

# **Delivering Affordable Housing Using Section 106 Agreements:**

## **A Guidance Update**

**October 2009**

# 1 Introduction

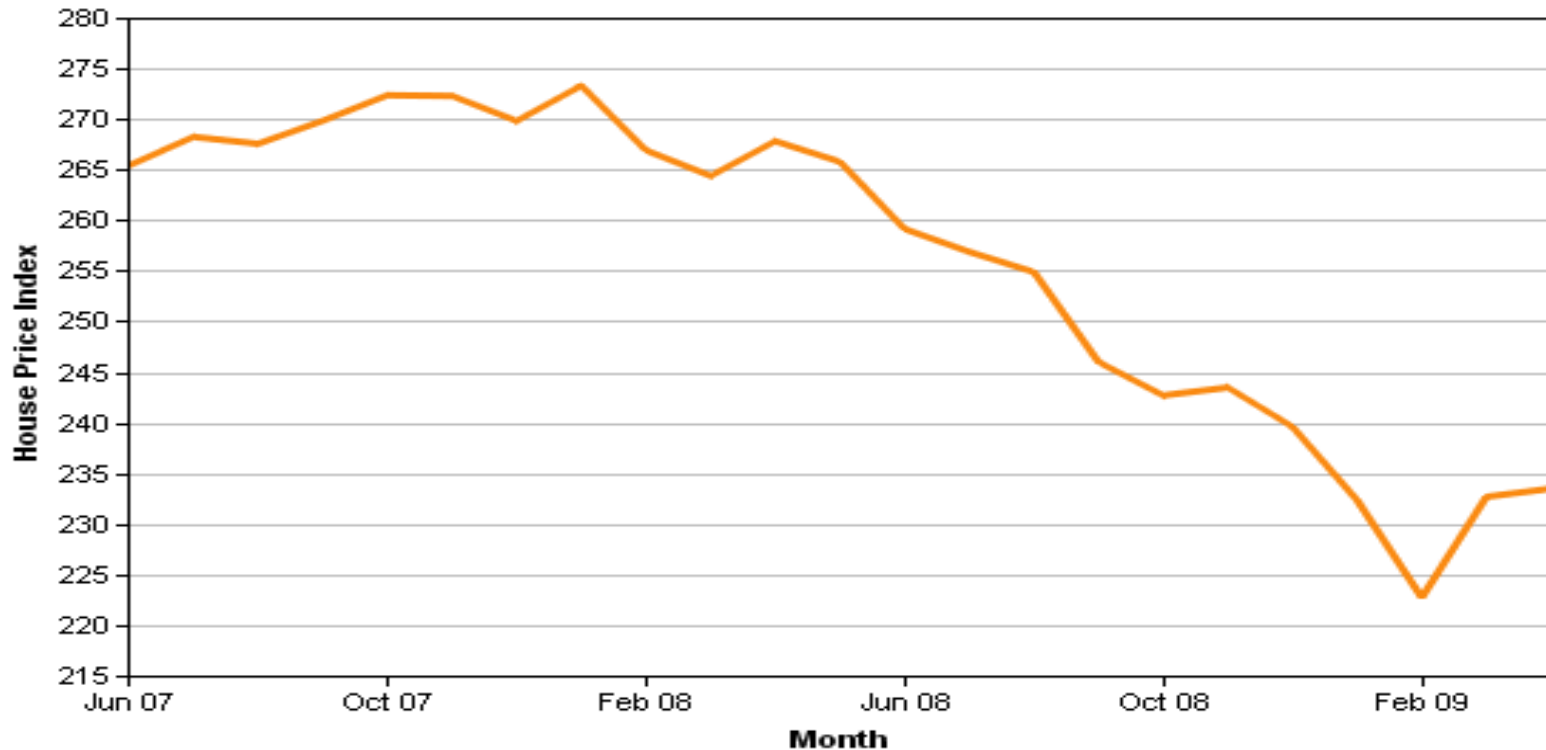
- Original S106 Guidance published in July 2008
- Since then, housing market downturn
- But fall in house prices does not have to mean long term drop in output
- Update draws on emerging good practice on how planning process can facilitate and bring forward development
- At the same time, delivering the maximum possible amount of affordable housing

# What the Update covers

1. Purpose of update
2. Market overview
3. Government initiatives
4. Understanding viability
5. Working with the planning system
6. Effective procedures
7. Innovative approaches

