge only on residential development. As viability varies across the LPA, there are three charging rates of £0 on non-residential development, £40 sq m on residential development in the market towns and £80 sq m in all other areas. The proportion of affordable housing sought through planning obligations also varies in line with viability. The LPA has an industry ‘developer panel’ which is consulted on policy decisions such as these to ensure local buy in. By May 2013 £130,000 had been collected with £400,000 committed where building has started and £1.2 million is potentially liable.

The LPA has tried to make where funds will go transparent and clear. For infrastructure delivery for the LPA there is an overall implementation Plan and local infrastructure delivery plans (called Place Plans and available online). The plans define local infrastructure and investment priorities. They identify contributions to priority projects from a range of sources including CIL, S106 and the new Homes Bonus. The LPA said that this clarity is valued by developers and utilities to be able to pan ahead.

Most CILs will have a spending sequence which determines the proportion of the collected levies spent on different aspects. For example, Shropshire uses 5% as an administrative charge to go towards the cost of collecting the levy, 15% if for the Neighbourhood Fund which goes to parish councils (25% in Neighbourhood Plan areas). Of the residual, 90% is spent on local infrastructure priorities and 10% on strategic infrastructure priorities, defined in Place Plans).

The LPA reported some issues that have been encountered as the CIL has been charged. Operational issues include the need to get information and calculate liability e.g. defining when a building is ‘in use’ and whether mezzanines count in the calculation of liable floor space for charging. In terms of administration the LPA has invested in staff resources and new software.

London

The CIL works differently in London as both the Mayor and the boroughs are charging authorities, although the boroughs collect the Mayoral CIL. The Mayor is restricted to using the CIL for transport, currently only for Crossrail and is expected to contribute £300 million.

Both levies can contribute towards the administrative costs of charging the levy at 4% for the boroughs and 1% for the Mayoral CIL. Boroughs have to take account of both local viability and the Mayoral CIL in setting their own charging schedules. The Mayoral CIL has been levied since 1st April 2012. The per square metre rates for different types of development vary considerably between the different London boroughs.

Impact of the CIL

It is still perhaps too early to say anything conclusive about the impact of the CIL on the delivery of planning obligations. At the beginning of May 2013 out of 349 potential charging schemes, only 13 had been implemented, with a further 55 at various stages from adoption to preparing evidence.

Research with LPAs in 2011 explored how they were dealing with the transition to the new system (Burgess and Monk, 2012). Whilst most research participants said that they had successfully been using S106 to secure planning gain, sometimes for many years, the CIL, with a scaled back S106, was broadly welcomed by local authorities and most local authorities were planning to introduce a CIL within the next three years. However, almost all participants stressed the continued importance of still being able to use S106 to secure contributions for affordable housing, to mitigate specific site related impacts and for unique types of contributions.

The main finding from the research was that, whilst seen as a positive change, there was still a lot of uncertainty about the CIL – how to develop the evidence base, how to determine an appropriate charging schedule, how to use S106 alongside the CIL and how to collect the CIL funds. One point that became clear during the research is that all participants were very keen to know what other local authorities were doing and what issues they were grappling with. The frontrunners were being closely watched by those who will follow later.

Whilst the CIL was intended to be simpler than the negotiated S106 system, as local authorities have tried to develop and then implement their CIL charges, it has become clear that collecting planning gain through CIL can be complex. It has required numerous changes to legislation and guidance. With the introduction of the National Planning Policy Framework, Circular 5/05 relating to the site specific nature of panning obligations was cancelled. In 2012 regulation was changed in relation to charges on Section 73 applications and statutory guidance was revised to clarify the scale back of S106 in CIL regulations. In 2013 there were regulations on neighbourhood funding and consultation on further reforms to the CIL in response to many issues and complexities arising as local authorities began to implement the CIL.

