

18/11/2022

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Dear Andrew,

Please find below the further viability information requested:

1. Summary of key issues

- 1.1 Having reviewed the committee's main concerns, we note the issue of gross development value (GDV) sales, and build costs were key inputs raised for further clarification.
- 1.2 We note concerns as to '*what has changed*' since the original application to render the scheme unviable.
- 1.3 We also note the officer's report did not fully detail the extensive viability discussions on this site to date, with para 102 simply summarising that the submitted viability assessment was reviewed and independently verified.

102. While the proposal no longer intends policy compliant contributions towards affordable housing, a robust Financial Viability Assessment has been submitted, and independently verified, which demonstrates that the scheme is unviable with full contributions at this present time. However, the applicant has agreed to enter into a s106 legal agreement to ensure that a deferred payment mechanism would enable for a further affordable housing commuted payment should the profitability of the scheme improve in the future. On balance, the significant benefits of this scheme outweigh the current shortfall in affordable housing contributions especially given the scope to secure the aforementioned deferred payments.

- 1.4 And finally we note that, while the late review mechanism / deferred payment mechanism is referred to, the terms of this mechanism and its implications are not covered in detail.

2. Contents

- 2.1 Given the above points, for members' benefit we have summarised the most pertinent points below as succinctly as possible:
 - Further detail on the extensive viability assessment process: the key inputs of the viability assessment, its independent verification by the council's representatives BPS Surveyors, and the final agreed position.
 - What has changed since the original application to impact the scheme's economic viability.
 - The terms of and implications of the offered deferred payment mechanism.

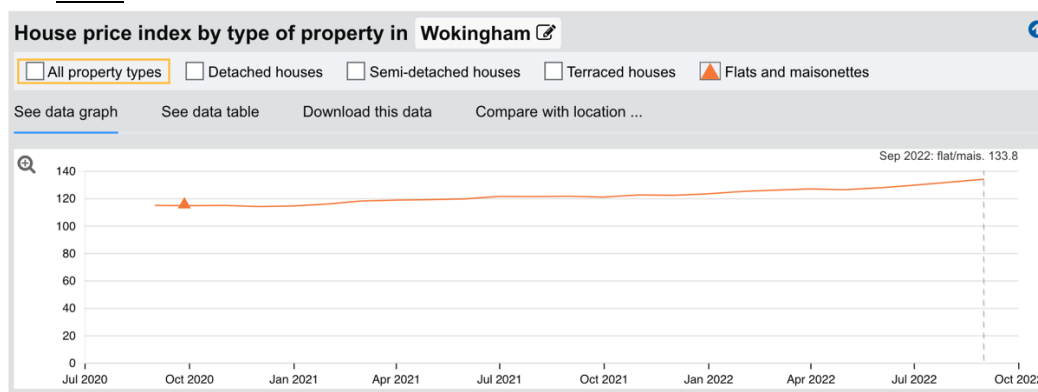
3. Viability assessment summary

- 3.1 The table at **Schedule 1** summarises the key inputs of the viability assessment, and the four stages of review that the scheme underwent from March to September 2022. All four stages agreed a conclusion of non-viability, the discussion was the extent to which it was unviable.
- 3.2 The Notes column summarises the key challenges and reductions advocated by BPS acting for the council to verify the viability assessment.
- 3.3 The surplus/deficit column highlights that the scheme was always considered by both BPS acting for the council and S106M acting for the applicant to be unviable, running a deficit in all appraisals (March-September 2022).
- 3.4 Green cells indicate agreement while orange cells indicate any challenges and their resolutions.

4. What has changed

- 4.1 Original application 201833 was assessed and granted in the period July 2020 – July 2021.
- 4.2 There were originally viability concerns about the proposed £1.6m contribution during this application, as evidenced by the planning file for this scheme.
- 4.3 Between September 2020 and the current date the following economic statistics are relevant as context for what has changed over this period:

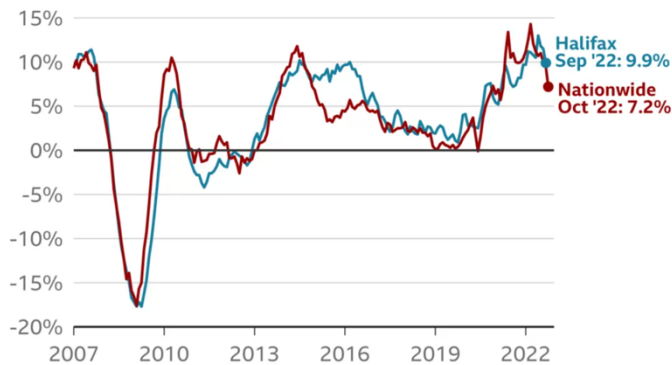
Sales



- 4.4 Land Registry House Price Indexation data for flats in Wokingham increased from 114.7 – 133.8 (16%).
- 4.5 The difference between the GDV (sales) assumption in the applicant's 2020 viability report and the current assumption is +24%. The increase in GDV recommended by BPS on behalf of the council therefore exceeds house price index increases in Wokingham over this period.
- 4.6 This should be seen within the context of a currently stalled housing market. Both Nationwide and Halifax reported in November 2022 that house prices are now declining, and Savills expect house prices to fall 10% in 2023 in their latest update, not recovering for several years (see below extracts).