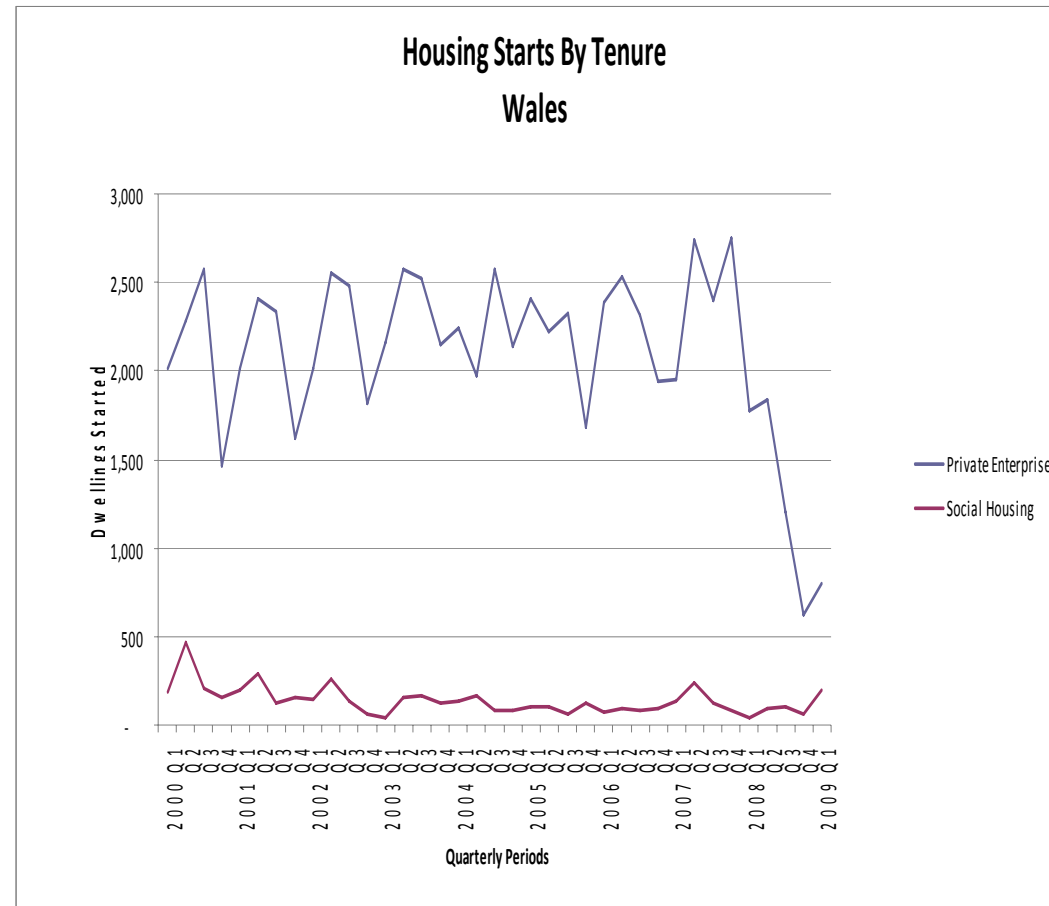
# 2 House prices in Wales

House Price Index - Wales Region



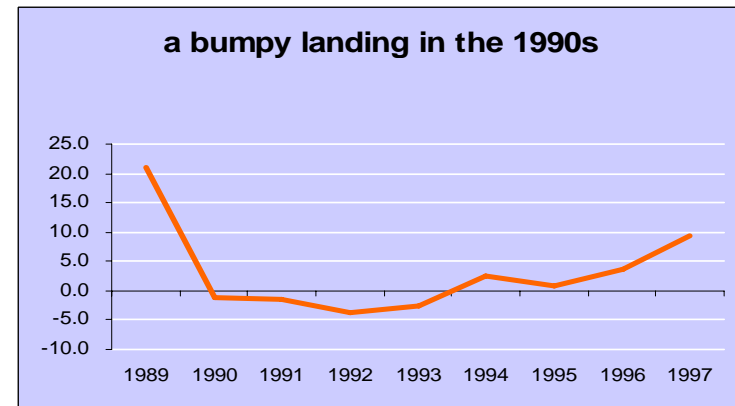
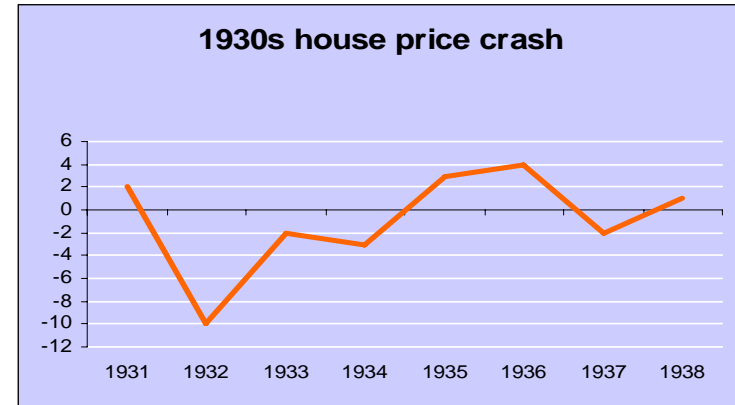
# Housing starts