A number of issues of concern were raised about the transition to the CIL which were very similar across all local authorities (Burgess and Monk, 2012). A key concern raised was about the economic viability of charging a CIL and the impact on development, particularly where land values vary across an area. There was particular concern in London about how the Mayoral CIL will impact on viability, as it will be charged along with both individual Borough CILs and S106. Even in high pressure areas, such as in London and the South East, values can vary across the district. Many local authorities were grappling with the technicalities of developing differential rates for the CIL charge across their authority and across different use classes, and there was some confusion about the regulations governing state aid. It is possible to charge less CIL than is proved to be viable, according to the agreed evidence base, but the reduction has to be proportionate across all use classes.

Now that some CILs are in operation it is possible to see how LPAs have dealt with some of these issues. One frontrunner LPA decided to set “modest” CIL rates that were about half the rate that viability modelling suggested were possible in order to act as a “viability buffer”.

Another advised that keeping the CIL charges simple, realistic and not having too many different rates made collecting it easier once the charge was implemented. However, one benefit of the CIL was felt to be that it is based on viability which means that different rates can be used where appropriate. For example, one LPA which has a lot of student housing development has a much higher rate for this type of development than ordinary residential development, but has seen a big increase in applications for student housing as this type of development is “very viable” in this local market.

The early adopters of the CIL have dealt with some of these issues in different ways. For example, one ‘frontrunner’ installed new IT infrastructure and a new administrative team to collect the CIL charges, but another adapted their current monitoring system and is collecting the CIL within existing resources.
Pooled contributions secured through S106 can only be sought from up to five separate planning obligations for an item of infrastructure that is not locally intended to be funded by the levy. Local authorities are finding the decision about what to specify as included in the CIL, and what to continue to seek to secure through S106, a difficult one. Some have dealt with this by scaling S106 right back for only affordable housing and site specific infrastructure e.g. pedestrian crossings. CIL is then being used to collect monies for all other infrastructure. One LPA said that this was both transparent and fair. Also, in a LPA where most development is small and so unlikely to individually require large infrastructure such as a school, but which collectively has an impact on local infrastructure requirements, it is a better way to ensure all development makes a “fair” contribution.

There was concern that there will be a funding gap for providing infrastructure as CIL will not meet all costs, will not raise sufficient funds to pay for everything and it is felt that expectations of what it can deliver are unrealistic (Burgess and Monk, 2012). Priorities will need to be determined locally and there will be difficult decisions to be made. There is a lot of uncertainty about the interface between S106 and CIL and some concerns that less affordable housing will be secured through S106 once CIL is implemented. However, interviews with LPAs suggest that it is the recession and market downturn that has reduced overall housing delivery, and therefore the delivery of affordable housing through S106, rather than the ‘burden’ of planning obligations sought through S106 and CIL. One LPA with a CIL in place pointed out that their neighbouring LPAs do not charge a CIL, but development rates there have been dropping faster. The introduction of CIL clearly requires LPAs to be realistic about what level of affordable housing contributions can be secured in the current market conditions.

There have been instances in the first few CILs where viability of charging rates was modelled based on the average proportion of affordable housing delivered, not on the Local Plan policy requirement for the proportion of affordable housing, suggesting that less affordable housing will be secured overall in the future under the new CIL regime. However, recent cases suggest this will not be permitted going forward, after two draft CILs were rejected by the Planning Inspector who argued that modelling them based on the average proportion of affordable housing delivered in the past undermined the local authority’s established policy.

Initial reports from authorities which have implemented a CIL suggest that what is collected through CIL in the first year can be lower than forecast. One reason for this is the higher than average submission of planning applications with S106 agreements attached in the months preceding the introduction of the Levy. For example, in London where both the Mayor and the Boroughs are charging authorities, the Greater London Authority’s projection for the Mayoral CIL was to collect £14.6 million in the first year, but the actual amount collected was around £5 million. The first few years of charging a CIL are likely to see initially modest but growing amounts collected through the levy. The first year or two may see developments being built out that were granted permission under the old system and so only have S106 agreements attached; it will take time for the planning permissions signed under the CIL regime to get underway and therefore make payments.

