HEREFORDSHIRE COUNCIL

ECONOMIC VIABILITY ASSESSMENT

Final Report

June 2011

Three Dragons and Roger Tym & Partners

This report is not an independent scheme valuation for the strategic sites. It has been prepared using the relevant toolkit and is based on data supplied by Herefordshire Council and quoted published data sources. The toolkit provides a review of the development economics of a scheme and the results depend on the data inputs provided. Sources for the data inputs specific to individual sites are indicated in the report and have not been independently validated. No responsibility whatsoever is accepted to any third party who may seek to rely on the content of the report unless previously agreed.

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1 INTRODUCTION

Purpose of the study

1.1 Three Dragons and Roger Tym and Partners were appointed in May 2010 to undertake an Economic Viability Assessment (EVA) as part of the Local Development Framework (LDF) evidence base. Specifically the EVA will inform the Core Strategy, Hereford Area Plan and Market Towns and Rural Areas plan.

1.2 As the brief states, the essential purpose of the EVA is, *'to test through the application of a thorough methodology, the circumstances in which the Council can expect the scale of planned development in Herefordshire to deliver an appropriate level of developer contributions/community infrastructure levy towards required new infrastructure'* (Para 3.2 of the study brief)

1.3 The EVA will also reflect and inform the preparation of the Infrastructure Delivery Plan being produced concurrently by the Council.

1.4 Since the inception of the Study it is apparent that there are a number of wider issues impacting on the LDF process going forward which not only creates uncertainty about the process itself but also impacts on the future of development generally. The main issues are:

- The abolition of the housing targets in the regional spatial strategies which had been withdrawn by the Secretary of State in June 2010[1].
- The impending Localism and Decentralisation Bill which is unlikely to be enacted before late 2011.
- The government will retain but amend the Community Infrastructure Levy regulations
- The reductions in public sector funding across many sectors announced by the Government in October 2010 in the Comprehensive Spending Review. This will impact on the delivery of a range of physical and social infrastructure but there are also a number of new funding initiatives e.g. the New Homes Bonus and Regional Growth Fund that offer new sources of potential funding for such infrastructure.
- The uncertainty that the above and the economic climate creates for residential development, in particular on large strategic sites in the county which form the bulk of new housing in the future and require long lead in times to deliver.

1.5 The brief required us to provide guidance on;

- Viability and infrastructure delivery across the county in different locations.
- How best to strike a balance between what is needed to fund infrastructure and economic viability and whether different payment levels are justified for different land use types.
- Dealing with economic uncertainty over the life of the Core Strategy.

[1] Noting that a recent legal challenge in the High Court by Cala Homes deemed this action to be unlawful.

Relationship to the Affordable Housing Viability Assessment

1.6 The Affordable Housing Viability Assessment(AHVA) was prepared last year and set out advice on targets and thresholds for affordable housing taking into account viability and changing market conditions. A set of market value areas was identified and used in this analysis. Whilst the AHVA concentrated on the levels and mix of affordable housing across the county the assumptions used in the EVA reflect those of the earlier AHVA. Unless specifically stated, the reader can assume that assumptions in the EVA are those of the AHVA.

1.7 The EVA takes a broader approach than the AHVA but is still based on the viability toolkit provided for the Council. The toolkit incorporates a discount function which can be used to assess the economics of major sites built out over many years. This facility has been used in the EVA.

1.8 It should also be noted that the EVA also considers development economics for a number of non residential uses and comments on the suitability of these uses to contribute to wider infrastructure provision in the County.

Relationship to the Infrastructure Delivery Plan

1.9 The consultant team has worked closely with the Council to understand the types and costs of the infrastructure required to support the level of housing being proposed. Part of our remit was to provide assistance in developing the cost basis for future requirements for elements such as education and health. This information has been incorporated into the IDP produced by the Council.

Research undertaken and approach to viability

1.10 The work was undertaken in the following way:

- Inception meeting to review work on IDP, key assumptions on major sites, issues for viability testing.
- Research and liaison with the Council on identifying infrastructure requirements and costs.
- Production of a draft schedule to identify total costs of infrastructure provision to assess possible level(s) of s 106/CIL.
- Research on major strategic sites and phasing profiles.
- Viability testing on non residential development including rental levels, yields and development costs to assess appetite for these uses in the area and their ability to contribute to infrastructure requirements.
- Identifying and agreeing a typology of sites for viability testing for residential testing and use of previous market areas

- Agreeing all the assumptions for the testing using a range of national (eg Building Cost Index) and local data (house prices) together with research /experience from current and previous studies.
- Agreeing the key variables for the sensitivity testing ,for example, value uplift, costs for higher Code levels, s 106 contribution levels etc .
- Running of the model and sensitivity tests.
- Reporting

2 POTENTIAL FUNDING SOURCES FOR DEVELOPMENT

Background

2.1 Herefordshire's ability to achieve the Core Strategy growth programme and the associated infrastructure will be largely determined by the market (and the rate at which development investment is attracted) and the extent to which funding for infrastructure provision can be enabled in a timely manner.

2.2 In relation to private residential investment there has been a decline in house value since the highs of 2007 but in the beginning of 2010 the residential land market began a small recovery which was partly driven by an upturn in demand in relation to a shortage of land supply, together with a return of limited bank financing. Over the summer in 2010 the market has slowed down again and uncertainty remains about future prospects.

2.3 Employment and commercial investment is flat at present in all sectors. The rate at which the investment market in these sectors improves will reflect the performance of the national economy and the propensity of banks to lend for commercial development.

2.4 In recent years, funding for Herefordshire's infrastructure would have been expected from a number of mainly public sector sources. Key amongst these sources of funding and the key implications for change in the future are set out below.

- Mainstream government departmental budgets have generally been increasing over the last decade but the Comprehensive Spending Review (CSR) sets out deep cuts.
- Transport – The DfT has recently announced a limited number of schemes which have either been allocated funding or listed for further investigation but the list did not include any schemes in Herefordshire.
- Flood prevention – flood prevention schemes continue to be funded by the EA on a case by case basis but it is likely that the scale of funding will be reduced.
- Housing – housing grant for affordable housing projects will be further restricted.
- Growth Area funding via CLG is being replaced by the Regional Growth Fund for which the CSR allocates £1.4 billion over the next three years.
- RDA funding of economic development initiatives will cease and be replaced by initiatives promoted by Local Economic Partnerships. Whilst Herefordshire as part of the Marches bid were successful in receiving LEP status it is still unclear how LEPs are to be funded.

2.5 We review key potential infrastructure funding sources below.

Regional Growth Fund

2.6 The Government has committed that £1.4bn will be made available to the Regional Growth Fund to support activity that has the greatest impact on sub-national growth. The fund will be spread over three years. It has two main objectives:

- To encourage private sector enterprise by providing support for projects with significant potential for economic growth and create additional sustainable private sector employment; and
- To support in particular those areas and communities that are currently dependent on the public sector make the transition to sustainable private sector led growth and prosperity.

2.7 The first round opened on 28 October 2010 and closed on 21 January 2011. The first round will be open to applications for Projects (individual) and Project Packages (number of individually specified projects that form a coherent package). The first bidding round is intended for projects that are at an advanced stage of planning.

Local Investment Plan

2.8 A Local Investment Plan (LIP) is the mechanism for agreeing investment delivery in a location in line with locally determined priorities. It is an agreed document between a local authority or a group of local authorities and the Homes and Communities Agency (HCA). Herefordshire Council completed and agreed its LIP with the HCA in January 2011.

2.9 A good Local Investment Plan should have a clear narrative "golden thread", rooted in analysis and understanding of the evidence base, so that investment priorities can be clearly seen to flow out of the strategic challenges identified. A LIP has to be appraised in order to ensure alignment with Government priorities and provide evidence of value for money.

Green Infrastructure Bank

2.10 The Local Growth White Paper indicates support for low-carbon energy and climate change adaptation, including the creation of a UK-wide Green Investment Bank (GIB) that will be capitalised with a £1 billion spending allocation and additional proceeds from the sale of Government owned assets to catalyse significant additional investment in green infrastructure. In the immediate short term it is too early to submit bids and the mechanism for disbursing funding is not yet known. However, since the Council has highlighted its aspirations to improve its green credentials in its economic strategy, work should be undertaken in due course to prepare potential biddable projects.

Tariff/CIL

2.11 The Council is familiar with the concept of taking contributions from across more than one development to fund infrastructure that benefits a number of developments. Herefordshire Council published its Planning Obligations Supplementary Planning

Document in April 2008. This provides the detailed policy in relation to the adopted UDP.

2.12 However the regulations and mechanisms through which contributions can be collected were changed in March 2010 when the Community Infrastructure Levy (CIL) Regulations were enacted, setting out detailed arrangements for operating a Levy at the local level. In essence, the key difference between the section 106 and the current CIL regimes is that section 106 agreements allow more flexibility to negotiate on a site by site basis whereas CIL provides a generic overall standard charge approach which could be easier and quicker to apply once the charging schedules have been formally approved following an examination in public.

2.13 The Coalition Government has announced that CIL will remain but it is likely that the regulations will be amended. The Government's announcement says that CIL will be reformed to ensure that neighbourhoods share the advantages of development by receiving a proportion of the funds councils raise from developers. These will be passed directly to the local neighbourhood so community groups can spend the money locally on the facilities they want, either by contributing to larger projects funded by the council, or funding smaller local projects.

2.14 The CIL is proposed to be charged across all types of new development per square metre where new floorspace is created, with only affordable housing and development for charitable organisations exempt.

2.15 It is not clear at this stage the form of the detailed changes to the regulations, the implications of localism and whether there will be more flexibility in application than currently allowed.

Local Asset Backed Borrowing

2.16 The Council has used its ownership of the livestock market to facilitate new town centre development in Hereford. There may be additional opportunities to use Herefordshire's land and property assets in the future in order to either form joint ventures which will release capital value or an income stream or, as an asset which can be used as collateral for a loan.

Local authority prudential borrowing

2.17 There is also a wider debate about the structure of local authority financing which is relevant to their actual as opposed to perceived capacity to support investment in Herefordshire. For instance, the authority could use their prudential borrowing powers to effectively advance funding for key elements of infrastructure in anticipation of planning contributions or other possible increases in their income.

2.18 Development finance for the private sector is expensive. In contrast, the financial cost of public sector capital is much lower. There are opportunities to improve the economics of development by delaying the implementation of infrastructure schemes for as long as

possible and using public funds to pay for what is required on an interim basis with repayment once the proceeds from development begin to materialise.

2.19 Repayment could come from the proceeds of a CIL tariff, or user charges. For example, if a district heating network was to be provided, a local authority could set up a company to provide the network, borrow money, and build the network. Developers would then be charged to connect to the district heating scheme, or costs could be reclaimed from the tariff, and householders would pay an ongoing charge to the local authority company. Note that this would have to be a service provided across a number of developments, or the approach could fall foul of state aid rules.

2.20 Historically local government financial management practices have been conservative and in any event, it is possible that the government will constrain their ability in this respect. Uncertainty, however, exists about the level of freedom that councils will have on their borrowing and investment capabilities with some clarification on this issue expected in the forthcoming Local Government Finance Review.

Private Finance Initiative

2.21 The private finance initiative has been successfully used by the public sector on projects since it was introduced in the UK in 1992. This mechanism allows the public sector to pay for infrastructure with a periodic payment to cover construction, and often maintenance and/or operation as well, rather than using a large initial payment.

2.22 Under the private finance initiative the public sector decides what services it thinks are needed but uses the private sector to determine the most economical and efficient way of delivering these services. The private sector designs, builds, finances and sometimes operates the infrastructure. The emphasis is not on the provision of the infrastructure itself but on the provision of the stream of services based on its use. The anticipation is that the private sector will be better able to manage costs and by providing a combined package can produce better value over the life time of the project. PFI can be a cost-effective way of providing asset-based services. It is often used to provide buildings such as schools and hospitals where there is a requirement to build and maintain the buildings and often to provide auxiliary services. In Herefordshire it has been used to develop a new hospital and magistrates' court.