- Private housing starts down by 68% from their 2000-2007 average
- RSL starts fell in 2008 but are now at their highest level since 2002
- *Total starts only below 2,000 in 12 qtrs from 1990-2007.*
- *Been below 2,000 in all the last 5 qtrs.*



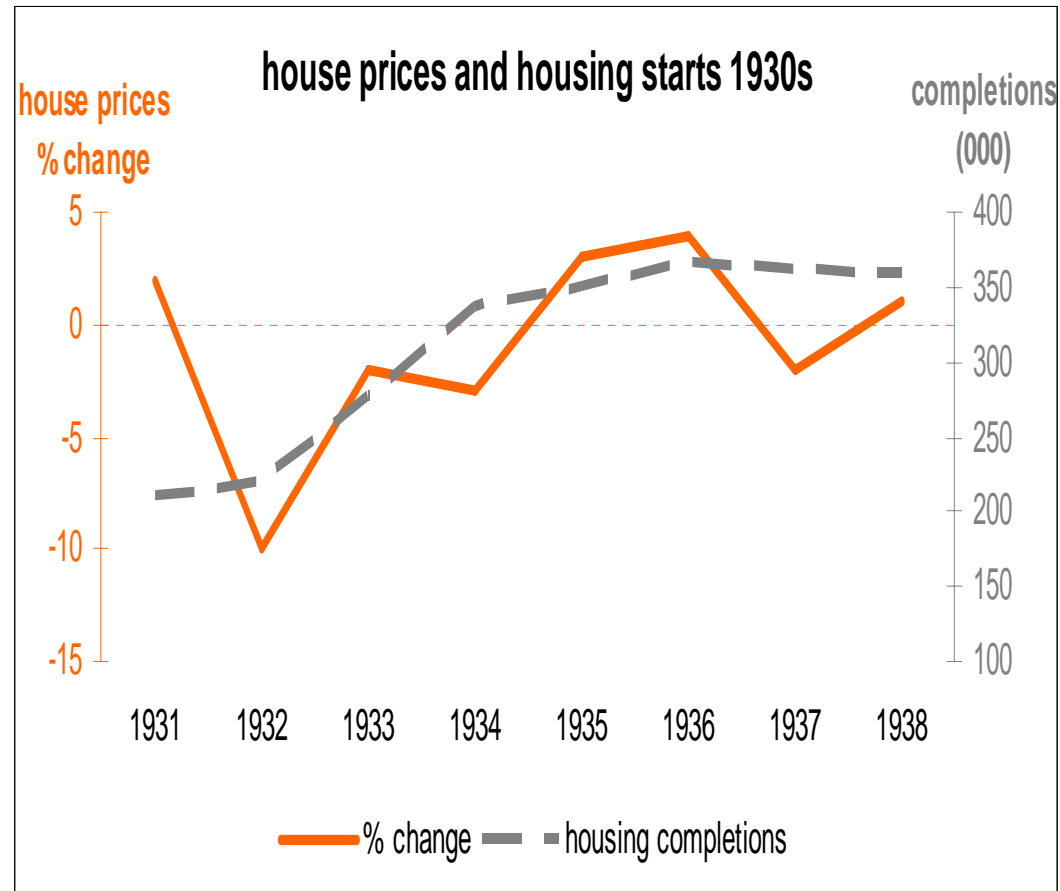
# Lessons from previous downturns

- it takes several years for recovery to commence.
- In the 1990s house prices did not recover to their 1989 peak until 1997.
- By 1938 house prices were still below their 1931 peak.
- House prices fell in 4 of the 8 years following a downturn