The next section explores the impact of the interaction between S106 and CIL using a simple version of the standard development viability model to explore i the impact on affordable housing.

4) Analysing the impact of CIL on viability

Viability is usually measured in terms of ensuring that the costs of development do not outweigh the expected returns from that investment. A profit margin, determined by what is expected from shareholders, is included in costs. Where the land element has already been purchased, that is also included in costs, and in such cases the difference between expected receipts and costs can be quite small so long as it does not become negative which would be unviable.

Increasingly developers are taking out options on land, preventing sites from being sold on the open market but tying the developer to a future land value according to an agreed formula once planning permission has been obtained. This means that if the formulaic land value is higher than the residual, the development will not be viable and the scheme will not go ahead (the option will lapse and the owner will take a new decision on whether to offer it on option to someone else).

However, at the point when the decision is made whether or not to take up the option and invest in a particular proposed development, the calculation will not include land value in costs. Instead, the difference between receipts and costs, known as the residual, is what can be paid for the land.

The problem is that when making a decision about something that will happen in the future, assumptions about the future have to be made. In particular, development viability appraisal requires technical knowledge of financial appraisal and analysis, market knowledge of development costs, market values and timing, and knowledge of the policy context and the regulations and guidance relating to housing development.

Key inputs to development appraisal include:

Revenues

- The appropriate density of development
- The mix of units in terms of size and type and their likely values
- The proportion of affordable housing required under S106

Costs

- Normal development costs
- Any abnormal development costs
- The costs of CIL as CIL charges are introduced
- The costs of any other planning obligations

Revenues minus costs produces a residual land value (RV) which can be compared with a Threshold Land Value (TLV). If the RV is greater than the TLV then the development is viable.

There are two fundamental problems with this model of development appraisal. The first is that it does not take time into account, and the second is the TLV – is this the existing use value or the market value?

Government guidance (DCLG, 2013) states in Annex A that current costs and the agreed land value as set out in the original option should be used. The purchase price should be benchmarked against the market value or sale prices of comparables. There is no explicit assumption about TLV, only 'market value'. However, Annex A is not yet a Statutory Instrument.

There are a number of similar models that can be used for viability appraisal. Some are freely available, for example, on both the GLA and the HCA websites, while others are only available using consultants. University College London recently interviewed 11 viability modellers (McAllister, 2013) and found that when assessing the viability of area-wide policies such as proposed CIL charging schedules, they usually use hypothetical rather than actual sites. They also tended to avoid projecting changes in costs and revenues over time, instead expressing them in current terms, which is in effect a projection of zero growth. For area-wide policies such as CIL, this means that they are actually modelling whether area-wide planning policies that will be implemented in the future for actual sites are viable at present for hypothetical sites (ibid).

Clearly the models of development viability that are being used to assess whether CIL charging schedules are viable have important limitations. Coleman et al (2012) review 19 development appraisals and conclude that they deviate significantly from the tenets of capital budgeting theory. They tend to oversimplify the timing of income and expenditure. The way they handle debt, developer's return and changes in values and costs suggests a major gap between mainstream capital budgeting theory and development appraisal in practice. Yet investment in housing is as much a capital investment decision as investment in any other asset, including stocks and shares. The experience of the years since the global financial crisis would suggest that it is important to quantify uncertainty as far as possible in order to spread risks and reduce the likelihood of financial collapse. This is as relevant for housing development investment as any other area of investment where potential future gains are inherently risky.

So given that the viability appraisal models in practice across the country are so flawed, why is such appraisal widely used? Compared with capital budgeting approaches to investment appraisal, development viability appraisal offers a simplified short cut. There is no need to gather the detailed information required by capital budgeting, which is just as well since such information currently barely exists. Those who invest in the stock exchange, for example, have a wealth of information available to inform their decisions, information that is changing all the time as different sales and purchases are recorded. Real estate only provides that information in the form of REITs and development companies quoted on the stock exchange. This information relates to the performance of the REIT or the company, not to any area or group of individual sites that may or may not be ready for development.