2.23 PFI may be suitable for some of the infrastructure required in Herefordshire, however the precise opportunities change depending on local and national policy priorities and will require public support and acceptance within wider service delivery plans prepared in the public sector.

New Homes Bonus

2.24 The Local Growth White Paper announced a new funding stream to promote housing growth. Consultation has begun on the model to be used to determine how the New Homes Bonus will work and what funding could be available to local authorities The model will be based on the principle that central government will match fund the extra

money that council's receive through council tax for six years. Around £950m has been set aside over the spending review period and starting in 2011-12, the scheme will provide £196 m rising to £250 m in the following three years

2.25 The Government's preferred model set out in its consultation paper is to link the level of grant for each additional dwelling to the national average of the council tax band. In addition the Government will also provide an affordable homes enhancement of £350 for each of the six years.

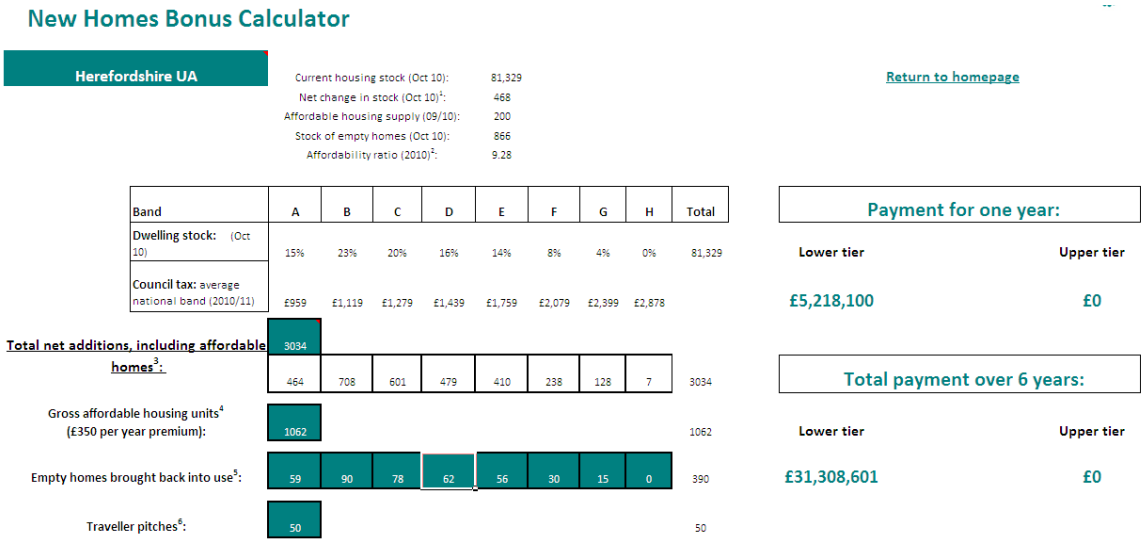
2.26 In practice it is anticipated that the funding will work as follows:

- The grant for the authority's area would be calculated by multiplying the relevant figure (i.e. 6/9 for Band A, 7/9 for Band B, 8/9 for Band C etc) by the average Band D council tax in England for the previous year.
- The grant would be payable for the relevant year and the five financial years following that year (that is, for a total of six financial years).
- This process would be repeated each financial year with each new amount of grant being added to the amount of grant payable in the preceding financial year.
- From the seventh year of the scheme onwards the grant calculated six years earlier will no longer be included in the total grant payable (and so in the seventh year the amount calculated for the first year will no longer be paid, in the eighth year the amount calculated for the second year will no longer be paid and so on).

2.27 On this basis to provide a flavour of what Herefordshire could potentially receive we have made an initial calculation based on a number of assumptions regarding the average national council tax figure, overall number of dwellings, affordable housing and likely rates completion for **the first five years** of the Plan. The assumptions are as follows:

- Each completion would attract grant for a six year period (therefore the period of receipt will start in 2011 and end in 2022)
- Herefordshire has a policy target of 18,000 new dwelling 2006 – 2026. We are working on the presumption that Herefordshire will deliver around 3034 dwelling completions between 2011 and 2016
- Affordable housing will make up 1062 of this supply and (policy target of 35% affordable dwellings).
- Around 390 empty dwellings will be brought back into use (Empty Homes Strategy)
- 50 gypsy and traveller pitches to be completed

Figure 2.1 Herefordshire potential New Homes Bonus



New Homes Bonus Calculator

Herefordshire UA

Current housing stock (Oct 10): 81,329
Net change in stock (Oct 10)[1]: 468
Affordable housing supply (09/10): 200
Stock of empty homes (Oct 10): 866
Affordability ratio (2010)[2]: 9.28

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Band	A	B	C	D	E	F	G	H	Total
Dwelling stock: (Oct 10)	15%	23%	20%	16%	14%	8%	4%	0%	81,329
Council tax: average national band (2010/11)	£959	£1,119	£1,279	£1,439	£1,759	£2,079	£2,399	£2,878	
Total net additions, including affordable homes[3]:	3034								
	464	708	601	479	410	238	128	7	3034
Gross affordable housing units[4] (£350 per year premium):	1062								1062
Empty homes brought back into use[5]:	59	90	78	62	56	30	15	0	390
Traveller pitches[6]:	50								50

Payment for one year:

Lower tier	Upper tier
£5,218,100	£0

Total payment over 6 years:

Lower tier	Upper tier
£31,308,601	£0

2.28 Figure 2.1 illustrates the results when the assumptions are inputted into the DCLG consultation calculator. The calculator shows that Herefordshire could attract around £31m for the first five years worth of completed housing (grant would be received from 2011-2022 for the first years completions). Grant over the plan period and the following six years could amount to over £100m funding from the New Homes Bonus. However this is only an illustration and should therefore be treated with caution.

2.29 It should also be noted that none of this money will be ring fenced for a particular use and it will be at the discretion of the council as to how much of the New Homes Bonus is used to support new infrastructure

2.30 Clearly it will be necessary to wait for the details of the model to be confirmed before detailed financial planning can take place. In the meantime it is apparent that the New Homes Bonus could represent a significant source of funding for the Council, some of which could be used to finance the infrastructure which will enable the planned growth to take place.

Other Incentives for Growth – Local Government Resource Review

2.31 The White Paper highlights that the Government has been developing proposals for the following innovative forms of financing local government spending:

- Business Increase Bonus – similar in concept to the New Homes Bonus but based on additional business rates.
- Retention of locally-raised business rates – a more advance version of the above.

- Tax Increment Financing – borrowing against projected increases in business rates – the Government will be consulting on possible approaches.

2.32 It is too early to assess the full potential of these White Paper initiatives but there would seem to be increased scope for Herefordshire to plan locally for the way in which it finances its local spending.

3 VIABILITY AND COMMERCIAL DEVELOPMENT TYPES

Introduction

3.1 In this section we consider whether employment and commercial development (offices, retail, industrial and warehouse development) in Herefordshire is likely to be able to contribute to infrastructure costs.

3.2 The employment and commercial development sector operates very differently from the housing sector and therefore requires a different approach to assessing viability, especially at the more generalised plan making level. In particular there is greater variance in the range and type of employment and commercial developments and a more limited and different type of transaction base, especially for retail development.

Office, industrial and warehouse development

Background

3.3 The market trends and demand in the employment property market were assessed as part of the Employment Land Study for Herefordshire in October 2009 and updated in 2010[2]. This analysis was divided into the following sub-areas:

- City of Hereford
- The Eastern Corridor - comprising the rural area in the east of Herefordshire and the towns of Ross on Wye, Bromyard and Ledbury
- The Rural Heartland - comprising the rural northern, western and southern parts of Herefordshire, including the towns of Kington and Leominster

3.4 The study reported that Hereford itself is the prime location for business within the study area, and attracts a mix of international, national and regional covenants. However, Ross on Wye in the Eastern Corridor has a relatively large concentration of industrial estates reflecting its location close to the M50.

3.5 The study also reported that the Rural Heartland is generally the least attractive location for employment uses as there are only A and B roads linking the market towns and villages. Consequently, the property that is available is small scale and occupied by local businesses.

Rental values and demand

Office

3.6 The office sector in Herefordshire is relatively small, with the majority of demand being for relatively small units of up to 200 – 300 sq m. In Hereford, local agents report the majority of demand is from small, local professional services firms including solicitors and accountants, where prime rents are around £145 per sq m (£13.50 per sq ft).

[2] Employment Land Study - Drivers Jonas (October 2009) and 2010 update

However, none of the available space at the time of the employment land study was speculative new build, which is perhaps an indication of the limited requirements for new space.

3.7 Rents within Ross on Wye, in the Eastern Corridor, are reported to vary from £75 - £108 per sq m (£7-£10 per sq ft) for secondary poorer quality space to £108 - £151 per sq m (£10-14 per sq ft) for better quality accommodation. Rents at Burnside Court in the Rural Heartland, where most of the office accommodation is located in this area, were reported to have achieved in the region of £102 per sq m (£9.50 per sq ft) from a quoting price of £118 per sq m (£11 per sq ft). The Employment Land Study also reported that there are few purpose-built new office premises in the area, the only one at that time being Alton House at Alton Business Park in Ross on Wye. Units of approximately 40 sq m to 1,000 sq m are available at £135 per sq m (or £1,350 per sq m freehold).

Industrial & warehouse

3.8 The Employment Land Study reports that the majority of demand for industrial and warehouse space is relatively small, in this case up to approximately 300 sq m and that larger units can take time to let. For example, it is reported that it took over 18-months to let a warehouse unit of 19,509 sq m (210,000 sq ft) at Moreton Business Park in the Rural Heartland area.

3.9 Consequently, new build has tended to be smaller units. For example, Marches Trade Park on the Leominster Enterprise Park is a new build development of five terraced industrial unit of 180 sq m (1,937 sq ft). A number of these had been sold freehold, at around £645 per sq m (£60 per sq ft). We understand from the latest Property Register the second phase is now available and units of 180 sq m are for sale freehold at £125,000 (£695 per sq m).

3.10 Estates Gazette Interactive (EGi) reports that two units of approximately 230 sq m on Alton Business Park in Ross on Wye were let and sold in 2008 for £77.20 per sq m and £860 per sq m respectively. A larger unit of 483 sq m was reported to have been let for £67 per sq m. These are the highest reported rental and freehold values for industrial space in Herefordshire.

Land values

3.11 The Affordable Housing Viability Study reported that average industrial land values in the West Midlands at July 2009 were around £500,000 per hectare based on Valuation Office Agency information. However, the Council provided comment that, based on recent land transactions of which they are aware, that Herefordshire values are lower than those shown for the region at approximately £300,000 to £400,000 per hectare.

Table 3.1: West Midlands industrial land values (July 2009)

WEST MIDLANDS			
	From £s per ha	To £s per ha	Typical £s per ha
Birmingham	450,000	1,200,000	800,000
Coventry	275,000	625,000	575,000
Sandwell	325,000	540,000	430,000
Wolverhampton	350,000	600,000	500,000
Tamworth	250,000	550,000	400,000
Telford	230,000	400,000	300,000
Stoke/Stafford	250,000	500,000	325,000
Leamington Spa	500,000	675,000	650,000
Redditch	450,000	800,000	625,000
Dudley	325,000	540,000	430,000

Source: Valuation Office Agency: Property Market report, July 2009

3.12 The VOA does not currently provide as detailed a sub-regional breakdown of industrial land values and does not report land values for office development. Information from January 2010 reports average industrial land values in the West Midlands for Birmingham and Stoke of £650,000 and £300,000 per ha respectively, showing a slight fall from values in July 2009.

3.13 The latest Council Property Register reports there is land available for industrial and warehouse development at the Leominster Enterprise Park on a site of approximately 10 ha, with plots from 0.37 ha at £130,000 (£350,000 per ha) being available. We understand that land values might be slightly higher than this level north of the river in Hereford due to the shortage of premises in the area.

Employment development viability

3.14 In line with our approach to assessing the viability of residential development, we have employed a traditional residual land value approach. The uses we have tested are:

- Office
- Small industrial
- Large warehouse

3.15 We have also tested indicative "pessimistic" and "optimistic" scenarios for each of these uses, giving a total of six indicative "typologies". The indicative "pessimistic" scenario assumes the lower rental, longest void period and highest (i.e. weakest) yield assumptions, with the "optimistic" scenario being the opposite.