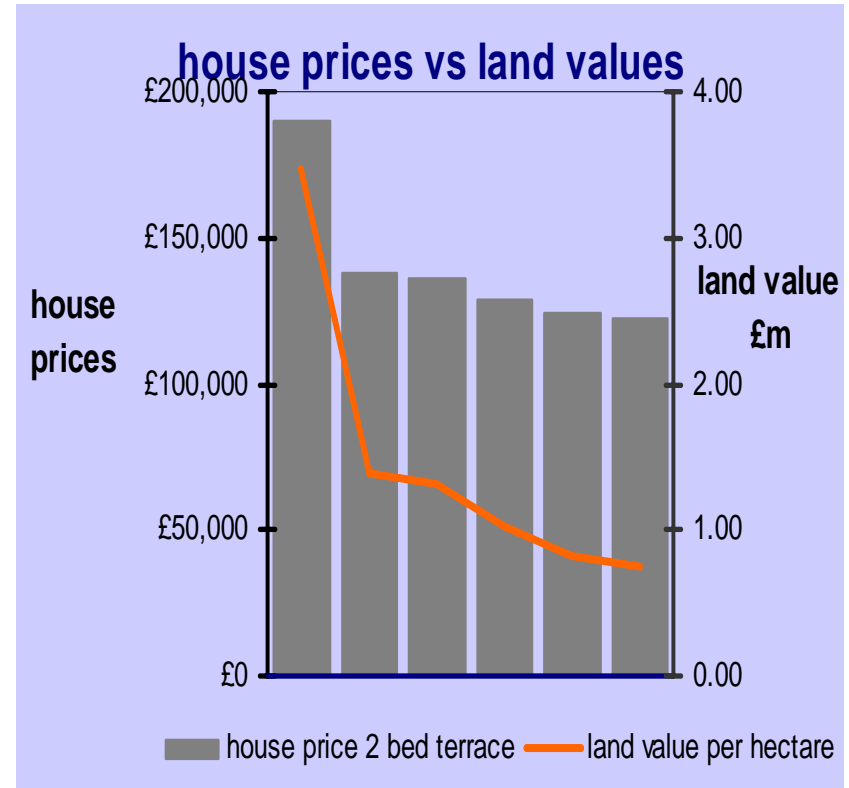
# Rising output whilst house prices fall

- Falling house prices need not mean a fall in housing output
- 1930s housing starts rose from 225,000 to 350,000+ pa
- *But required active programme of public and private sector intervention*
- *And radical reshape of land market*



# Falling house prices impact harder on land values

- Land prices fall by 3-5 times as much as house prices
- Relationship is not linear – related to differential between build cost and house price
- Implications for planning obligations and affordable housing provision



# 3 Welsh Assembly Government initiatives

- Affordable Housing Delivery Statements – as interim measure prior to adoption of Local Development Plans
- Strategic Capital Investment Fund – to maintain momentum in house building and support delivery of affordable housing
- Considering further measures e.g. Welsh Housing Bond
- Also, Land Release Protocol for affordable housing – encourage release of public land

# 4 Understanding viability

- Relationship between house prices and viability
- Depends on price developer can get for new homes
- Number of units x price = Gross Development Value
- Subtract all costs including S106 contributions and developer profit – if positive, scheme is viable, if not, it is not viable and will not go ahead as planned
- Key issues facing local authorities:
  - 1) How to be convinced scheme is unviable with S106 contributions as originally agreed
  - 2) What to do once they are convinced

# Circumstances where viability is an issue

- Falling house prices
- Falling sales rates
- Increased payments for affordable housing / other planning obligations
- Rising costs, including those associated with higher standards (Code for Sustainable Homes, Lifetime Homes)

## Negotiating with developer in these circumstances

- LPAs need to be clear about what is needed as a pre-requisite before making a decision – evidence required