In the context of the introduction of CIL, viability appraisal is necessary partly because of the lack of information available to local authorities. They face the problem of setting charges that on the one hand might be so high as to prevent new development, while on the other hand they might be so low that very little 'planning gain' is captured for the community. Indeed, even low CIL rates could stifle development if it depended on infrastructure provision planned by the local authority, yet the CIL revenue was insufficient to cover the costs of that infrastructure. The government, when introducing CIL, had always stipulated that the levy should not be set so high as to make development unviable. Local authorities were understandably concerned that their CIL schedules would be at a level that was appropriate for their local circumstances. The viability appraisal requirements have become even more important now that there is a new appeal process in the S106 Review Guidance which introduces a test of viability (DCLG, 2013).

The model

For the purpose of this research, we have developed our own version of the development viability model. However, we are using it to simulate what might have happened on existing schemes had CIL been introduced. Our information all comes from schemes that have now been completed and have proved viable with S106 contributions, including not only affordable housing but the full range of planning obligations then operating in each location. This means that many of the limitations of these models are not relevant.

Data

It proved difficult to obtain detailed information on completed housing schemes. Private developers in particular were reluctant to provide anything other than broad cost/revenue proportions, usually 'a third, a third, a third' – i.e. one third of the development value on build costs, one third on land and one third on (gross) profits. Instead we were able to obtain information from nine social housing providers who had entered the market in order to cross-subsidise their affordable housing development in the face of dwindling public subsidy. In almost all cases some of the details of market values and costs were lacking, usually because the scheme was part of a wider market scheme for which they did not have any information. We were able to substitute published data and this resulted in just six schemes for analysis.

The six schemes were in different parts of the country with different costs and values. The aim of the simulation was to model the impact of CIL on the output of affordable housing. The approach was first to model the original scheme, which in all but one case was a mixture of market and affordable housing, sometimes social housing only, sometimes a mix of social housing and shared ownership, as if all the units had been for market sale. This involved including a profit margin that was of course missing from the original housing association scheme. That scheme was then modelled on the basis of a commuted sum. Further simulations looked at the impact of a CIL contribution using the nearest relevant CIL charge to that location, alongside scaled back S106 contributions and a commuted sum. Finally, the commuted sum was replaced by on-site affordable housing.

As noted above, data was difficult to obtain and where the housing associations did not have full information we substituted published data or made our own estimates. In particular, we assumed a gross profit margin of 26 percent on all costs (but not on commuted payments). All the examples have been anonymised because the data provided was commercially sensitive. The sites covered locations across the South East, East, London and the South West. They included brownfield as well as greenfield sites. Unfortunately we did not have sufficient data to include sites in the midland or northern regions. The table below provides some basic information about the sites. In all cases except the south west, on sites where there is a mix of market and affordable homes, the affordable units are approximately a third of the total (which accords with other research evidence, see Crook et al, 2010).

1 South West	2 South East	3 East	4 South East	5 South East	6 London
55 (16 market sale; 11 market rent; 28 social rent	24 (18 market; 6 social rent	25 (15 market; 3 shared ownership; 7 social rented	35 (25 market; 4 shared ownership; 6 social rent)	40 (14 intermediate rent; 13 shared ownership; 13 social rent)	157 (101 market; 15 shared ownership; 41 social rent)

Table 1: The six schemes

Limitations

The main limitation is data. This meant that in some cases data had to be used from the Valuation Office Agency (for land prices) and the Building Costs Information Service, (for construction and related costs) which is widely regarded as the benchmark despite relating to affordable housing construction (HCA, 2010). However previous research using similar data found that the results for different parts of the country were remarkably similar, reflecting the valuation approach to land values (Monk *et al*, 2008).