3.16 Our use of development typologies means that our analysis is not on an individual site basis.

3.17 The figures reported from our analysis need to be treated as indicative figures on the basis of the inputs and assumptions made. They are not based on, and do not constitute, "Red Book" valuations (RICS Valuation Standards 6th Edition) and do not provide any kind of reliable guide to the market value of any particular site.

Assumptions

3.18 Although our assessment is at a high level, a large number of assumptions have still needed to be made. The residual land worth calculations are extremely sensitive to these assumptions; however these are all based on published data and provide sufficient evidence for the purpose of testing for the Core Strategy. We have set out the basis for all the following assumption in Annex 1.

- Plot ratio
- Rental values and void
- Yields
- Build costs
- External costs
- Other costs

Results of indicative typology analysis

3.19 The results of our indicative typology analysis are set out below. These demonstrate the marginal viability of commercial development in Herefordshire; in our indicative pessimistic scenarios the residual land worth is negative in each case, particularly for offices where the risks are higher due to the higher costs of development.

Table3.2: Indicative residual land worth results for employment typologies

	Indicative Pesimistic Scenario	Indicative Optimistic Scenario
Office	-£2.3m per ha	£0.8m per ha
Industrial	-£0.7m per ha	£0.4m per ha
Warehouse	-£0.5m per ha	£0.8m per ha

3.20 The indicative optimistic scenarios show residual land worth figures closer to market levels. This indicates there need to be relatively strong market conditions and straight forward sites, as we have not assumed abnormal and off-site infrastructure costs, in order for employment development to be viable.

3.21 Although the warehouse typology produces the highest residual, this is only likely to occur where it is a large unit and the rental void is minimal. Given the risks of letting large units, this suggests that speculative development may not be attractive. As set out above in our market assessment, where there has been speculative development in recent years this has been for relatively small industrial units where there is relatively good demand and the risks of significant letting or sale voids are much lower.

3.22 The risks of letting also apply to office development. Although the office typology produces the second highest residual land worth, the relatively low demand levels mean that speculative demand is unlikely to be attractive to developers.

Implications for developer contributions from employment development

3.23 Our analysis indicates it is unlikely that any significant contribution is likely to be secured from employment development in Herefordshire.

3.24 For example, if a £25 per sq m contribution to infrastructure were required on the gross floorspace, this would result in a charge of £125,000 on our indicative one hectare industrial development typology. In the optimistic scenario, this would correspondingly reduce the residual land worth from £400,000 to approximately £275,000; a reduction of almost 40%. Alternatively if the contribution requirement was £10 per sq m (i.e. £50,000 in our indicative one hectare example), this would result in the residual land worth falling to approximately £350,000 per hectare representing a reduction of 15%.

3.25 The benefits of securing such levels of contribution need to be weighed against the need for new employment development in Herefordshire and the relative impact of employment development on infrastructure requirements.

Retail

3.26 Whilst we have provided a high level testing framework for office, industrial and warehouse development we have not adopted the same approach towards retail development. This form of analysis requires a degree of uniformity in the development being tested i.e. assumptions on values and costs that are broadly reflective of a limited number of development types. Retail development, particularly comparison development in town centres, is much less uniform in this respect and there is only limited data available across Herefordshire.

3.27 However, this is not to say that contributions should not be sought from retail schemes. In some circumstances the level of contributions that could be sought may be substantial and will often be greater than employment development. For the purposes of this report and based on past experience it is considered that retail development, especially food stores are both viable and capable of contributing to infrastructure requirements. However, if the Council wants to set a CIL then it is considered that more detailed work is required to assess values across a wider area, coupled with research on past contributions.

Viability of employment and commercial development summary

3.28 It has been demonstrated that if developer contributions are uniformly sought from employment development then it is likely that such development may prove to be unviable and unable to be delivered.

3.29 In terms of retail development, it is likely that some forms of development such as out of centre foodstores could potentially deliver contributions, however this may not be the case with all forms of retail development, for example a town centre regeneration scheme.

3.30 Therefore it is recommended that contributions could be sought from retail development but that further viability work is required as part of the evidence base for setting the CIL. In setting a CIL or in seeking site specific mitigation measures through a s106 agreement, regard will need to be had for viability, the likely impacts of the development and the objectives of the Council to support economic regeneration.

4 RESIDENTIAL DEVELOPMENT - ASSUMPTIONS USED FOR VIABILITY TESTING

Background to the Viability Testing

4.1 This chapter sets out the assumptions used in the viability testing for the types of residential sites considered and the testing criteria used, including that of discounting over time. The assumptions follow the work undertaken for the Affordable Housing Viability Assessment (AVHA) carried out earlier in 2010 and any differences in assumptions and testing criteria will be highlighted. Some new assumptions have been introduced, particularly for the large strategic sites

4.2 The approach to viability adopted in the EVA is the same as used in the AHVA. The EVA uses a residual value methodology which is now typical of nearly all viability studies used to underpin LDF policies. The methodology assumes that the value of a scheme (its residual value) is the difference between the revenue generated by the scheme and the costs incurred in developing it. Scheme costs are deducted from scheme revenue to give a gross residual value of the site from which the planning obligation payments are deducted to come up with a net residual value.

4.3 This can then be compared with either the site's existing value (e.g. an industrial use) or an alternative use to assess whether the site will come forward for development. The AHVA, in consultation with the local development industry, set a broad benchmark figure of £600,000 per ha above which land could be brought forward for development. This figure is an estimated 25/30% above industrial land values in the County.

Market value areas

4.4 In the AHVA a set of market value areas was identified across the County in which average values/prices were broadly similar. A map showing these value areas is shown below, followed by a table setting out indicative new build values as at Summer 2009.

Figure 4.1: Map showing market value areas – Herefordshire

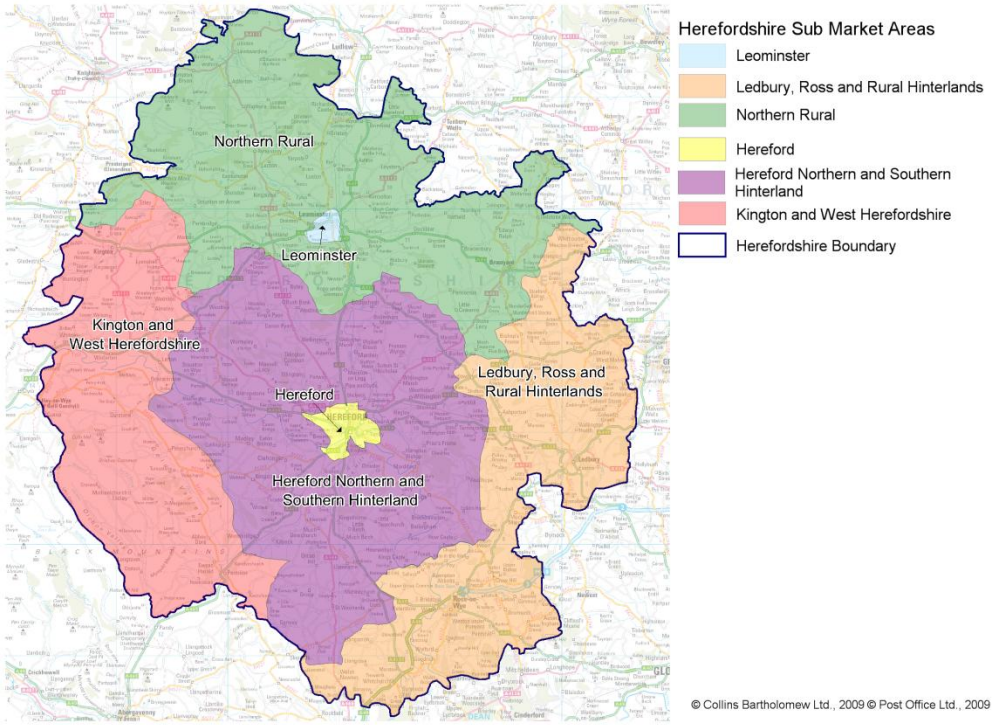


Table 4.1: Market Values Areas

Market Value Area	Detached			Semi-detached		
	5 bed	4 bed	3 bed	4 bed	3 bed	2 bed
Ledbury, Ross and Rural Hinterlands	£400,000	£345,000	£315,000	£235,000	£215,000	£190,000
Northern Rural	£385,000	£335,000	£300,000	£230,000	£210,000	£185,000
Hereford	£345,000	£295,000	£270,000	£205,000	£185,000	£170,000
Kington and West Herefordshire	£335,000	£290,000	£260,000	£200,000	£180,000	£165,000
Hereford Northern and Southern Hinterland	£330,000	£285,000	£255,000	£195,000	£175,000	£160,000
Leominster	£280,000	£245,000	£220,000	£180,000	£160,000	£120,000

Market Value Area	Terraced			Flats		
	4 bed	3 bed	2 bed	3 bed	2 bed	1 bed
Ledbury, Ross and Rural Hinterlands	£210,000	£210,000	£180,000	£205,000	£160,000	£120,000
Northern Rural	£205,000	£200,000	£175,000	£195,000	£155,000	£115,000
Hereford	£200,000	£180,000	£155,000	£170,000	£140,000	£105,000
Kington and West Herefordshire	£195,000	£175,000	£150,000	£165,000	£135,000	£100,000
Hereford Northern and Southern Hinterland	£190,000	£170,000	£145,000	£160,000	£130,000	£95,000
Leominster	£165,000	£150,000	£130,000	£140,000	£110,000	£85,000

4.5 We reviewed these figures in Summer 2010. Data from HM Land Registry showed a net increase in house prices of approximately 4.5% between June 2009 and August 2010. However, more recent data in Autumn 2010 indicates a weakening of the housing market and there is continued uncertainty over future market conditions. The EVA therefore uses the house prices from the AHVA but the analysis includes an assessment of the impact of any (long term) increase in prices.

4.6 There is a range of other assumptions used for the modelling described in the next section. The assumptions common to all the testing are set out in Annex 2. They include assumptions for build and other development costs, social rent levels, dwelling sizes and notional mixes of dwellings (depending on scheme density).

Section 106 contributions package

4.7 Herefordshire Council has identified an emerging infrastructure package within its Infrastructure Delivery Plan (IDP). The IDP sets out local and strategic infrastructure requirements for Herefordshire, how much is anticipated to be levied from development through planning contributions and what is anticipated by way of public funding or other private sector investment. The IDP also provides an indication of when infrastructure is required within five year periods to the end of the plan period.

4.8 The latest draft of the IDP set a total infrastructure requirement of over £560m over the plan period. These requirements include a wide range of items including, for example, transport schemes, education, health and utilities provision. The emerging information for the IDP sets out whether the requirements are site specific on a town or rural basis or strategic and any funding identified. It is expected that development will contribute around £355m.

4.9 This figure and location split has provided the broad basis for testing a potential requirement with the anticipated number of dwellings expected to be brought forward through plan policy.

4.10 Allowing for completions and commitments with planning consent there is a residual net dwelling policy requirement of 12,363 for Herefordshire based upon the Preferred Options. The following table identifies the county split of housing requirements and the contributions package cost for each area and for each of the identified urban extension for Herford and the market towns. The council's IDP sets out the rational for this in more detail. (Note that Kington has been included within the rural figure for the purposes of the EVA.)