# Principles of viability appraisal

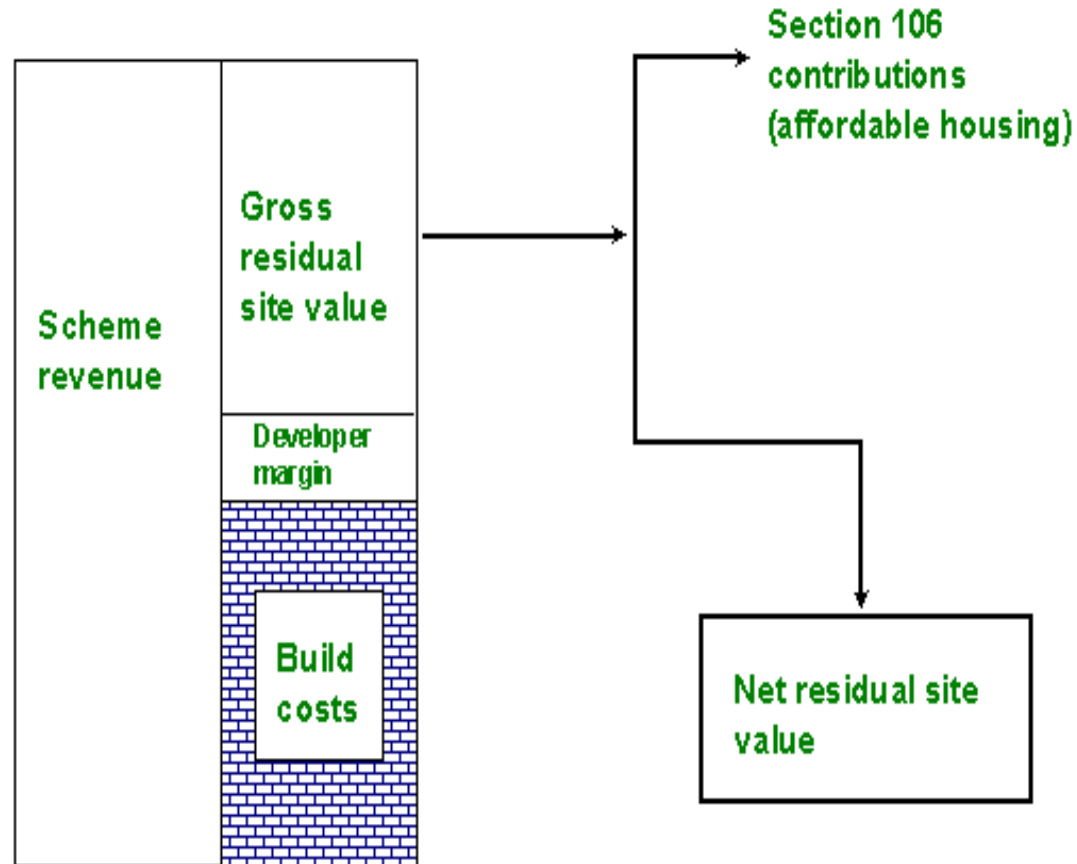
- A range of models e.g. Development Appraisal Toolkit (DAT)
- Development will not go ahead unless there is a positive residual value and the land value exceeds both existing use and alternative use by a reasonable margin, to cover tax obligations etc. on sale of land

# What LPA needs to take into account

- What would have been a realistic land value at the time, and how did it compare with existing /alternative use value? (also whether held on option – if so land price should be renegotiated otherwise public subsidy or reduced S106 contributions will accrue to landowner)
- Impact of change in house prices or costs since then
- Assumption made about grant and whether realistic
- Whether wider planning obligations or cost requirements have changed and impact of these on viability
- Whether density or mix has changed to reflect market conditions and impact on viability
- Impact of any known abnormal site constraints and costs of remediation

# Residual valuation model

- Gross Residual = revenue – costs
- Net Residual (RV) = gross residual – (S106 contributions + AH)
- S106 UP
- Build Costs UP
- Revenue DOWN
- AH squeezed



# Specimen viability appraisal (base)

- 35 three bed houses on 1 ha site,
- market value per dwelling £170,000
- 70% open market
- 20% social rent, 10% Homebuy,
- full grant available

Option 1 – 2007 house prices **RV = £1.96m**

Option 2 – house prices fall by 20%, **RV = £1.34m**

# Specimen viability appraisal (no grant and house prices fall)

## Option 3 –

- house prices fall by 20%,
- grant no longer available,
- developer required to provide affordable
- housing at a 25% discount on ACG,
- **RV = £903,000**

## Option 4 –

- as 3
- but 50% discount on ACG,
- **RV = £475,000**

# Specimen viability appraisal (CSH and house prices fall)

## Option 5 –

- house prices fall by 20%,
- grant is available and
- scheme costs rise by £5,000 per unit,
- **RV = £1.16m**

## Option 6 –

- house prices fall,
- grant available,
- scheme costs rise by £15,000 per unit,
- **RV = £815,000**

# Data sources

- The output from the appraisal process will be a series of figures on land value showing both the original taking into account planning policies in place at the time and the current value
- Actual prices paid for land are available post 2002 from the Land Registry website for a fee
- Valuation Office Agency may be able to assist verifying land values
- Also it may be known that developers or RSLs have written down land values across their portfolio by a specified amount

