

T: 0203 897 6700

M: 07496 611110

The Stanley Building, 7 Pancras
Square, London, N1C 4AG

mp@powerhausconsultancy.co.uk

www.powerhausconsultancy.co.uk



**4& 6 Manor Road, Teddington
APP/L5810/W/19/3242694 and APP/L5810/W/19/3242696**

**The Draft Unilateral Undertakings Position Statement
9th November 2020**

Initial drafts of proposed Unilateral Undertakings (UU's) were prepared by the Appellants solicitors, Town Legal LLP and first sent to the Council for comment on 7th August 2020. Negotiations of the drafts have continued since this date and as the drafts are not wholly agreed at this time the Appellants will continue seeking to agree the drafts with the Council right up to the date of the Hearing.

The Appellants do not foresee any difficulty in getting the final Unilateral Undertakings executed because the signatories are ready for this and because it is not necessary for any banks to sign the documents.

The following two sections explain the drafting of certain areas of the unilateral undertakings and the main points of difference between the two parties at this time.

1) Definitions used in the review formula of the draft Unilateral Undertakings that are at variance to the information contained within the Appellants submitted Viability Report prepared by Bailey Venning Associates(BVA) (the BVA Report) dated April 2020.

a) Build Costs or Application Build Costs

The BVA Report at Section 7.0 confirms that the estimated build costs, as prepared by Quantity Surveyors Christopher Smith Associates (CSA) for the 15 unit scheme as £3,949,480 and £5,686,000 for the 21 unit scheme. The Council's viability consultant Bespoke Property Consultants (BPC) reviewed the BVA Report with input from MiCam cost consultants and in their reports dated June 2020 (the BPC Review Report) for each of the 15 unit and 21 unit schemes at para 4.6 suggests that the build costs assessed by MiCam should be £3,667,271 for the 15 unit scheme (a 7.15% reduction) and £5,144,604 for the 21 unit scheme (a 9.52% reduction).

The draft Unilateral Undertakings have used the build costs advised by the Council's consultants as the Application Build Costs within the proposed planning obligation formula ie £3,667,271 for the 15 unit scheme and £5,144,604 for the 21 unit scheme.

b) The Level of Developers Profit

In the viability assessment of these two schemes, the Appellants have continually adopted a profit level of 20% which is considered to reflect the risks involved with a housing development for apartments that includes substantial excavation, construction above an existing building and construction that maintains access for existing residents whilst also ensuring their safety and continued access to their existing dwellings. The use of a 20% level of developers profit in the appraisal of the viability of the two proposed schemes is asserted in para 9.1 of the BVA Report. There is an argument for the profit level being higher than this in the current, exceptional, economic circumstances. The acceptability of a 20% profit level is also confirmed in the Local Plan viability evidence. BPC, in their review dated May 2017 of the BVA viability report initially submitted in respect of the 2016 15 unit application, wrote at para 4.6.8 :

'Profit – the applicant has adopted a figure of 20% of GDV for the return for risk and profit. For this development we consider that this is appropriate in the current market which reflects the risks involved in the scheme and that is the figure we have adopted in our appraisal'.

However, the BPC Review Report dated June 2020 confirms, after acknowledging the current uncertainties caused by Coronavirus and at para 1.10 d) that they '...have risk adjusted the profit margin used in the attached appraisal to reflect the current uncertainties' and then in para 4.7.8 that they have risk adjusted the profit margin down from the 20% thought to be appropriate in May 2017 to 17.5% during the current pandemic period. The Appellants consider that risk takers expect a proportionately greater return on their capital when the risks are higher rather than one that is lower.

Whilst the Appellants are firmly of the view that a developer's profit level of not less than 20% is entirely appropriate for an open market appraisal of this project at this time they have nonetheless adopted a 17.5% figure for use purely in the review formulae contained within the draft Unilateral Undertakings. In the event that viability improves, the planning obligation allows for a share in surpluses to be divided between the Council for additional affordable housing and the developer. The basis for doing this is set out in the following section.

c) Gross Development Value (GDV) and Application GDV vs. Breakeven GDV

The GDV stated in the BVA Report for the 15 Unit Appeal A scheme is £8,955,227 and for the 21 unit Appeal B scheme it is £12,586,768. We refer to these figures as the Application GDV for each scheme. They reflect the likely value of the proposed units in the current market. They are not contested by BPC.

The viability appraisals included in the BVA Report confirm that when using these GDV figures neither scheme achieve the 20% profit that a developer would expect in return for the risks associated with such a development. The same conclusion is drawn by the Council's own consultants and is set out in the BPC Review Reports albeit BPC refer to a 17.5% return (see b) above).

This situation is not unusual because viability appraisals are undertaken on the basis of current cost and value at the time of appraisal. An appraisal will vary over the lifetime of a development and especially when this timescale is long because the inputs used in the appraisal will vary over time. The recognition of the changing aspect of development viability over time gives rise to the need for a review mechanism enshrined in Local Plan policy and emerging London Plan policy. However, it would of course be perverse for the development, planning and construction industries to temporarily cease, to stop planning and organising new projects just because an appraisal at a certain point in time is less than ideal as many projects involve long timescales and because this is the exact opposite of what the achievement of housing targets and the present economic circumstances needs.