Table 4.2: Assumed Development Contributions

Area and Hereford strategic sites	**Residual housing requirement in dwellings *(strategic sites)***	**Development contribution per dwelling *strategic sites* –to nearest £100**
Bromyard	288 *(250)*	£30,100 *(£30,900)*
Ledbury	742 *(700)*	£41,400 *(£42,400)*
Leominster	1760 *(1700)*	£33,000 *(£33,300)*
Hereford	6323 *(5300)*	£27,600 *(£28,100)*
Urban village	*(800)*	*(£26,500)*
Northern extension	*(1000)*	*(£27,700)*
Western extension	*(2500)*	*(£28,000)*
Southern extension	*(1000)*	*(£30,200)*
Ross-on-Wye	506 *(350)*	£28,500 *(£30,000)*
Rural areas	2744	£25,100
Herefordshire	12,363	£28,800

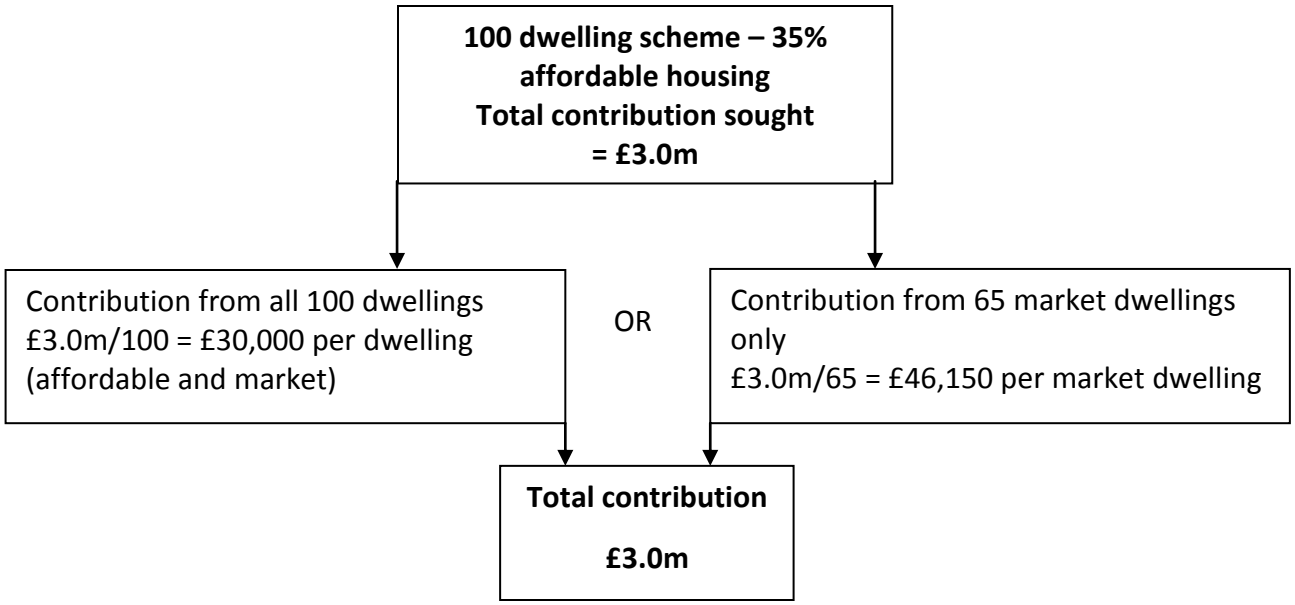
Source: Herefordshire Council

4.11 The above contribution schedule assumes that all dwellings (market and affordable) contribute equally. The coalition government has recently provided further information about its approach to the Community Infrastructure Levy[3]. As in the CIL regulations published last March, social and affordable housing will be exempt from the levy.

4.12 So, for a given amount of infrastructure to be funded, if no contributions are to be collected from affordable housing, there will need to be a higher levy on market housing. But, in a mixed tenure scheme this should have a neutral impact on the overall development contribution sought. This is illustrated in the following flow chart using a notional 100 dwelling development, with 35% affordable housing and a total contribution of £3m sought from the scheme via the Levy.

[3] CLG Press Release November 18 2010

Figure 4.2: Illustration of how a Levy could be calculated– With Affordable Housing Included and Excluded



Site Typologies

4.13 It was agreed to test three types of sites, which are considered to be broadly illustrative of the future supply of housing in the county. The three are:

- Strategic sites
- Medium sized sites
- Small sites

4.14 The assumptions for these different types of sites (in addition to the general assumptions set out in Annex 2) are described in turn below.

Strategic sites

4.15 Three notional strategic sites have been modelled – one assumed in each of Hereford, Leominster and Ledbury. It should be noted that the analysis is not intended to represent a particular scheme or replicate the development economics of a particular scheme that may be identified at a later date. The analysis is **illustrative only** of the development economics of these types of sites in these sorts of locations.

4.16 The main characteristics of the three illustrative strategic sites are set out below. The information used for the modelling process has been drawn from the council's SHLAA Schedule of developable sites and experience of the consultant team of developments of this kind from elsewhere.

4.17 **Hereford**

- c35 ha (net)
- 1,000 dwellings
- Completions - assumed 100 dwellings per year for 10 years from year 3
- Assume 2 years to open up site
- Developed over 12 years

4.18 **Leominster**

- c50 ha (net)
- 1,700 dwellings
- No completions in year 1
- Developed over 15 years

4.19 **Ledbury**

- c15 ha (net)
- 700 dwellings
- Assume 2 years to open up site
- Development over 10 years

4.20 As general guidance, and if more specific information is not available, it has been assumed that the **net developable area** will be 70% of the gross area. This is a lower figure than the Council has assumed in its recent Strategic Housing Land Availability Assessment. where a net developable area of 90% has been taken. Previous government guidance (Tapping the Potential for Urban Capacity Studies[4]) supported this; for example, indicating that for sites between 0.4 and 2ha total gross site area , 90% to 100% net developable area is acceptable.

4.21 However, in our experience of larger strategic sites (1000 houses plus) the net developable area reduces in order to accommodate other land uses and facilities and environmental constraints. The above quoted guidance says that for sites > 2ha total gross site area the net developable area should be 75% (range 50% to 75%). It is not unknown for strategic sites to have a net developable area of 50% where there are flooding or other environmental constraints and land on which development can take place is severely constrained.

4.22 An allowance has been made for **opening up and servicing sites**. A figure of £200,000 per net hectare has been used. In the light of other information and research available, this is considered to be a broadly realistic figure but towards the top end of the range of costs for opening up sites. It should also be noted that some sites may prove more costly to 'open up' whilst the development of other sites may be achieved at a lower cost.

[4] Tapping the Potential. Assessing Urban Housing Capacity: Towards Better Practice, DETR, December 2000 and also in Housing Land Availability Assessment, Identifying Appropriate Land for Housing Development, Draft Practice Guide, ODPM, 2005

4.23 The level of affordable housing assumed is that set out in Policy AH.1 – Affordable Housing in Shaping Our Place 2026 Local Development Framework Preferred Options: General Policies (Aug. 2010). It is therefore as follows:

- Hereford – 35%
- Leominster – 25%
- Ledbury – 40%

Assume 80% social rented, 20% New Build Homebuy (50% purchase share).

4.24 The level of development contributions assumed for the strategic sites is:

- Hereford – £30,000 per dwelling
- Leominster – £33,000 per dwelling
- Ledbury – £42,000 per dwelling

4.25 Contributions are assumed to be collected from both market and affordable housing for the purposes of the EVA.

Medium sized sites

4.26 These sites represent smaller greenfield urban extensions and the following assumptions have been made:

- Notional sites in three locations - Hereford, Leominster and Ledbury
- Size of site is 5.6 hectares of which 5 ha is developable (i.e. 90% gross to net developable area)
- Number of dwellings is 200 at a density of 40 dph
- Assume one year lead in time then built out over 4 years
- Infrastructure costs – assume £100,000 per net hectare with 50% in year one and 50% in year 2
- All other assumptions as for the strategic sites above

Small sites

4.27 Two examples of a notional small site were tested – one to represent a greenfield location and the other, a brownfield site. The characteristics of the two site types are set out below.

Table 4.3: Characteristics of small sites

Existing Use	Size	Number of Dwellings	Density
Brownfield	0.4 ha	10	25 dph
Greenfield	0.3 ha	8	27 dph

- Sites tested in all market value areas
- Target affordable housing on small sites (Policy AH 1– Affordable Housing in *Shaping Our Place 2026 Local Development Framework Preferred Options: General Policies* (Aug. 2010) also tested

- Development contribution package of £29,000 per dwelling

Testing criteria and sensitivity analyses (including discounting)

Baseline testing

4.28 The baseline testing uses the values and costs as set out above (and in Annex 2) for each of the types of sites viz strategic, medium and small. This testing is referred to as **static** in the results tables in the next chapter as the testing assumes all costs and values occur at the same point in time – now. It should be noted that all the modelling undertaken assumes there is **no** public subsidy available (such as grant from the Homes and Communities Agency) for the affordable housing.

Taking time into account (discounting)

4.29 The toolkit used for testing allows for a discount rate to be applied to cost and values where a scheme is being developed over several years. In simple terms a discount rate is applied to flows of values and costs which have been allocated annually and it represents the annual percentage rate at which the present value of a future pound is assumed to fall away through time.

4.30 We have assumed a rate of 6.5% pa. The Treasury Green Book uses a discount rate of 3.5% pa (changed from 6% pa in January 2009) which represents a fairly conservative, risk free approach used for long term public investment programmes. Private housebuilding in the current economic climate has a different risk profile and this explains the higher rate that has been adopted for the testing in the EVA.

4.31 The tests using a discount rate are referred to as DCF Tests in the results tables in the next chapter.

4.32 Other assumptions used alongside the discounting for sites developed over a number of years include a credit and a debit rate. We have modelled a debit rate of 6.5% (applied when a scheme is in debt) and a credit rate of 4.5% (applied when a scheme is generating a positive residual value).

Phasing

- Assume no completions in years 1 and 2
- Thereafter, distribute dwelling completions evenly across remaining years.

Infrastructure Costs

- Assume total of £200,000 per net ha
- Assume 25% of cost in year 1, 25% of cost in year 2. Distribute remaining cost evenly across remaining years.

Sensitivity Tests

4.33 When the values of selected variables such as house prices, build costs, and s 106 packages are changed in the model their impacts on the residual value outcome can be measured. These are known as sensitivity tests. The EVA uses a range of sensitivity tests, some with the static model and others when there is discounting. The sensitivity tests are set out in the following table. It is noted that the tests undertaken for each of the illustrative strategic sites are not identical (although in all three the same two basic static tests – with 100% of the contributions package and 50% of the package – are replicated). After the first two static tests, the tests chosen reflect the results of the static tests e.g. where it is clear that schemes will not be viable with 100% of the development contributions package, we do not pursue this in subsequent testing.

Table 4.4: Variables used in the sensitivity tests – Strategic Sites

Test name	Affordable housing	Development contribution package	Timing of development contribution package	Value/costs
Static 1 (Baseline)	As per policy	100%	n/a	n/a
Static 2	As per policy	50%	n/a	n/a
Static 3 Hereford only	As per policy but 60/40 split – social rent/NBHB	100%	n/a	n/a
Static 3b Hereford only	As per policy but 60/40 split – social rent/NBHB	50%	n/a	n/a
Static 4	As per policy but 60/40 split – social rent/NBHB and 30% share purchase	100%	n/a	n/a
DCF 1	As per policy	100% (50% in Leominster)	50% in years 1. Rest spread evenly over development period	n/a
DCF 1b Hereford only	As per policy	100%	50% in years 1. Rest spread evenly over development period	Discount rate at 3.5%
DCF 2	As per policy	100% (50% in Leominster)	0% sought in years 1 and 2; rest spreads evenly over the development period	n/a
DCF 2b	As per policy	50%	0% sought in years 1 and 2; rest spreads evenly over the development period	n/a
DCF 2c Hereford only	As per policy	100%	0% sought in years 1 and 2; rest spreads evenly over the development period	Discount rate at 3.5%
DCF 2d Hereford only	As per policy	50%	All sought last two years of development (50% in each year)	Discount rate at 3.5%
DCF 3	As per policy	50%	0% sought in years 1 and 2; rest spreads evenly over the development period	3% pa growth in house prices
DCF 3b	As per policy	50%	0% sought in years 1 and 2; rest spreads evenly over the development period	3% pa growth in house prices AND extra £6,000 per dwelling for CSH4 and LTH[5]

[5] Assumes moving from CSH 3 to CSH level 4 adds c£5,500 per dwelling to costs and that building to Life time Homes standards adds c£500 per dwelling (a total additional cost of £6,000 per dwelling)

Test name	Affordable housing	Development contribution package	Timing of development contribution package	Value/costs
DCF 4 Hereford only	20% (80% social rent and 20% NBHB)	100%	0% sought in years 1 and 2; rest spreads evenly over the development period	n/a
DCF 4b Hereford only	20% (80% social rent and 20% NBHB)	100%	0% sought in years 1 and 2; rest spreads evenly over the development period	3% pa growth in house prices
DCF 4c Hereford only	20% (80% social rent and 20% NBHB)	100%	0% sought in years 1 and 2; rest spreads evenly over the development period	3% pa growth in house prices AND extra £6,000 per dwelling for CSH4 and LTH
DCF 5 Ledbury only	30% (80% social rent and 20% NBHB)	100%	0% sought in years 1 and 2; rest spreads evenly over the development period	3% pa growth in house prices AND extra £6,000 per dwelling for CSH4 and LTH
DCF 5b Ledbury only	As per policy	100%	0% sought in years 1 and 2; rest spreads evenly over the development period	3% pa growth in house prices AND extra £6,000 per dwelling for CSH4 and LTH

The table above summarises all scenarios modelled for any of the strategic sites. Note that not all scenarios have been modelled in all locations. The test numbers set out in this table correlate with the test numbers shown in the results tables in the following section.