# Undertaking viability appraisals – what to do

- Provided the policy, threshold and targets accord with national policy and have had a viability appraisal, then onus is on developer to explain why scheme is no longer viable – so developer must supply information and indicate what sort of changes would make it viable
- Then can either use LPA's own resources (toolkit) but with inputs agreed with developer, or
- Go 'open book' with developer, using independent assessor
- In either case LPA can use in-house expertise or external experts – including the District Valuer

# Evidence required from developers

- Number and mix of units (total)
- Type and number of affordable units
- Prices currently achieved /proposed for completed units
- Sales records over time
- Assumed receipts for affordable units and assumptions about availability of grant
- Price paid for land and date (if option, details of contract)
- Build costs – including assumed level for Code for Sustainable Homes
- Other development costs (fees, marketing)
- Assumed developer /contractor return
- Contributions from other sources if any
- Planning obligations

# Key to success

- Agree all factors to be included
- If not, fall back position should be either
  - Use of independent expert at developer's expense, or
  - Use the agreed toolkit but with different assumptions to show differences between developer's and LPA's versions
- Ideally, the procedure that the LPA will follow if developers seek renegotiation should be set out clearly in advance

# 5 Working with the planning system

- Review of emerging mechanisms
- Developing effective procedures
  
- Very new ideas – need to keep up to date
- Relevant to re-negotiations and new applications

# Emerging mechanisms – some ‘principles’

- ‘Principles’ emerged from the research – not copied
- LAs and developer – shared understanding of viability issues
- Circular 13/97 remains
- Can the s106 requirements (including affordable housing) be reviewed to encourage early development?
- **But guard against an advantageous permission being saved for a better market**
- Is something else holding back development?
- Make best use of WAG initiatives

# More affordable housing!

- An 'emergency' measure – sites underway – less of an issue now?
- Is there the cash? Is there an RSL ready to take on the AH?
- Does this involve a redesign? And does this work – for the scheme as a whole? For the residents?

# Key mechanisms to date

- Time limited permissions
- Review obligations through the life of a permissions
- A deferred payment arrangement
  
- (but not 'profit sharing')

# Short life permissions

- Seems counter-intuitive?
- Really saying – LA accepts lower s106 package (including AH?) in return for a speedy development – say permissions limited to 2 years
- Defining ‘speedy development’ – contract to get going?  
X dwellings complete/started?
- Limited examples to date

# Reviewing obligations through the life of a permission

- Most relevant to larger (phased) schemes
- Identify full set of obligations at outset
- Review viability at fixed points (e.g. X dwellings occupied, Y change in house prices)
- May accept lower contribution for defined phases
- (But does not mean gets built out quickly!)

# Deferred payment arrangement

- A more complex arrangement
- Again, starting point = ‘what is the full package of obligations per dwelling’?
- Payment of an initial contribution (what the development ‘can afford’) – with a ‘deferred contribution’
- Review value of market units when sold – can they afford more towards the ‘deferred contribution’?
- Various arrangements for pooling and spending contributions

# Some issues

- How to cope if LA doesn't get the contributions it has calculated are needed?
- Affordable housing – mechanisms geared towards to financial contributions
- Mechanisms for smaller as well as large schemes
- Requires financial 'open-ness' and planners/lawyers being 'in tune'

# 6 Effective procedures

- An effective local authority is one that :
  - Understands viability issues;
  - Is approachable ;
  - Takes a consistent approach;
  - Has a long term view.
- Approach shaped by discussion with development industry

# A clear approach

- Approach needs to cover:
  - What will justify a (re)negotiation;
  - Who will deal with (re)negotiations;
  - How viability issues will be examined – information required, mechanisms used etc (and how paid for);
  - What mechanisms to improve viability will be considered;
  - How the s106 agreement gets sorted
- Plus - Being proactive in identifying ‘stalled schemes’
- Can set this all out in an action plan/protocol – which is well publicised and may go beyond planning mechanisms

# 7 Innovative approaches from local authorities

- Use of public sector land to bring forward development:
  - Shared risk/reward – clawback, build under licence of WDA
  - Look at scope for a JV – but make sure it delivers what you want
- Use of public funds to stimulate housing demand
  - Mortgage guarantees/
  - second charge for LCHO
  - LA mortgages
- Securing private finance
  - Essex County Council Bank
  - Yorkshire Deposit Bond
  - TIFs/ADZs