The issue that this causes for the affordable housing review mechanism in the Unilateral Undertakings is that the use of the recently appraised GDV figures in the standard review formulae as Application GDV is that this will contractually ensure that the developer is unable to achieve a commercial return from the project ie by capping the return to that shown in the appraisals. No developer will wish to move forward with a project where it is not permitted to earn a commercial return for the risks that it undertakes and the issue is indeed terminal for small developments such as this which are undertaken by SME builders/developers. Such developers almost wholly rely on bank financing as opposed to the cashflows enjoyed by the national housebuilders as a means to finance the development costs and a prerequisite of such financing is that the developer has the ability to earn a commercial level of return.

To address this problem in the present case, it is proposed to use the approach favoured by the Mayor of London, which is to apply the Breakeven GDV in the review formulae in place of the term Application GDV. Breakeven GDV is the development sales value at which the scheme would achieve an acceptable return (and hence be viable) with all of the other agreed assumptions in place. The calculation of Breakeven GDV requires a 2nd appraisal to be undertaken to calculate that level of GDV that will allow the developer to achieve its appropriate level of return. The Appellants' viability consultant, BVA, prepared these Breakeven GDV calculations and in doing so used the building costs estimates prepared by the Council's consultants and, in recognition of the need to use the Breakeven GDV concept, the Appellants accepted a reduction in the level developers profit from 20% to 17.5%.

In proposing the mechanism in this way, an additional affordable housing obligation would arise sooner than if a 20% of GDV profit rate were to be maintained.

The Breakeven GDV calculates to £10,090,000 for the 15 unit Appeal A and £13,223,088 for the 21 unit Appeal B.

The Appellants explained the concept of Breakeven GDV in its covering email when it first sent a copy of the draft Unilateral Undertakings to the Council on 7th August. Copies of the Breakeven GDV calculations together with an explanatory note as prepared by BVA were sent to the Council on 1st September 2020 and to the Council's viability consultants, BPC on 2nd September 2020.

2) **There are a small number of provisions not currently fully agreed between the Council and the Appellants in the drafting of the Unilateral Undertakings at this time. Minor amendments have been agreed.**

a) **Whether the First Viability Review Should Result in a Financial Contribution or the Provision of On-Site Affordable Housing Units.**

The Appellants are of the view that the provision of on site units following the early stage review is not appropriate. Within the realm of reasonable possibilities based on the current less than ideal level of viability and the current economic situation, the viability review is only likely to result in a surplus sufficient to provide a maximum of 1 or 2 units. It just does not make sense for a small scheme such as this to include one affordable housing unit amongst the remaining market housing. Registered Providers will find it unattractive to hold such a unit on this basis where they have no control over management or service charges.

The issues affecting on site delivery of a small number of units are:

Providers are required to be efficient in their delivery of housing management and maintenance to best utilise scarce resources. Small numbers of units are inefficient for a provider to successfully deliver cost effective housing management services and maintenance. For this reason many providers look to a minimum number of affordable homes in a development, often around 15.

Shared circulation is also an issue for providers, due to housing management issues of managing anti-social behaviour. Providers prefer arrangements where the front door to affordable housing, either individual units or multiple units, is to the street. Housing management failures and friction can result where tenures mix in vertical and horizontal circulation which results in an increased need for housing management input.

Providers also prefer to be able to control service charges for management and maintenance of communal areas and building insurance. Service charges are an issue in terms of affordability and cannot be distinguished by statute on the basis of ability to pay. In terms of rented accommodation, an affordable rent is set at a level inclusive of service charges. Changes in the cost of service charges (which a provider may not be able to control) for rented affordable housing can have a significant impact on a provider's business model.

The payment of a commuted sum for affordable housing is an accepted way of delivering an affordable housing planning obligation where it is not reasonable or practicable to do so on site. It allows the housing authority to aggregate commuted sums to improve affordable housing outcomes within the local authority boundaries to meet housing need.

b) **Whether the Viability Review Formulae Should Permit the Developer to Earn its Reward Prior to any Financial Contribution towards Affordable Housing Accruing to the Council.**

The Appellants solicitors drafted the viability review formulae using Breakeven GDV and on a basis that ensures that the developer is able to achieve a 17.5% reward for the risks that it is undertaking prior to monies accruing to the Council as a financial contribution towards Affordable Housing. The Council's proposed changes to the draft undertakings prevent the developer from earning its commercial return which would have the impact of frustrating this development.

c) A New Provision For a Late Stage Review of the Carbon Offset Payment

The Council has recently requested that a new provision be added to the agreement whereby a post completion review of the carbon offset payment will be undertaken. The Appellants have confirmed their acceptance of the new provision but have suggested minor amendment of the wording proposed by the Council. The carbon price per tonne should be the local plan figure of £60 rather than £95, as suggested by the LPA.

d) The Deadline for Achieving Substantial Implementation in the Early Stage Review.

The Council confirmed its tentative agreement to the deadline being 26 mths but has said that it needs to formally confirm this.

e) Minor Amendments Agreed

- The parties have agreed that the late stage review will be triggered by disposal of 65% of the units rather than occupation of 65% of the units.