Table 4.5: Variables used in the sensitivity tests – Medium Sites

Test name	Affordable housing	Development contribution package	Timing of development contribution package	Value/costs
Static 1 (Baseline)	As per policy	100%	n/a	n/a
Static 2	As per policy	50%	n/a	n/a
DCF 1	As per policy	100%	50% in year 1. Rest spread evenly over development period	n/a
DCF 2	As per policy	100%	0% sought in years 1 and 2; rest spreads evenly over the development period	n/a
DCF 3	As per policy	100%	0% sought in years 1 and 2; rest spreads evenly over the development period	3% pa growth in house prices
DCF 3b	As per policy	100%	0% sought in years 1 and 2; rest spreads evenly over the development period	3% pa growth in house prices AND extra £6,000 p dw[6]
DCF 4	As per policy	50%	50% in years 1. Rest spread evenly over development period	n/a
DCF 5	As per policy	50%	0% sought in years 1 and 2; rest spreads evenly over the development period	n/a
DCF 6	As per policy	50%	0% sought in years 1 and 2; rest spreads evenly over the development period	3% pa growth in house prices
DCF 6b	As per policy	50%	0% sought in years 1 and 2; rest spreads evenly over the development period	3% pa growth in house prices AND extra £6,000 pdw[7]

[6] Assumes moving from CSH 3 to CSH level 4 adds c£5,500 per dwelling to costs and that building to Life time Homes standards adds c£500 per dwelling (a total additional cost of £6,000 per dwelling)

[7] Assumes moving from CSH 3 to CSH level 4 adds c£5,500 per dwelling to costs and that building to Life time Homes standards adds c£500 per dwelling (a total additional cost of £6,000 per dwelling)

Small sites

4.34 In addition to the baseline test, the impact of an additional £750,000 per hectare for the brownfield site only is tested. This cost is used as a notional amount of funding for significant remediation).

5 RESIDENTIAL DEVELOPMENT –VIABILITY TESTING RESULTS

Introduction

5.1 This section sets out the results of the financial modelling across the three types of sites – large strategic greenfield sites in Hereford, Ledbury and Leominster, medium sized greenfield sites in the same locations and small sites (greenfield and brownfield) across the range of market value areas. The testing includes use of discounted cash flow (DCF) methodology for the larger strategic and medium sized sites where development takes place over a number of years.

5.2 The tables below are a summary of the residual values for different sites on a gross and net basis with a baseline based on the assumptions set out in section 4 and with a number of sensitivity tests applied to gauge the impact of changes to key variables viz;

- Reduction of 50% to s 106 package
- Deferred development contributions
- Changes to affordable housing percentage (Hereford only) and tenure split
- Changes to percentage purchase share for NBHB
- 3% pa house price inflation
- Additional cost of Code Level 4/Lifetime Homes.

(All testing is on the basis of nil grant for affordable housing)

5.3 In assessing the residual values under each scenario, the key question is whether the value generated will be sufficient to bring the land forward for development to take place (over the life of the Core Strategy). The residual value can be compared with a number of comparator values including, for instance, existing or alternative use value (e.g. an industrial use). The AHVA, in consultation with the local development industry, set a broad benchmark figure of £600,000 per ha as an estimate of the value of 25/30% above industrial land values in the county and used this as a comparator value.

5.4 It should also be noted that the strategic sites identified for the Core Strategy are urban extensions into greenfield land. As agricultural land, land values of about £20,000 per hectare would be a reasonable estimate.[8] It is not suggested that a 25/30% uplift over these values will be sufficient to encourage land to be brought forward for development but we note that achieving an increase in value to the notional £600,000 per hectare equates to, for example, a £5.8m uplift in value for the land owner for a 10 hectare site.

5.5 Throughout this chapter we report the results as found and have not rounded them. This approach is accurate but, as with all such testing, should not be taken to imply a spurious degree of precision. The tests show the likely broad level of residual value with the assumptions as described.

[8] For equipped land with vacant possession as at January 1 2010. Source: Valuation Office Agency, Property Market Report, July 2010. Figures quoted are for Herefordshire.

Strategic sites

5.6 The three strategic sites in Hereford, Ledbury and Leominster represent the main contributors of future housing in the county and the largest potential contributors to fund new infrastructure. The information below, whilst using site specific characteristics, does not provide the actual residual value for the main strategic sites only a 'modelled' version for comparative purposes. Each strategic site type is discussed in turn. The label for each test is that shown in Table 5.6 (and so there may be 'gaps' in the number sequence).

Hereford Strategic Site

Table 5.1: Hereford Strategic Site Type - Residual Values (per hectare)

Static / DCF	Static 1	Static 2	Static 3	Static 3b	Static 4
Description	Base	15K S106	30K S106, AH split 60% SR, 40% NBHB	15K S106, AH split 60% SR, 40% NBHB	As static 3, 30% purchase share for NBHB
RV per ha (net)	£149,400	£546,300	£395,100	£792,000	£299,700
RV per ha (gross)	£83,700	£306,900	£221,400	£443,700	£168,300

Static / DCF	DCF: Test 1	DCF: Test 1b	DCF: Test 2	DCF: Test 2b	DCF: Test 2c	DCF 2d
Description	Frontload S106 (30K) i.e. 50% in year 1	As test DCF 1 with 3.5% discount rate	Deferred S106 (30K) i.e. none in years 1 and 2	As test DCF 2, 15K S106	As test DCF 2 with 3.5% discount rate	As test DCF 2b with 3.5% discount rate and all S106 sought in last two years of development
RV per ha (net)	-£36,395	-£53,165	£97,123	£326,602	£141,876	£533,615
RV per ha (gross)	-£20,403	-£29,805	£54,446	£183,092	£79,535	£299,051

Static / DCF	DCF: Test 3	DCF: Test 3b	DCF: Test 4	DCF: Test 4b	DCF: Test 4c
Description	As test DCF 2b, 3% per annum house price inflation	As test DCF 3, CSH 4 and Lifetime Homes (additional 6K per dwelling)	As test DCF 2, 30K S106, 20% AH (split 80% social rent and 20% NBHB)	As test DCF 4, 3% per annum house price inflation	As test DCF 4b, CSH 4 and Lifetime Homes (additional 6K per dwelling)
RV per ha (net)	£848,835	£757,579	£375,098	£989,546	£898,448
RV per ha (gross)	£475,852	£424,694	£210,277	£554,733	£503,663

5.7 The key points from the results set out above are that:

- The tests show how future residual values are affected by the assumptions used and that there is a trade off to be made between the amount of affordable housing sought and the level of development contribution package.
- With the development contribution package set at £30,000 per dwelling and a 35% affordable housing contribution, (Static 1) a residual value of about £150,000 per hectare is generated. This is below the notional benchmark of £600,000 but well in excess of agricultural value.
- When the development contribution package is reduced by half i.e. £15,000 per house - the residual value increases but is still slightly below the £600,000 benchmark (but again, well in excess of agricultural values).
- Introducing an alternative mix of affordable housing (as in Static 3) improves the residual value quite significantly. A net residual value above the £600,000 benchmark is achieved with a development package of £15,000 per dwelling, 35% affordable housing but with the alternative mix of affordable housing (as in Static 3b).
- The effect of time is to reduce the residual value. With the full development contributions package of £30,000 per dwelling, the Net Present Value (NPV), using the discounted cash flow method and frontloading the contributions ie 50% in year 1, produces a negative residual value. This increases to a positive (but very low) value if payments are deferred for two years (DCF 2).
- Test DCF 4 shows the impact of reducing the amount of affordable housing. This test uses a £30,000 per dwelling development contribution package with 20% affordable housing. It produces a NPV broadly comparable with DCF 2b (i.e. with £15,000 package and 35% affordable housing). This is a clear indication that there is a trade off to be made between the development contribution package sought and the affordable housing target.
- If market conditions improve over the period of the core strategy, residual values will increase. Tests DCF 3, DCF 4b and DCF 4c show this with a notional annual house price inflation at 3% pa. Such an uplift in values more than compensates for the introduction of the higher costs modelled for the introduction of the Code for Sustainable Homes (Level 4) and Lifetime Homes (Test 4c).

5.8 While the residual value of large developments (built over a longer term) are sensitive to finance and discount rates, the timing of S106 payments can also have a significant impact on residual value. But the most significant differences in results are found when i) the development contribution is halved (as we tested it) ii) the amount of affordable housing is reduced and/or iii) there is an assumed increase in house prices over the period in which the development is built out. But with current market conditions it does not appear realistic to expect to achieve BOTH 35% affordable housing and the full development contribution package of £30,000 as modelled.

Ledbury Strategic Site

5.9 The Ledbury market value area should, all other things being equal, produce higher residual values than either of the other strategic site types modelled, reflecting the higher house prices found. However, as the table below illustrates, even in this higher market value area, absorbing a development contribution of £42,000 per dwelling is not realistic with current market conditions and in combination with the target for affordable housing. It is useful to set this in context and to observe that, for example, at 40 dph, a contribution of £42,000 per dwelling would imply a total contribution of about £1.7m per hectare of housing development (with the implied equivalent reduction in the residual value of land).

Table 5.2: Ledbury Strategic Site Type - Residual Values (per hectare)

Static / DCF	Static 1	Static 2	DCF: Test 1	DCF: Test 2	DCF: Test 3	DCF: Test 3b
Description	Base	21K S106	Frontload S106 (21K) i.e. 50% in year 1	Deferred S106 (21K) i.e. none in years 1 and 2	As test DCF 2, 3% per annum house price inflation	As test DCF 3, CSH 4 and Lifetime Homes (additional 6k per dwelling)
RV per ha (net)	£99,900	£878,400	£407,344	£531,204	£1,212,714	£1,072,755
RV per ha (gross)	£85,500	£747,000	£346,242	£451,524	£1,030,807	£911,842

Static / DCF	DCF: Test 5	DCF: Test 5b
Description	As test DCF 2, with 42K S106, 30% AH, 3% per annum HP inflation, CSH 4 and Lifetime Homes (additional 6K per dwelling)	As test DCF 4 with 40% affordable housing.
RV per ha (net)	£972,659	£570,670
RVper ha (gross)	£826,760	£485,069

Note that the test numbers in the table above correlate with those set out in table 4.6 (which summarises all tests undertaken). Also note that tests 4, 4b and 4c were only run in Hereford and that tests 5 and 5b were only run in Ledbury.