Data limitations also meant that because the developers of the actual schemes were not-for-profit organisations, a true 'market' profit margin did not exist. The market units were generally developed by a wholly-owned company set up for the purpose so that the costs of development included marketing and sales and the surplus made was used to cross-subsidise the affordable housing.

Example 1

Scheme 1 – South West
The first scheme was 55 units in the South West comprising a mix of 16 market sale, 11 market rent and 28 social rent. The scheme was developed by a social landlord which was cross subsidising its development programme by producing units for sale. The site was brownfield in a semi-rural location.

1. Actual scheme
First we simulated the actual scheme (we had to simulate it because the developer did not provide full details of costs and as a not for profit organisation we had to assume a margin on costs to allow for fees, interest, and surplus to be used for the cross subsidy). We had information on the size and type of units in terms of floorspace, build costs per m sq, the actual s106 contribution which worked out at £10,000 per market unit (or £5,000 per unit if all are included) and we used a 26% margin on costs.

The gross development value (GDV) comprised the full market value of the market sale units, 80% of market value for the market rental units, and 60% of market value for the social rental units. This was considered the right order of magnitude for RPs bidding to purchase affordable housing from private developers on s106 sites.

The residual value (RV) was then calculated by deducting total costs from the GDV. This was small but positive, as expected since this was a successful actual scheme. The positive element probably reflects our assumptions which were fairly conservative.

2. 100% market scheme
We then used the same scheme to simulate a 100% market scheme, with the same mix of house type and size and cost structure but assuming that all units sold at open market value. This produced a larger RV of £2.4m.

3. Market scheme with CIL and scaled back S106 plus a commuted sum
We used two methods to calculate the commuted sum, according to known practice among some local authorities. First, we took the sale value of the affordable units in the original scheme i.e. the developer paid the amount that the RP would have paid for the units had they been delivered on site.

This was thought to be one of the most likely scenarios once CIL had been introduced. We used a CIL rate of £80 per sq m which is the CIL charge in Shropshire, which is in a different region but one of the CIL front runners and also a rural authority. The s106 contribution was scaled back to £2,000 per unit. The outcome in terms of RV was very close to the original scheme i.e. positive but small.

4. As above but different method of calculating a commuted sum
The alternative commuted sum was the land value and build costs of the affordable units in the original scheme which was higher. In both cases the RV was negative.

5. Market scheme with CIL, scaled back s106 but 30% affordable housing on site
This was expected to be the most expensive to the developer and to produce a negative RV. However this was not the case as the RV was £1.4m.

Example 2

Scheme 6 - London

This scheme produced 157 units of which 101 were market sale, 41 social rent and 15 shared ownership. It was a brownfield site in an inner city location. Because it is London the values are very different from the rest of the country. Again the developer was a housing association wishing to cross subsidise its affordable housing development programme in the absence of public subsidy.

1. Actual scheme
Again we assumed a margin of 26% on costs and in this case as details of the floorspace of each unit were not available, we used information from Nationwide and HCA for each dwelling type (one bed, two bed etc.). The simulation of the actual scheme produced a large RV of £37m which was expected given the high proportion of market units.

2. 100% Market scheme
The RV without an affordable housing contribution but with all other planning obligations was 25 percent higher than the RV of the original scheme.

3. Market scheme with CIL, scaled back S106 and commuted sum
Adding a commuted sum to cover the costs of all planning gain including affordable housing produced a RV that was lower than the actual scheme by different amounts depending on how the commuted sum was calculated. If the actual sale price of the affordable housing was used, the RV was 19 percent lower

4. Market scheme with different method of calculating the commuted sum
Using replacement build and land costs for the affordable units produced a RV that was only 12 percent lower than the actual scheme. Both were more than £25m.

5. Market scheme with CIL and scaled back S106
Replacing the commuted sum with CIL and scaled back S106 produced a RV that was just six percent less than the actual scheme RV at £34m.