UK house prices

Year-on-year percentage change



Source: Nationwide, Halifax



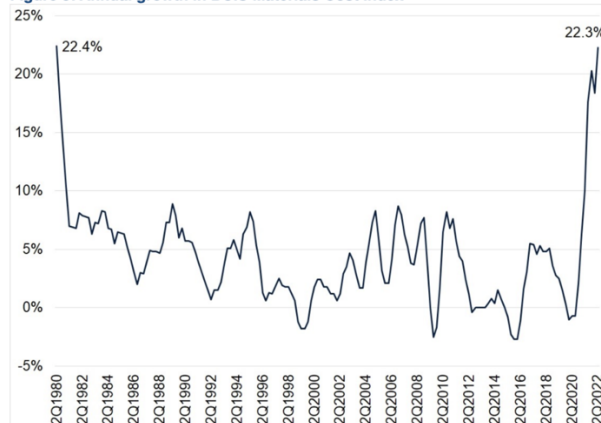
Table 4 House price forecasts (published November 2022)

Region	2023	2024	2025
UK	-10.0%	1.0%	3.5%
London	-12.5%	-1.0%	2.0%
South East	-11.0%	0.0%	3.0%
East of England	-11.0%	0.0%	3.0%
South West	-10.0%	1.0%	3.5%
East Midlands	-9.0%	1.5%	4.0%
West Midlands	-9.0%	1.5%	4.0%
North East	-8.5%	2.5%	4.5%
Yorks & Humber	-8.5%	2.5%	4.5%
North West	-8.5%	2.5%	4.5%
Wales	-8.5%	2.0%	4.5%
Scotland	-9.0%	2.0%	4.0%

Build costs

4.7 The below figure is taken from the RICS BCIS quarterly briefing:

Figure 8: Annual growth in BCIS Materials Cost Index



Source: BCIS

4.8 This suggests 22.3% annual growth in materials costs, largely driven by gas, steel and concrete prices as a knock-on impact of the recent energy crisis. You will note from the graph the bottom of this recent increase began in 2020 driven by supply/demand imbalances provoked by the Covid-19 Pandemic.

4.9 The latest BCIS update also suggests labour cost increases of 7-12% across all trades in 2022, which should be viewed in the context of 11.1% general inflation (November 2022).

4.10 In terms of borrowing costs, the Bank of England raised the base rate from 0.25% at the last application to 3% as of November 2022, massively increasing the cost of finance +2.75% during this period.

4.11 These economic factors are not developer specific but will apply to all developers.

5. Deferred payment mechanism

- 5.1 Turning to the terms of the deferred payment mechanism advocated by BPS acting for the council, officers in subsequent discussion, and agreed by the applicant, the following points are material to the council's position:
- 5.2 The deferred payment mechanism (otherwise known as a late review mechanism) secures the council's position – such that if economic conditions improve, i.e. the scheme's sales improve or have been underestimated, or the build costs decrease or have been overestimated, compared with the current viability position, such that it becomes viable, then a further contribution will be made at a later date. It essentially defers the viability calculation until actual figures can be obtained rather than early valuations.
- 5.3 Unlike a viability report, the deferred payment mechanism assesses 'actual' sold prices and QS certified construction costs at 75-85% completion of a development. It is therefore a 'true' reflection of the values achieved and costs incurred. It is therefore more reliable than a valuation prior to disposal.
- 5.4 The developer is prevented from disposing of the last X number of dwellings until such time as the review is completed by the council's consultants, and the resulting contribution if any is agreed and paid.
- 5.5 Review mechanisms of this type are most commonly used in Greater London as they are advocated by the London Plan, but are increasingly common outside GLA, particularly in instances where there is any valuation uncertainty over sales. Reading council apply these mechanisms as a standard feature of any s106 agreement following their Affordable Housing SPG.
- 5.6 The Planning Inspectorate commonly find deferred payment / review mechanisms to be an appropriate planning obligation where up front contributions are deferred on the basis of viability, as in the below extract from recent appeal ref APP/H2265/W/22/3294498.
13. The Council contends that the appellant's stance on GDV is too pessimistic. However, both parties have exercised judgments on valuations and the relevance of and interpretation of comparable evidence based on their knowledge and experience.
 14. Despite this, the parties agree that a total contribution in line with the appellant's case should be payable through the s106 agreement⁴. This would be the affordable housing contribution that the scheme could viably afford on the appellant's case. However, given their difference on GDV, the parties agree in this case to the inclusion of a late-stage viability review mechanism in the s106 agreement⁵. This would allow GDV to be revisited if sales values exceed those expected by the appellant so that the maximum affordable housing contribution possible from this single-phase development is achieved. Review mechanisms are a tool to strengthen local authorities' ability to seek compliance with relevant policies over the lifetime of the project⁶. No more than 70% (25 no.) of the units could be disposed of until the review takes place, and the maximum contribution would be capped at 50% to ensure there remains an incentive to sell the units at a higher value to those anticipated by the appellant.
 15. Whether there will be any additional affordable housing contribution from the development is unclear and cannot be guaranteed, but the review mechanism in the s106 agreement does strengthen the Council's ability to seek a higher order of contribution approaching the aspiration of 40% set out in CS Policy CP17 over the lifetime of the project. This would help address the unmet need for affordable homes in the borough.

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- 5.7 These mechanisms are supported by Planning Practice Guidance, RICS guidance, and academic literature on viability as a fair, proportionate and reasonable approach to balancing deliverability and planning obligations. They ensure that where a development can afford to do so, a contribution will always be made up to the maximum policy compliant amount. They provide more certainty that the development is providing its maximum possible contribution, rather than relying on early projections which can be out of date by the time the development is complete.
- 5.8 For avoidance of doubt, these mechanisms are 'one-way' – so the contribution will only increase from the initial £100,000 without prejudice offer, it will not decrease.
- 5.9 The S106 agreement sets strict terms on what information can be included within the costs, timing of the review, dispute resolution mechanisms, and formulae for the mechanism. Heads of Terms have already been discussed and any consent would be subject to the satisfactory conclusion of a signed s106 agreement.

Kind regards,
S106 Management

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