5.10 The key points from the results set out above are that:

- For all the tests a positive residual value is generated and this is well in excess of agricultural land value.
- However, with a 40% affordable housing and a development contribution package of £42,000 per dwelling (Static 1), residual values are less than £100,000 per hectare.
- With a development contribution package at half the rate assumed in the first test (ie £21,000) residual values increase to upwards of around £0.75 - on a static analysis assuming no uplifts in values or costs over time (Static 2).
- When the element of time is introduced, small changes in the timing of payments of the development contribution package improves the residual value (see comparison of DCF Tests 1 and 2) but residual values remain around or below about £0.5m per hectare.
- The full development contribution package of £42,000 per dwelling would be achievable if there was deferred payments and value uplifts occur over time BUT with a lower affordable housing percentage than the target ie 30% not 40% The additional costs of Level 4 of the Code for Sustainable Homes can also be accommodated in this scenario. But with the 40% affordable housing target restored, (as in DCF: test 5b), the residual value falls considerably (from about £1m to about £0.6m per hectare.
- There appears to be a trade off between the full development contribution package and a 40% affordable housing target.

Leominster strategic site

Table 5.3: Leominster Strategic Site Type - Residual Values (per hectare)

Static / DCF	Static 1	Static 2	DCF: Test 1	DCF: Test 2	DCF: Test 3	DCF: Test 3b
Description	Base	16.5K S106	Frontloaded S106 (16.5K) i.e. 50% in year 1	Deferred S106 (16.5K) i.e. none in years 1 and 2	As test DCF 2, 3% per annum house price inflation	As test DCF 3, CSH 4 and Lifetime Homes (additional 6K per dwelling)
RV per ha (net)	-£364,100	£178,200	£86,805	£166,542	£748,536	£659,702
RV per ha (gross)	-£286,000	£140,400	£68,090	£130,637	£587,155	£517,473

5.11 The key points from the results set out above are that:

- High negative residual values are generated using the baseline assumptions on a static basis which indicate that this scheme will not come forward for development with 25% affordable housing and a contributions package of £33,000 per dwelling (Static 1).

- Even with a reduction of 50% on the per unit development contributions package (£16,500 per dwelling), residual values of less than £200,000 per hectare are found. Again it should be noted that this figure is well in excess of agricultural values but below the broad indicative benchmark of £600,000 per hectare.
- Using the lower development contribution package (£16,500 per dwelling) and discounting the cash flow, residual values remain relatively low, even if the contributions are deferred (DCF Tests 1 and 2).
- Residual values at or above £0.5m gross and £0.9m net for this type of scheme in this market value area are achieved with the reduced contributions package when there is a value uplift (3% per annum) which also offsets any cost uplift due to higher build standards for Code Level 4/Lifetime Homes.

Introduction of Affordable Rent

5.12 In the analysis above (and elsewhere in the report), the affordable element of each scheme has been modelled as 80% social rent and 20% shared ownership. The contribution to scheme revenue from social rented housing has been calculated using 'target rents' to determine the amount a housing association could pay to acquire the units.

5.13 From April 2011 housing associations will be able to let new and vacant properties at 'affordable rent' levels. 'Affordable rent', as described in the consultation paper *Local Decisions: a Fairer Future for Social Housing*[9], will be up to 80% of typical market rent (for a given location and like property). By this definition, affordable rents will be higher than target rents in the majority of locations as indicated in the table below.

[9] http://www.communities.gov.uk/documents/housing/pdf/1775577.pdf

Table 5.4: Target rents and affordable rents (at 80% of market rent)

Property Size	Target Rent (per week)[10]	Affordable Rent (per week)[11]
2 bed	£65.00	£97.00
3 bed	£75.00	£115.00
4 bed	£85.00	£138.00
5 bed	£91.00	£166.00

5.14 The affordable rents set out above are entirely illustrative and housing associations will have their own views on the level affordable rents will be set (within the guidance set out by government). However, as affordable rents will be higher than social rents, and properties let at affordable rent levels will generate higher rental incomes which will have implications for scheme revenue and viability. To illustrate the possible implications of the introduction of affordable rent on viability we have replicated a selection of the scenarios modelled above using affordable rents instead of target rents. Table 5.5 compares baseline results (derived using target rents) with results derived using affordable rents (based on the notional 80% of market rent we have defined).

[10] Rounded average target rents for Herefordshire derived from Dataspring

[11] 80% of median weekly rents for the Herefordshire Broad Rental Market Area. Rent data compiled by the Valuation Office Agency for the purpose of calculating Local Housing Allowance rates. These estimates of market rents have not been verified by any local market analysis and are used for testing purposes only.

Table 5.5: Impact of Affordable Rent on Residual Values.

Strategic Site		**Static 2**: Affordable housing as per policy, 50% of total developer contribution		**DCF 2 (2b in Hereford)**: Affordable housing as per policy, 50% of total developer contribution, deferred payment i.e. no developer contributions sought in years 1 and 2	
		Base (social rent)	**Affordable rent**	**Base (social rent)**	**Affordable rent**
Hereford	Per ha (net)	£546,300	£835,200	£326,602	£492,292
	Per ha (gross)	£306,900	£468,000	£183,092	£275,976
Ledbury	Per ha (net)	£878,400	£1,307,700	£531,204	£799,682
	Per ha (gross)	£747,000	£1,111,500	£451,524	£679,730
Leominster	Per ha (net)	£178,200	£403,200	£166,542	£281,383
	Per ha (gross)	£140,400	£321,300	£130,637	£220,719

5.15 The amount of revenue added to a scheme through the introduction of the affordable rent tenure depends on the development mix, the number of dwellings and the proportion of affordable housing. However, in all cases the introduction of affordable rents (in lieu of social rents) increases residual value and quite significantly.

5.16 The implications for viability are greatest where social rented housing levels are highest. So, for example, in Ledbury, the introduction of affordable rent brings gross residual value from just over £450,000 in the second DCF scenario to close to £680,000, above the £600,000 per ha benchmark value. Conversely, in Leominster (with the lowest affordable housing percentage), the introduction of affordable rent certainly improves residual values but not to the same extent.

5.17 While the above analysis illustrates the potential scale of impact on scheme economics of introducing affordable rents in Herefordshire, we note that it is currently not Herefordshire Council policy to support the new tenure.

Medium sized sites

5.18 These are modelled as notional sites of c 5-6 ha, mainly as greenfield extensions accommodating c 200 dwellings in Hereford, Ledbury and Leominster.

Hereford – medium sized site

Table 5.6: Hereford Medium Site Type - Residual Values (per hectare)

	Static tests		Development obligations package at £30K per dwelling			
Static / DCF	**Static 1**	**Static 2**	**DCF: Test 1**	**DCF: Test 2**	**DCF: Test 3**	**DCF: Test 3b**
Description	Base	15K S106	Frontloaded S106 i.e. 50% in year 1	Deferred S106 i.e. none sought in years 1 and 2	As test 2, 3% per annum house price inflation	As DCF test 3, plus CSH 4 and Lifetime Homes (additional 6K per dwelling)
RV per ha (net)	£121,500	£657,000	£12,804	£105,426	£495,619	£328,292
RV per ha (gross)	£108,900	£591,300	£11,525	£94,883	£446,057	£295,464

	Development obligations package at £15K per dwelling			
Static / DCF	**DCF(B): Test 1**	**DCF(B): Test 2b**	**DCF(B): Test 3**	**DCF(B): Test 3b**
Description	Frontloaded S106 i.e. 50% in year 1	Deferred S106 i.e. none sought in years 1 and 2	As test 2, 3% per annum house price inflation	As test 3, plus CSH 4 and Lifetime Homes (additional 6K per dwelling)
RV per ha (net)	£482,983	£523,742	£913,935	£746,609
RV per ha (gross)	£434,685	£471,368	£822,542	£671,947

5.19 The key points from the results set out above are that:

- A £30,000 per dwelling development contribution package generates a residual values of around £ 100,000 per hectare – again in excess of agricultural value but well below the notional benchmark value of £0.6mper hectare.
- But when the development contribution package is halved (i.e. to £15,000 per dwelling), residual values increase to about £0.6m per hectare (see Static 2).
- The above findings are mirrored when timing of the development is taken into account. With the development obligations package at £30,000 per dwelling, it is only when 3% house price inflation is introduced, do residual values of around £0.5m per hectare get generated. (DCF Tests 1 to 3).
- However, with this type of scheme in this location, a reduced development obligations package of £15,000 generates residual values at or in excess of £0.5m per hectare with the DCF method (DCF (B) Tests 1 and 2).

- When a 3% per annum uplift in values is then assumed (DCF (B) Tests 3 and 3b), residual values of around £0.7 to £0.9m per hectare are found (depending on whether higher levels of the Code for Sustainable Homes is included).

Ledbury – medium sized site

Table 5. 7: Ledbury Medium Site Type - Residual Values (per hectare)

	Static tests		Development obligations package at 42Kper dwelling			
Static / DCF	**Static 1**	**Static 2**	**DCF: Test 1**	**DCF: Test 2**	**DCF: Test 3**	**DCF: Test 3b**
Description	Base	21K S106	Frontloaded S106 i.e. 50% in year 1	Deferred S106 i.e. none sought in years 1 and 2	As test 2, 3% per annum house price inflation	As test 3, plus CSH 4 and Lifetime Homes (additional 6K per dwelling)
RV per ha (net)	£180,000	£930,600	£31,311	£159,718	£587,810	£420,484
RV per ha (gross)	£162,000	£837,000	£28,180	£143,745	£529,029	£378,436

	Development obligations package at 21K per dwelling			
Static / DCF	**DCF (B): Test 1**	**DCF(B): Test 2**	**DCF (B): Test 3**	**DCF(B): Test 3b**
Description	Frontloaded S106 i.e. 50% in year 1	Deferred S106 i.e. none sought in years 1 and 2	As test 2, 3% per annum house price inflation	As test 3, plus CSH 4 and Lifetime Homes (additional 6K per dwelling)
RV per ha (net)	£688,803	£745,359	£1,173,452	£1,006,126
RV per ha (gross)	£619,924	£670,824	£1,056,107	£905,513

5.20 The key points from the results set out above are that:

- Even in high value Ledbury, relatively low residual values are generated with the full (£42,000 per dwelling) development contribution package (Static 1and DCF Tests 1 and 2).
- Sustained house price inflation would significantly increase residual values (as shown in DCF Test 3 and DCF (B) Tests 3 and 3b) and with the full package, residual values in excess of £0.5m are generated.
- But when the development contribution package is halved £21,000 per dwelling) residual values of at least £600,000 per hectare for all the tests using this level of contribution (Static 2 and DCF(B) tests). Residual values rise to over £1.0m per hectare when an assumed 3% per annum increase in value is introduced.

Leominster – medium sized site

Table 5.8: Leominster Medium Site Type - Residual Values (per hectare)

	Static tests		Development obligations package at 33K per dwelling			
Static / DCF	**Static 1**	**Static 2**	**DCF: Test 1**	**DCF: Test 2**	**DCF: Test 3**	**DCF: Test 3b**
Description	Base	16.5K S106	Frontloaded S106 i.e. 50% in year 1	Deferred S106 i.e. none sought in years 1 and 2	As test 2, 3% per annum house price inflation	As test 3, plus CSH level 4 and Lifetime Homes (additional 6K per dwelling)
RV per ha (net)	-£507,100	£174,600	-£540,878	-£403,393	£43,466	-£155,747
RV per ha (gross)	-£455,400	£157,500	-£486,791	-£363,053	£39,119	-£140,172

	Development obligations package at 16.5K per dwelling			
Static / DCF	**DCF(B): Test 1**	**DCF(B): Test 2**	**DCF(B): Test 3**	**DCF(B): Test 3b**
Description	Frontloaded S106 i.e. 50% in year 1	Deferred S106 i.e. none sought in years 1 and 2	As test 2, 3% per annum house price inflation	As test 3, plus CSH 4 and Lifetime Homes (additional 6K per dwelling)
RV per ha (net)	£91,248	£140,708	£503,614	£336,287
RV per ha (gross)	£82,124	£126,637	£453,253	£302,658

5.21 The key points from the results set out above are that:

- Large negative residual values are found in this lower value area when modelled with the full development contribution package. Development will not therefore, take place in these circumstances.
- At reduced levels of the development contributions package (£16,500) there is a relatively small positive residual value with the Static Model (Static 2).
- With the discount function introduced, and ,even if the development contribution package of £16,500 is deferred for two years , residual values are only just positive (DCF (B) Tests 1 and 2).
- Value uplift improves viability even with cost increases (DCF (B) Tests 3 and 3b). The values modelled of around £0.3m to £0.5m are well above agricultural land values but still fall below the notional £600k per ha benchmark.
- There is ,therefore, uncertainty that these site types can be delivered in this market value area without a further reduction in the development obligations package and/or other sources of funding are available.