All the RVs were positive and large, reflecting the location and scale of the scheme.

The results and implications

The results showed that the schemes were all very different and thus were affected in different ways by the simulated changes.

Table 2 compares the simulation results for all six schemes. The final row also shows our estimate of the RV using the Valuation Office Agency's estimates of the average value of greenfield sites that take S106 contributions into account. We used the values in the VOA's published data for the nearest equivalent planning authority in our sample sites.

Simulation	South West	South East 1	East	South East 2	South East 3	London
Actual scheme, s106	£0.8m	£3.6m	£1.5m	£3.3m	£0.3m	£36.7m
Market only, other s106	£2.4m	£5.2m	£3.3m	£5.6m	£4.5m	£49.3m
CIL and scaled back s106, commuted payment (1)	£0.7m	£3.90m	£1.7m	£4.0m	£2.3m	£29.8m
CIL and scaled back s106, commuted payment (2)	£0.4m	£3.6m	£0.6m	£3.4m	£0.6m	£32.4m
CIL and scaled back s106, on site provision	£1.4m	£3.6m	£1.1m	£2.7m	£3.5m	£34.5m
Estimated site value	£3.1m	£2.2m	£2.4m	£3.2m	£3.9m	£22.6m[1]

Table 2: Comparing the simulations

This comparison suggests that the introduction of CIL with scaled back S106 contributions are likely to have a very varied impact on residual values and therefore on the future of securing affordable housing through planning obligations.

In the South West and South East 1 schemes, on site affordable housing provision after CIL produces a similar or better RV than the actual scheme. This suggests that developers will be able to acquire land and deliver viable schemes with on site provision. In the South West, commuted payments would be less feasible to a developer than on site provision, whereas in South East 1 it would be more feasible although not much more so than on site provision. These differences result from the higher proportion of affordable housing in the South West case study than the South East one.

In the East, on site provision with CIL is less viable than before and a commuted payment to enable a housing association to acquire land and build the homes is even less viable. However, a commuted payment where the housing association receives funds to buy homes is more viable than on site provision and indeed that the original scheme.

In South East 2, commuted payments with CIL produced higher residual values than either on site provision or the actual scheme, whereas the reverse is true for South East 3. These differences are related to variations in land and house prices. London is different again. On site provision gives a higher residual value than both types of commuted payment and is slightly lower than the actual scheme.

Comparing the RV with our assessment of the market prices for residential land suggests that on site provision would be viable in London and two of the South East case studies, but not in the South West, East or South East 1 (although commuted payments in South East 1 would generate residual values close to the market estimate).

[1] We know from the figures provided by the case study RP that it paid £22.6m for the site. So this is not an estimate from Valuation Office Agency figures

Impact on affordable housing

The simulations illustrate the important point that the impact of CIL and S106 affordable housing on viability depends on the interplay of local housing and land markets, local policy and negotiating practice. As a result there are significant variations between the six case studies.

On the one hand, market conditions, specifically in terms of achievable sale prices, can vary between localities within the same local planning authority. Land prices also vary more than build costs as we found when we used these to calculate the commuted payment. On the other hand, local policies and practices between and even within a planning authority can affect their ability to successfully negotiate contributions and therefore can affect the outcomes in terms of numbers of affordable units and their tenure mix. Previous research (Crook et al, 2008) showed how important these are in securing affordable housing outputs, and it is therefore not surprising that local variations are confirmed in our modelling. This was supported by LPAs. One LPA pointed out that they have higher application and build rates than adjacent LPAs even though they are the only one also charging a CIL, but said that neighbouring LPAs had not changed their expectations about the viability of affordable housing delivery in line with changes in the local markets:

> "We have been keeping an eye across our borders and even though we are the only one with a CIL, in adjacent areas their development rates have been dropping faster, even though there is no CIL. This suggests that it is not CIL or S106 driving the fall but perhaps unrealistic affordable housing contributions. Some are still asking for 40% and this means too much negotiation".