Small sites

5.22 It is anticipated by Herefordshire Council that most new housing will be delivered from the major strategic sites and other 'medium sized sites'. These have been the focus for the viability testing (as reported above). For completeness and to complement this testing, testing of a limited selection of examples small sites has been undertaken. Repeating the table from chapter 4 of the report, the small site examples that were tested are set out below.

Table 5.9: Characteristics of small sites

Existing Use	Size	Number of Dwellings	Density
Brownfield	0.4 ha	10	25 dph
Greenfield	0.3 ha	8	27 dph

5.23 The emerging Core Strategy policy indicates that sites of this size will not be required to provide affordable housing in all circumstances. To examine the implications of introducing the levels of development contribution packages identified from the Infrastructure Delivery Plan, we have modelled residual values at 100% market housing and then with the amount of affordable housing set out in the emerging Core Strategy. The table below restates these percentages – the development contribution package assumed at £29,000 per dwelling (as the notional average figure for across the County).

Table 5.10: Affordable Housing Target Percentages[12]

Ledbury, Ross and Rural Hinterlands	40%
Northern Rural	40%
Hereford	35%
Hay-on-Wye, Kington and West Herefordshire	35%
Hereford Northern and Southern Hinterland	35%
Leominster	25%

5.24 In the tables of results that follow, the values in the upper rows are the residual values for the scheme and the values in the rows below are the equivalent residual value per ha. For the brownfield site there is an additional sensitivity test undertaken to illustrate the impact of a significant cost of decontamination – with £750,000 per hectare as the example of the cost modelled.

[12] *Shaping Our Place 2026 Local Development Framework Preferred Options: General Policies* (Aug. 2010)

Table 5.11a Small Site – Greenfield - Residual Values – 100% Market Housing

Small Greenfield	Test 1 Base (development contribution at £29k per dwelling)	Test 2 Test 1 plus , CSH 4 and Lifetime Homes (additional 6K per dwelling)	Test 3 Development contribution at £14,500 per dwelling	Test 4 Test 2 with 20% increase in market values [13]
Ledbury et al	£619,200	£576,000	£723,600	£788,400
Per ha	*£2,063,700*	*£1,919,700*	*£2,412,000*	*£2,628,000*
Northern Hint.	£564,300	£521,100	£668,700	£722,700
Per ha	*£1,881,000*	*£1,737,000*	*£2,229,300*	*£2,409,300*
Hereford	£393,300	£350,100	£497,700	£516,600
Per ha	*£1,311,300*	*£1,167,300*	*£1,658,700*	*£1,721,700*
Kington and W. Herefordshire	£357,300	£314,100	£461,700	£473,400
Per ha	*£1,190,700*	*£1,046,700*	*£1,539,000*	*£1,577,700*
Hereford North and South Hint.	£328,500	£285,300	£432,900	£439,200
Per ha	*£1,095,300*	*£951,300*	*£1,442,700*	*£1,464,300*
Leominster	£164,700	£121,500	£269,100	£241,200
Per ha	*£549,000*	*£405,000*	*£897,300*	*£803,700*

Table 5.11b Small Site - Brownfield - Residual Values – 100% Market Housing

Small Brownfield	Test 1 Base (development contribution at £29k per dwelling)	Test 2 Test 1 plus , CSH 4 and Lifetime Homes (additional 6K per dwelling)	Test 3 Development contribution at £14,500 per dwelling	Test 4 Test 2 with 20% increase in market values	Test 5 Test 1 plus , 750K per ha decontamination cost
Ledbury et al	£747,900	£693,900	£878,400	£957,600	£504,900
Per ha	*£1,870,200*	*£1,735,200*	*£2,196,000*	*£2,394,000*	*£1,262,700*
Northern Hint.	£679,500	£625,500	£810,000	£875,700	£436,500
Per ha	*£1,699,200*	*£1,564,200*	*£2,025,000*	*£2,189,700*	*£1,091,700*
Hereford	£464,400	£410,400	£594,900	£618,300	£221,400
Per ha	*£1,161,000*	*£1,026,000*	*£1,487,700*	*£1,546,200*	*£553,500*
Kington and W. Herefordshire	£420,300	£366,300	£550,800	£564,300	£177,300
Per ha	*£1,051,200*	*£916,200*	*£1,377,000*	*£1,411,200*	*£443,700*
Hereford North and South Hint.	£384,300	£330,300	£514,800	£521,100	£141,300
Per ha	*£961,200*	*£826,200*	*£1,287,000*	*£1,303,200*	*£353,700*
Leominster	£179,100	£125,100	£309,600	£275,400	-£78,100
Per ha	*£448,200*	*£313,200*	*£774,000*	*£688,500*	*-£195,800*

[13] This sensitivity test models residual value of a scheme brought forward in year 7 of the Core Strategy - assuming a 3% per annum increase in value.

Table 5.12a Small Site – Greenfield - Residual Values – With Affordable Housing

Small Greenfield	Test 1 Base (development contribution at £29k per dwelling)	Test 2 Test 1 plus , CSH 4 and Lifetime Homes (additional 6K per dwelling)	Test 3 Development contribution at £14,500 per dwelling	Test 4 Test 2 with 20% increase in market values [14]
Ledbury et al	£206,100	£162,900	£310,500	£272,700
Per ha	*£686,700*	*£542,700*	*£1,035,000*	*£909,000*
Northern Hint.	£169,200	£126,000	£273,600	£228,600
Per ha	*£564,300*	*£420,300*	*£911,700*	*£762,300*
Hereford	£97,200	£54,000	£201,600	£143,100
Per ha	*£324,000*	*£180,000*	*£672,300*	*£477,000*
Kington and W. Herefordshire	£71,100	£27,900	£175,500	£112,500
Per ha	*£236,700*	*£92,700*	*£585,000*	*£375,300*
Hereford North and South Hint.	£50,400	£7,200	£154,800	£87,300
Per ha	*£168,300*	*£24,300*	*£515,700*	*£290,700*
Leominster	£0	-£52,800	£104,400	£31,500
Per ha	*£0*	*-£176,000*	*£348,300*	*£105,300*

Table 5.2b Small Site - Brownfield - Residual Values – With Affordable Housing

Small Brownfield	Test 1 Base (development contribution at £29k per dwelling)	Test 2 Test 1 plus , CSH 4 and Lifetime Homes (additional 6K per dwelling)	Test 3 Development contribution at £14,500 per dwelling	Test 4 Test 2 with 20% increase in market values	Test 5 Test 1 plus , 750K per ha decontamination cost
Ledbury et al	£232,200	£178,200	£362,700	£314,100	-£13,200
Per ha	*£580,500*	*£445,500*	*£907,200*	*£785,700*	*-£33,000*
Northern Hint.	£186,300	£132,300	£316,800	£258,300	-£69,300
Per ha	*£466,200*	*£331,200*	*£792,000*	*£646,200*	*-£173,800*
Hereford	£94,500	£40,500	£225,000	£152,100	-£181,500
Per ha	*£236,700*	*£101,700*	*£562,500*	*£380,700*	*-£454,300*
Kington and W. Herefordshire	£62,100	£8,100	£192,600	£113,400	-£221,100
Per ha	*£155,700*	*£20,700*	*£481,500*	*£283,500*	*-£553,300*
Hereford North and South Hint.	£36,900	-£20,900	£167,400	£82,800	-£251,900
Per ha	*£92,700*	*-£52,800*	*£418,500*	*£207,000*	*-£630,300*
Leominster	-£35,200	-£101,200	£101,700	£12,600	-£332,200
Per ha	*-£88,000*	*-£253,000*	*£254,700*	*£31,500*	*-£830,500*

[14] This sensitivity test models residual value of a scheme brought forward in year 7 of the Core Strategy - assuming a 3% per annum increase in value.

5.25 The key points from the results set out above are that:

With 100% market housing

- Generally, where sites have 100% market housing higher levels of development contribution package could be achieved as well as higher cost standards to meet Code Level 4 in all areas except Leominster.
- Even with a high decontamination cost (we modelled £750,000 per hectare), residual values remain in excess of £1m per hectare with a development contribution of £29,000 per dwelling, in the Ledbury and Northern Hinterland market value areas. The residual value falls to around £550, 000 per hectare in Hereford with this level of decontamination cost.
- As with the other tests undertaken, residual values are lowest in Leominster and are negative for the brownfield site with the additional £750,000 decontamination costs (even with 100% market housing). However, it should be noted that even in Leominster, residual values approaching £0.6m are generated for the greenfield site with the full development contribution package (Test 1) and the residual values are between £0.65m and £1m per hectare when the contribution is halved (Test 3 for both greenfield and brownfield) or when house price inflation is allowed for (Test 4)

With affordable housing

- Only in the highest market value areas (Ledbury and Northern Hinterland) are residual values in excess of £0.5m per hectare generated with both a £29,000 per dwelling contribution and the affordable housing target. In Leominster, residual values at or below £0 are found in the greenfield and brownfield situation and in Hereford, residual values fall below £100,000.
- Where a brownfield site requires remediation of the level we modelled (i.e. £750,000 per hectare)– it is clear that seeking both the full affordable housing target and the full development obligation package is not possible.

6 SUMMARY AND IMPLICATIONS

6.1 This report has reviewed, "*the circumstances in which the Council can expect the scale of planned development in Herefordshire to deliver an appropriate level of developer contributions/community infrastructure levy towards required new infrastructure'*.[15] It has taken as its starting point, the level of developer contributions identified in the council's emerging Infrastructure Delivery Plan.

6.2 The way infrastructure will be funded over the life of the core strategy has to be based on the best information available at the time it is prepared. In our view, it is right that the council takes a conservative view about the amount of public funding that is likely to be available in future years. In this respect, our starting point has been that the level of subsidy for affordable housing in mixed tenure schemes will be nil.

6.3 However, it is also reasonable to expect some public funding to be secured. The New Homes Bonus appears likely to be the main source of this but at the time of writing, the final details of this and other funding sources are still emerging.

6.4 Therefore, the information presented in this report needs to be treated as a realistic but cautious view of what can be achieved and can be used to help develop a robust approach to the Community Infrastructure Levy if this is the route that the council decides to follow.

Contributions from the Commercial Sector

6.5 The high-level review of viability of commercial development we carried out, indicates that, as a general rule, it will not be possible to collect a standard levy/tariff contribution from commercial development. (But this is not to imply that the council should not be negotiating s106 agreements to secure measures to mitigate the impact of schemes).

6.6 With retail development it is likely that some forms of development such as out of centre foodstores could potentially deliver contributions, however this may not be the case with all forms of retail development and viability will depend on the site specific circumstances of a scheme and the type of retail proposed.

Contributions from Residential Development

6.7 The Economic Viability Assessment tested three main scheme types (strategic sites, medium sized and 'small sites') and considered the development economics of these in different market value areas. The focus of the analysis (reflecting their importance for the emerging core strategy) has been on the strategic sites. It is important to re-iterate that the exemplar schemes devised for the analysis are purely illustrative in terms of likely future development characteristics and are not intended to replicate scheme - specific viability appraisal.

[15] Extract from the study brief

6.8 It is also important to note that the modelling undertaken has been based on conservative assumptions including that there is no public subsidy available for the provision of affordable housing, that the costs of opening up strategic sites can be significant (we took a figure of £200,000 per net hectare) and the allowance we made for non developable areas (i.e. to provide the gross to net ratios). These are all technical matters but they do imply that, in the real world, higher residual values than we have shown could quite probably be achieved. Having said that, our interpretation of the results is on the basis of the assumptions made.