There are other factors at play. What housing associations are prepared to pay for completed affordable units depends on rent levels, their financing costs and the extent to which they contribute funds from their reserves. We have not modelled the impact of the new affordable rents on residual values, but if it enables associations to pay more for affordable homes this will increase residual values and make sites more viable.

Most importantly, the simulations show that most of the sites would be viable in comparison with the actual scheme and/or our estimates of land values in the locality of the case studies. The introduction of CIL with scaled back S106 will not of themselves impact significantly on viability. This is because the cost to developers of the CIL and our estimate of the scaled back S106 charges are often less than in the actual schemes. There are two reasons for this: first, the CIL spreads infrastructure costs across many more schemes than under S106 along, and second it is not levied on the affordable homes. As one LPA said:

> "There has been a lot of fuss about CIL but it is fairer and more transparent. It is based on generic viability. Where you have a lot of one or two unit developments that were not contributing before, but incrementally have a big impact, now they do. And because it is based on viability, the types of development that can pay more do".

Overall this research has shown that on the basis of the simulations, the future of affordable housing delivered through planning gain depends not so much on CIL as on the wider interaction of house prices and local policy and practice. The overall economic context and its impact on the housing market more broadly is critical. For affordable housing through the planning system, this has always been the case and the introduction of CIL does not change this. LPAs have to be aware of variations in local viability and the complex interplay of factors that shape planning gain and viability:

> "You have to look at the combination of effects. You have to develop realistic contributions. We should all be in the business of making acceptable things happen".

5) Conclusions

There was successful delivery of an increasing number and value of planning obligations through S106 during the period of a buoyant rising market. It became an important way of securing financial and in kind infrastructure to mitigate against the negative impacts of development. In particular, S106 was very successful at delivering affordable housing.

The impact of the downturn has meant that sites have stalled and there has been a significant fall in the level of development. As market housing development falls, so too does the delivery of affordable housing through S106, although this can be offset where in places where local RPs have access to funding and are actively developing locally. For S106 agreements signed when the market was buoyant and land values high, the downturn has meant a fall in the level of planning gain that can be extracted under current conditions, given the fall in the market and the relatively higher prices paid for the land in a rising market.

The impact of the CIL on the delivery of planning gain is still uncertain. But the views of the early implementers of the levy suggest that as long as rates are realistic and based on viability not policy, then the CIL will not hinder development, and it is the current market conditions that are keeping development at low levels, rather than the extraction of planning gain, whether through S106 or CIL. However, this does require LPAs to be realistic about what is viable and can therefore be extracted under current local market conditions.

The discussion about the need for viability modelling, for example to determine CIL rates or viable levels of affordable housing contributions, suggests that viability models are limited in many ways, but may be the best available way to analyse what level of planning gain is viable. In terms of the impact of CIL on the level of affordable housing it is possible to secure, the modelling suggests that sites can still maintain affordable housing, but this will depend on other viability factors, such as when the land was bought and the ways in which local market conditions have changed.

Renegotiation of S106 agreements, with a reduction in the level and/or tenure of affordable housing, has been permitted to try and ensure development goes ahead. However, the time limited nature of the new government legislation allowing renegotiation suggests that improvement in the market in the future is expected and therefore developers will return to delivering higher levels of development, and thus planning gain, than they did during the recession.

The findings of the model echo the reports from LPAs that it is the complex interplay of local market conditions, site specific factors, local policy, practice and expertise that shape the level of planning gain that is viable on individual schemes, rather than simply the CIL rate or affordable housing policy.