6.9 For the strategic sites the key messages are:

- The sensitivity of the analysis of residual values depends upon the assumptions used and, in particular, whether there is an increase in values over the long term;
- The combination of the draft target percentages for affordable housing and the full amount of contributions we modelled, generates residual values that are either negative or only marginally positive. This is the same for the strategic sites modelled in Hereford, Leominster and Ledbury. We have to conclude that this combinations of affordable housing and development contribution package (in the absence of significant public funding) is not realistic and would hold back development;
- In Hereford and Ledbury, at around 50% of the level of development contribution we modelled, residual values appear reasonable (especially if there is some modification of the mix of affordable housing). In Leominster, even at 50% of the development contribution package, residual values are relatively low and require an uplift in house prices over the period of development to achieve a more robust residual value;
- The differences found in residual values between Hereford, Leominster and Ledbury are large enough to indicate that different levels of contribution package in different parts of the county should be considered further (in addition to the different percentages of affordable housing);
- There is a trade off to be made between the development contributions package and the level of affordable housing. (e.g. in Hereford we found the same residual value with the DCF based test at a £30,000 per dwelling development contribution package and 20% affordable housing as with a £15,000 contribution and 35% affordable housing (clearly the trade off will vary depending on assumptions made);
- The timing of development contribution payments can have an impact on viability, with later payment improving residual values. Therefore, careful structuring of payments (e.g. using an appropriate type of s106 agreement) could help viability. But we do not believe, on its own, changing the timing of payments will make deliverable the full development obligations package;
- Increases in market values over the life of the core strategy would significantly improve residual values as would adopting affordable rent in lieu of social rented housing.

6.10 For the medium size sites the key messages are:

- Again, the analysis of residual values depends greatly on the assumptions used;
- Residual values found closely mirror those for the strategic sites and the combination of the draft target percentages for affordable housing and the full amount of contributions, generate residual values that are either negative or only marginally positive.
- Similarly, in Hereford and Ledbury, at around 50% of the level of development contribution we modelled, residual values appear reasonable (especially if there is some modification of the mix of affordable housing). In Leominster, even at 50% of the development contribution package, residual values are relatively low and require an uplift in values over the period of development to achieve a more robust residual value
- However, for Hereford and, more particularly, Ledbury, if future levels of house prices reflect historic trends in value, then these medium sized sites could provide a level of development contribution somewhat higher than the 50% we modelled (even if below the full package).

6.11 For the small size sites the key messages are:

- Where there is no affordable housing requirement, the full development contribution package could be sought in all areas except Leominster, (other than when there are significant decontamination or other expensive site circumstances to deal with). In Leominster, a reduced package will need to be identified – somewhere between 50% and 100%.
- But only in the highest market value areas (Ledbury and Northern Hinterland) does it appear at all realistic to consider a combination of both a £29,000 per dwelling contribution and the affordable housing target. Elsewhere, it is clear that seeking both the full affordable housing target and the full development obligation package is not possible.

Initial thoughts on options for Residential Development

6.12 The evidence from the Economic Viability Assessment shows that meeting the affordable housing target AND achieving the level of development contribution identified in the emerging IDP is not going to be possible in the short term – except for a limited type and location of small sites.

6.13 A level of contribution at about 50% of what is required would be more credible – in combination with the affordable housing target but in Leominster even this may have to be in combination with some element of public subsidy and a flexible approach to the mix of affordable housing (determined on a site by site basis).

6.14 The council could trade off affordable housing delivery for the full package of development contributions identified i.e. reduce the target percentage of affordable housing.

6.15 The new affordable rent tenure (as a replacement for social rented housing) improves viability quite significantly and more so the greater the percentage of social rented

housing in the tenure mix e.g. Ledbury. Its introduction would not change the overall message from the study (that achieving both the desired target for affordable housing and the developer contribution packages is not realistic in current market conditions) but it would make it easier to achieve a relatively high level of contribution (say approaching 50% of the full level of contribution tested).

6.16 Flexibility in when development obligations are collected will help with viability but not enough to justify the full development contribution package and affordable housing target.

6.17 But what happens if house prices increase over the life of the core strategy and by 2026 the council could be securing both 100% of the development contributions package and the full affordable housing target? This may or may not happen but the council should consider a flexible approach which allows for this possibility and ensures that the community also benefit from any value increases.

6.18 One option would be for the council to start with a relatively modest development package (say the full affordable housing percentage and 30/50% the full development contributions package) and to review the level in a forthcoming core strategy reviews. But a second option would be to set the development contribution package at a more ambitious level (if not 100% of the package at, say, nearer 50/65% of the full package), acknowledging that it cannot all be delivered at day 1 but then including mechanisms to increase contributions if and when prices rise. There are models for how this form of deferred contribution might operate with various approaches using s106 agreements. The council would need to give careful consideration to the detailed operation of a deferred contribution mechanism in combination with a Community Infrastructure Levy (if it chose to make use of the two together).

6.19 Whatever approach is used, the variation in residual values found across the County, leads to the conclusion that different levels of contribution in different locations, is a realistic option for consideration. If the Council were to introduce a Community Infrastructure Levy in the future, there would be the option to vary the Levy by location and the detailed viability work required to produce a CIL charging schedule would take this into account. From the analysis in this report, for residential developments, we would expect a lower rate for Leominster than elsewhere in the County and possibly a higher rate in the more rural areas.

ANNEX 1 – ASSUMPTIONS USED FOR THE NON RESIDENTIAL VIABILITY TESTING

Plot ratio (floorspace density)

The Employment Land Review (ELR) team undertook survey work to ascertain a suitable plot ratio to apply to future floorspace requirements. The survey of existing businesses showed fairly high densities for all types of 'B' space with the exception of office. However, as an aspirational study looking to the long term future, the study reverts back to the ODPM Employment Land Reviews Good Practice Note of December 2004 and assumes floorspace densities of 4,000 sq m per hectare for office and industrial development and 5,000 sq m per ha for warehouse.

As the viability study is testing the current market it was considered that using the lower densities, whilst a long term aspiration, may not reflect current and future supply in the short term. Therefore we have used densities which are between those in the survey and those recommended in ELR to reflect what may happen in the short to medium term. We have assumed slightly higher densities of 5,000 sq m for industrial, 6,000 sq m for warehouse and 8,000 sq m for offices[16].

Rental values & void

The low and high levels of rent will reflect factors such as location and general strength of the property market at the point when development is let/sold. Based on the market analysis above, we have assumed the following rental values for the different typologies:

	Low	High
Office	£125 psm	£150psm
Industrial/Warehouse	£60 psm	£70 psm

We have tested scenarios where development is pre-let (i.e. no void) and a 12-month void (i.e. the time taken to let or sell the development after it is completed).

Yields

The property 'yield' is critical to the value of property; when deciding whether to invest in property at all an investor will compare it against other competing investment opportunities such as company shares or government bonds or 'gilts' and also the different risks involved in each case. In the case of property the overall return or yield required by investors from property investments ranks between bonds which often

[16] Assuming a site coverage of 40% and 2-storey offices

offer higher initial income and lower risk, but little prospect of value growth; and shares where a higher overall return in justified by a lower initial return and higher risks.

A higher yield in a development appraisal will reflect one or both of the following key factors:

- Lower rental growth prospects
- Lower security of income (such as tenants with a weaker covenant, shorter leases and more sub-division of floorspace are anticipated)

Obtaining reliable yield information is, however, difficult. The best information is actual sales, but in smaller towns these are few and far between. This appears to be the case in Herefordshire, with few investment sales reported on EGi. There is no information on yields provided in the Employment Land Study.

In terms of general market yield levels, CB Richard Ellis provides a quarterly prime rent and yield monitor. The latest monitor[17] reports the following average national prime yields:

CBRE prime yield monitor

	Q4 2009	Q1 2010	Q2 2010
All Property	6.6%	6.4%	6.3%
Offices	6.5%	6.3%	6.3%
Industrial	7.4%	7.4%	7.4%

Source: CB Richard Ellis

It also provides sub-regional estimates of prime yields. The table below provides prime yields for West Midlands and Wales. We have included Wales as the West Midlands is likely to reflect Birmingham, will have lower (i.e. stronger) yields than Herefordshire.

[17] http://portal.cbre.eu/portal/page/portal/research/publications/CBRE_RY_INDEX_Q2_2010.pdf

CBRE Q2 2010 sub-regional prime yield monitor

	West Midlands	Wales
Offices	7.4%	7.7%
Industrial	7.2%	7.9%

Source: CB Richard Ellis

However, these are current yield levels which are higher (i.e. weaker) than a number of years ago. The CBRE monitor indicates prime industrial yields are now approximately 2% higher than their strongest point over the last five years in 2006-7, with offices are approximately 1.5% higher. Both are still approximately 1% lower than their weakest point in Q2 2009, indicating the investment market has recovered slightly in the last year.

We have tested yields at 7.5% and 9% to reflect different scenarios in terms of general investment market conditions and strength of developments.

Build costs

We have based build costs on our own experience and the latest information from the Building Cost Information Service (BCIS), and assumed the following indicative levels:

- Office - £1,000 per sq m
- Industrial - £500 per sq m
- Warehouse - £450 per sq m

External costs

In addition to the above assumed costs for the buildings, an allowance needs to be made for a range of external costs, such as roads, drainage, parking and landscaping. Many of these will depend on individual site circumstances, but for the purposes of our assessment we have assumed 7.5% of build costs which reflects a straightforward site with limited landscaping etc. We have not assumed site preparation costs or off-site infrastructure costs as it is more difficult to generalise about these; where such costs will be incurred, they would result in a lower residual land worth.

Other costs

We have assumed 10% professional fees and a contingency of 2.5%. In terms of developer's profit, we have assumed 17.5% of development costs. Finally, we have assumed finance costs of 7.5% pa.

ANNEX 2 - ASSUMPTIONS USED FOR THE RESIDENTIAL VIABILITY TESTING

Build Costs

	Cost in £/m²
Flats (3-5 storeys)	1,160
Flats (1-2 Storeys)	1,040
Houses <= 75m²	920
Houses > 75m²	800

Build costs include both construction and external works around the building.

Build costs assume Code for Sustainable Homes Level 3

According to data from BCIS, build costs fell approximately 4% between Q2 2009 and Q3 2010.

Other Development Costs

Professional Fees	12%	of build costs
Internal Overheads	5%	of build costs
Finance (market housing)	7%	of build costs
Finance (affordable housing)	7%	of build costs
Marketing fees	3%	of market values
Developers return	17%	of market values
Contractors return	6%	of development costs

No abnormal costs are included in above.

10% land financing costs will be deducted from the residual value to take account of the costs of holding land.

Social Rents

Dwelling Size	**Target Rent (£ per week)**
1 bedroom	56.00
2 bedroom	65.00
3 bedroom	75.00
4 bedroom	85.00
5 bedroom	91.00

Rents are rounded and sourced from Dataspring.

Affordable Housing Costs (Gross to Net Factors)

Social Rent Costs	
Management and maintenance	£1,000
Voids/bad debts	3%
Repairs reserve	£500
Capitalisation	6%

Intermediate Rent Costs	
Management costs	6%
Maintenance costs	£500
Voids/bad debts	5%
Repairs reserve	1% of build costs
Capitalisation	6%

Homebuy Costs	
Operating cost	2.75%
Capitalisation	6%
Percent purchased	50%

Development Mix Based on Density

	30 dph	40 dph	50 dph	60 dph
1 bed flat				10%
2 bed flat		5%	10%	25%
2 bed terrace	10%	15%	20%	25%
3 bed terrace	15%	25%	30%	30%
3 bed semi-detached	25%	20%	30%	5%
3 bed detached	15%	10%	10%	5%
4 bed detached	25%	20%		
5 bed detached	10%	5%		
	100%	100%	100%	100%

Typical Unit Sizes in m²

	Affordable	Market
1 bed flat	46	45
2 bed flat	67	60
2 bed terrace	76	65
3 bed terrace	84	80
3 bed semi-detached	86	90
3 bed detached	90	110
4 bed detached	110	135
5 bed detached	125	150

NB We have not researched or modelled bungalows in Herefordshire as a separate type of housing unit. Recent research in other rural areas of England indicates that selling prices of a 3 bed bungalow are likely to be similar to those of a 3 bed detached house and a 2 bed bungalow is similar to a 2 bed semi. Build costs for single storey dwellings are likely to be higher than general estate housing according to BCIS data (Q1 2010) by about 10% exclusive of external works..