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7) Appendices

A) S106 Interview Schedule

Planning permissions with s106 agreements

1. Have there been any changes to the proportion of planning permissions which have S106 agreements attached?

    a. Since the downturn
    b. Since you introduced a CIL

2. Have there been any changes to the proportion of planning permissions with agreements that actually go ahead? Any differences by:

    a. Commercial/residential
    b. Size/location
    c. Greenfield/brownfield

3. Where they have not gone ahead, what are the reasons for this? Is it:

    a. Can't sell because of downturn
    b. 'Burden' of S106
    c. Increases in developer's funding costs
    d. Change in AH policy

4. Any changes to what is negotiated in S106s since the downturn e.g. affordable housing agreed less than policy?

Renegotiation of s106 agreements

5. Have there been any increases in requests by developers for renegotiation of agreements?

6. If so, for what reasons? Do developers cite lack of viability because of:

    a. General result of downturn e.g. low sales
    b. Level of agreed planning obligations
    c. Something else

7. What is your policy on renegotiation and how has it changed since the downturn?

8. With what results? – do you have any examples?

9. Has this resulted in cuts to affordable housing? Education? Open space? Transport and travel? Community works and leisure? Other? Are the changes to timing, amount to be delivered, both?

10. What do you think about the Growth and Infrastructure Act 2013 insertion of new sections 106BA, BB and BC into the Town and Country Planning Act 1990 to introduce a new application and appeal procedure, to review affordable housing obligations on the grounds of viability on S106 agreements agreed prior to April 2010 aiming to bring stalled sites forward by reducing affordable housing contributions?

Increased planning / development delay

11. What has been the impact of the downturn on delivery of obligations (on planning permissions with S106s that have gone ahead), for example through changes in phasing or tenure?

12. Have there been any changes to the normal timescale for the completion delivery? Of different types of obligation?

13. Are you able to monitor the delivery of agreed planning obligations? Have you become more vigilant? Have any staff losses made it more difficult?

Experience of breached agreements, non delivery etc.

14. Have there been any increases in breached agreements?

15. How do you respond to there? Examples?

16. Have you changed your policy to deal with these?

The introduction of CIL

17. Are you planning to introduce a CIL? Why/why not?

18. How are you planning for CIL and changes to S106?

19. Is the introduction of CIL making any difference to S106 negotiations or developer behaviour?

20. What is the expected impact on the delivery of affordable housing? How will S106 deliver affordable housing alongside new policies such as the CIL?

21. How are you dealing with the proportion of CIL to be shared with the ‘neighbourhood’?

22. What has been the impact of the New Homes Bonus?

Viability testing and AH

23. Do you use viability testing/modelling? E.g for renegotiating agreements or setting CIL charges?

24. How do you do it?

25. What are your main concerns about how affordable housing will be delivered in the future?

26. Do you have any plans to deal with these issues? Are you exploring any other alternatives?

B) HEIF CIL Interview Schedule

For LPAs already charging a CIL

27. How long have you been collecting a CIL?

28. What have you collected against what you forecast?

29. Did you do your own viability testing to set the CIL levels? If not who did it for you? How was it received by the Inspector?

30. What AH level did you use in modelling and is it the same as your AH policy?

31. There is a lot of variation between LPAs on CIL levels – can this only be because of viability, or is it also political?

32. What proportion is going to the neighbourhood? How did you decide this?

33. What difference has it made to your S106 agreements?

34. Any impact on AH levels so far?

35. How have you dealt with your 123 list/pooling contributions?

36. Any issues arisen in relation to collection of the CIL?

37. The model:

For the purpose of this research, we have developed our own version of the development viability model. However, we are using it to simulate what might have happened on existing S106 schemes had CIL been introduced in six case studies across the country.

The simulations illustrate that the impact of CIL and S106 affordable housing on viability depends on the interplay of local housing and land markets, local policy and negotiating practice. As a result there are significant variations between the six case studies.

Overall this research has shown that on the basis of the simulations, the future of affordable housing delivered through planning gain depends not so much on CIL as on the wider interaction of house prices and local policy and practice. The overall economic context and its impact on the housing market more broadly is critical.

Build costs varied.

What do you think?

UNIVERSITY OF CAMBRIDGE